Consumers Energy

A CMS Energy Company

General Offices:
212 West Michigan Avenue Tel: (517) 788-0550
Jackson, MI 49201 Fax: (517) 788-0768

*Washington Office:
1016 - 16th Street, NW, Tel: (202) 293-5795
Washington, DC 20036 Fax: (202) 293-5367

Writer's Direct Dial Number · (517) 788-1482
E-mail Address · hrchambers@cmsenergy.com

LEGAL DEPARTMENT

DAVID A MIKELONIS
Senior Vice President
and General Counsel

James E Brunner
William M Lange*
Jon R Robinson
Arunas T Udrys
Assistant General
Counsel

David E Barth
Francis X Berkemeier
H Richard Chambers
James W Dempsey
John P Dickey
Ann F Goodman
Deborah Ann Kile
Wayne A Kirkby
Roger K Krakusin
Eric V Luoma
Wendy A McIntyre
Raymond E McQuillan
Deborah A Moss*
Mirče Michael Nestor
Robert M Neustifter
David A. Pell
Vincent P Provenzano
Susan L Rasmussen
Catherine M Reynolds
P Leni Staley
Charlotte A Walls
Michael G Wilson
Attorney

February 11, 2000

Ms. Dorothy Wideman
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
P.O. Box 30221
Lansing, MI 48909

Re: Case Nos. U-11955 and U-11956

Dear Ms. Wideman:

Enclosed for filing in the above-referenced matter are an original and four copies of the "**Reply Brief of Consumers Energy Company**". A Proof of Service is also enclosed.

Sincerely,

Richard Chambers

H. Richard Chambers

CC: Hon. James N. Rigas, ALJ
Parties per Attachment 1 to
Proof of Service

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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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-11955
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-11956

REPLY BRIEF OF CONSUMERS ENERGY COMPANY

Dated: February 11, 2000

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REPLY BRIEF OF CONSUMERS ENERGY COMPANY

Initial briefs were filed in this matter by Consumers Energy Company ("Consumers Energy"), The Detroit Edison Company ("Detroit Edison"), the Commission Staff, the Attorney General, the Association of Businesses Advocating Tariff Equity ("ABATE"), Energy Michigan, the Michigan Independent Power Producers Association ("MIPPA"), and Michigan Petroleum Association/Michigan Association of Convenience Stores ("MPA/MACS"). Consumers Energy files this reply brief.

The failure to address a particular argument raised by another party should not be interpreted as concurrence with that position. Rather, Consumers Energy relies on its initial brief and the record made in this case in those instances.

I. REPLY TO STAFF

A. MPSC Authority

At pages 3-10 of its brief, Staff discusses the Commission's authority to set rates, terms and conditions for a voluntary open access program. This is an issue which has previously been briefed by interested parties and addressed by the Commission. In its August 17, 1999 Order in Case No. U-11290, et al, the Commission concluded it could approve a voluntary program.

Subsequent to the Commission's August 17, 1999 Order, Consumers Energy and Detroit Edison notified the Commission they were willing to voluntarily implement the retail open access program set forth in the Commission's orders, based on their understanding of those orders. Both companies indicated that their voluntary commitment to proceed with implementation was based upon their understanding that the orders permitted recovery of certain costs associated with the implementation of the program.

The current proceeding concerns (i) recovery of implementation costs, (ii) operation of the stranded cost true-up mechanism, and (iii) whether metering and billing functions should be limited to utilities. If a voluntary retail open access program is going to be implemented consistent with the schedule which the Commission has set forth in prior orders, then it is imperative that the Commission grant authority for timely recovery of the prudently incurred implementation costs in this case and approve the stranded cost true-up methodology. The Commission's jurisdiction to authorize a voluntary retail open access program is not an issue which needs to be, or should be, revisited at this point in time. Whatever the Commission's authority may be with respect to retail open access service, it clearly has the ratemaking authority to grant recovery of implementation costs, and to establish a mechanism to adjust rates to allow recovery of costs incurred to provide service, including costs "stranded" by open access.

B. Implementation Costs

1. Staff's Proposed Disallowances Should Be Rejected

Staff, relying on the testimony of its witness Gerald F. Geml, recommends a disallowance of (i) $3.76 million of labor expenses incurred by Consumers Energy in 1997 and 1998 in connection with implementation of retail open access and (ii) $652,000 of employee impact-related costs which were incurred. Both of these recommendations should be rejected.

The Company presented evidence that the labor expenses being challenged were directly related to implementation of direct access. 4 Tr 488-489, 492, 523-526. In addition, the Company presented evidence that these expenses were attributable to activities that would not have been conducted if not for the retail open access program. 4 Tr 523. Further, the Company presented evidence that these costs were reasonably and prudently incurred. 4 Tr 160, 4 Tr 503. Staff does not challenge any of these conclusions. Indeed, Mr. Geml testified that it was not his position that any of the costs being challenged were imprudently incurred. 5 Tr 836.

The Commission stated at page 13 of its June 5, 1997 Order with regard to implementation costs:

> "If the costs are prudently incurred, it would also be inappropriate to disallow recovery by the utility." (Emphasis added)

The evidence is unrefuted that the $3.76 million of labor expenses which the Company seeks authority to recover was prudently incurred.

Staff's rationale for the proposed $3.76 million disallowance is that these labor expenses must not have been incremental since Other Operation and Maintenance ("Other O&M") expenses and overall employee levels in 1998 were lower than the amounts used in developing base rates in the Company's last general rate case. However, as discussed in Consumers Energy's initial brief, at pages 14-19, this is the wrong focus. The issue in this case is the determination of implementation costs, not the determination of base rates.

The evidence shows that the $3.76 million of labor expenses was directly related to activities that would not have occurred in the absence of retail open access and was incremental. 4 Tr 523. Because of the complexity of electric restructuring and the duration of time over which it will take place, many new employee positions were required. 4 Tr 524. The incremental workload exceeded available resources. 4 Tr 524. Mr. Gilzow explained that as a result of allocating Company personnel to the retail open access activities, it was necessary to (i) add new employees, (ii) move employees from their prior jobs and backfill their position with contract help, overtime or new employees, (iii) incur greater chargeback labor from internal support organizations, and (iv) incur overtime hours. 4 Tr 523-526.

Mr. Gilzow indicated that the chargeback services are effectively like outside consulting services. 4 Tr 525. He stated that the chargeback services provided on behalf of the retail open access implementation project would not have been provided to electric operations in the absence of that project. 4 Tr 525. He noted that the chargeback services for Information Services and Technology in 1997 and 1998 were $2.5 million and $3.2 million respectively, far in excess of the $991,000 amount charged back in 1996 to support electric operations. 4 Tr 525.

The amounts collected by the Company in base rates in 1998 were being recovered pursuant to rates approved by the Commission. The level of Other O&M expense used in developing base rates cannot lawfully be compared with actual amounts incurred in 1998 and then rates retroactively adjusted to reflect differences. Recoverable implementation costs incurred for labor cannot lawfully be reduced based on the rationale that the level of Other O&M expense used in developing rates exceeded actual 1998 Other O&M expenses. Further, Staff's argument fails to take into consideration that the amount it seeks to disallow relates to expenses that were deferred for future recovery.

The $3.76 million of labor expenses which Staff seeks to disallow is properly recoverable as part of implementation costs. Staff, by seeking to disallow recovery of this recoverable implementation expense, in essence seeks to retroactively adjust 1998 base rates in an amount equal to the $3.76 million of 1997-1998 implementation labor costs which were deferred for future recovery. As discussed in the Company's initial brief, such a de facto retroactive reduction in base rates would be inappropriate, inconsistent with the Commission's commitment to allow recovery of prudently incurred costs, unlawful and unreasonable.

Staff's rationale for the disallowance of $652,000 of employee impact-related costs is somewhat different. Staff argues (i) that these costs were incurred in 1997 before the Commission's June 4, 1997 Order in Case No U-11290, and (ii) the downsizing in 1997 must mean that these personnel were never needed in the first place.

The Staff Report on Electric Industry Restructuring was issued on December 19, 1996. In it the Staff stated that employee related restructuring costs should be recoverable and recommended that costs incurred to transition the work force as a result of industry restructuring should be included in recoverable stranded costs. Staff Report, pp. 14-15. The Commission quoted this language at page 8 of its June 5, 1997 Order in Case No. U-11290 and stated at page 11 that the Staff Report provided a reasonable basis for determining stranded costs.

Regardless of when in 1997 the $652,000 was incurred, it was incurred (i) subsequent to the Staff report, and (ii) to transition the work force. Mr. Gilzow testified that the employee impact costs were for programs which "related to transitioning the workforce as a result of industry restructuring." 4 Tr 491.

It is clear that industry restructuring will have an impact on employees currently employed in the generation sector of the electric utility industry. 4 Tr 490. Downsizing is part of transitioning of the work force. The types of activities which must be implemented to minimize any negative impact on current utility employees from restructuring include early retirement programs, separation incentive programs, severance plans, outplacement programs, relocation programs and retraining programs. 4 Tr 490-491. The Commission recognized in its June 7, 1997 Order that it would be inappropriate to disallow prudently incurred implementation costs.

The fact that these costs were incurred relatively early in the restructuring process should not make them more susceptible to disallowance. Consumers Energy has acted prudently in attempting to spread the employee impacts over an extended time period, rather than delaying and compressing those impacts into a shorter period. It should not be penalized for doing so.

Staff questions if the personnel were needed previously. However, Staff does not claim that the decision to streamline the work force was imprudent. Staff's focus relates to costs associated with keeping the employees, which are not at issue in this case, rather than the costs of transitioning the work force. Whether or not the employees were "needed in the first place" (Staff brief, p. 11) is irrelevant for purposes of Case No. U-11955. The costs in question are employee related restructuring costs incurred to transition the work force and are properly recoverable. The recoverability of the portion of the employee impact costs which the Staff seeks to disallow is discussed further in the Company's initial brief at pages 10 and 18-19.

At page 12 of its brief, Staff "notes" that the Commission may offset recovery of costs with any determination of "excess company earnings" which may result from the ABATE complaints in Case Nos. U-11495 for Detroit Edison and U-11560 for Consumers Energy. Staff offers no legal analysis for its proposition. Any attempt to retroactively adjust base rates through offsetting recovery of implementation costs against amounts recovered in base rates would be unlawful and unreasonable. See Michigan Bell Telephone Co v Public Service Commission, 315 Mich 533, 546-547; 24 NW2d 200 (1946), ABATE v Public Service Commission, 205 Mich App 383, 393-395; 522 NW 2d 140 (1994), lv den 448 Mich 854; 528 NW2d 731 (1995). Implementation costs are recoverable through an implementation surcharge, separate and apart from base rates.

2. Implementation Costs Should be Recovered From All Customers

The schedule for implementation of the voluntary electric restructuring program envisions that all electric customers will be able to choose their supplier beginning January 1, 2002, if they wish to do so, thus making the benefits of competition available to all customers. This will not be possible without having systems in place that can serve all customers.

Staff, in its brief, argues that changes in the billing system will only benefit retail open access customers and therefore should only be recovered from such customers. The Company disagrees. The changes in the billing system are necessary to support the full implementation of retail open access. 4 Tr 501.

The Company believes that all customers benefit as a result of having full open access available. The Company does not agree with Staff's assertions that applying an implementation surcharge to all customers "violates all cost of service principles" or is in conflict with the spirit of retail open access. The approach advocated by the Staff could deter customer participation. As discussed in the Company's initial brief at pages 19-22, it would be reasonable to recover implementation costs through a uniform surcharge applied to all customers.

C. Stranded Costs

1. Using Wholesale Market Prices to Compute Market Price of Power Is Appropriate; Using Retail Market Prices is Not

Staff discusses several alternative approaches to determining the market price of power and recommends that an estimate of $31.00 per MWh be assumed. Staff bases this on the retail price of power in 21 power sales agreements in the Rate DA program, a different program, and the price of power at the Cinergy hub. Use of either of these measures is faulty.

a. Use of Retail Market Prices Is Not Appropriate

Consumers Energy's witness William C. Keyser, Senior Engineer-Lead in the Electric Sourcing and Trading Department, identified four reasons why use of Rate DA power sales agreements would not be an appropriate proxy for market clearing price ("MCP"):

> "First, they do not represent the market in which Consumers Energy will be selling the released power.
>
> "Second, prices determined using the approach which Mr. Stanton discusses would not be a valid proxy for current market prices at any given future point in time....
>
> "Third, these contracts are not necessarily representative of MCP even at the time they were executed....
>
> "Fourth, there is no way to tell what 'packages' might have been included in the form of non-price items, other contracts, or other goods or services...." 5 Tr 767-768.

The same types of problems would occur using any retail power sales agreements as a proxy for market clearing price. 5 Tr 769.

Staff's witness Thomas S. Stanton, himself, admitted that for purposes of calculating the market price of power, there are important differences between the DA and ROA programs. 4 Tr 401. He acknowledged that differences in customer eligibility, allocation of available capacity, and transition charges could all affect the price paid. 4 Tr 401-405. During cross examination, Mr. Stanton testified:

> "Q Mr. Stanton, referring to your Exhibit S-18 -- I'm sorry -- S-17, do you know what the actual load factor for any of those DA customers was in 1998?
>
> A No, I do not.
>
> Q Or for any other period for that matter?
>
> A No, I do not.
>
> . . .
>
> Q So do you know whether the DA customer had agreed to provide the DA supplier with any other goods or services?
>
> A No, I do not.
>
> Q Do you know whether the DA customer had obtained some other commitment from the DA supplier with respect to any future business relationships?
>
> A No.
>
> Q ...Do you know whether the DA supplier had agreed to supply other goods or services besides simply the supply of power pursuant to that contract?
>
> A No.
>
> Q Would you agree that the differences between customers and suppliers with respect to those kinds of things would affect or could at least affect the comparability of prices in those contracts?
>
> A Yes. In fact, from the experience in the telecommunications industry, I think that that's a very serious concern: that price comparability is extremely important to this type of analysis, and to the extent that service offerings make price comparability harder and harder to determine, I think that makes this type of calculation much more difficult."
> 4 Tr 418-420.

Staff's witness Paul A. Carlson also identified problems with using direct access contracts to determine market price. 5 Tr 818-819. Thus, the testimony of Staff's own witnesses support rejection of Staff's proposal to use retail power sales agreements to determine the market price of power.

Staff acknowledges at pages 13-14 of its brief that its witness Mr. Stanton identified numerous reasons why use of the power sales agreements may not reflect the appropriate market price for true-up consideration, but Staff nevertheless seeks to use that measure as its sole or primary measure. Staff suggests in its brief that, in the future, detailed data regarding sales and billing determinants be determined from power marketers and used in conjunction with power supply agreements on file with the Commission. This would not, however, remedy the numerous problems with use of retail power sales agreements. The agreements would still be for a limited market, would encompass various factors and considerations that would be different from those faced by Consumers Energy, would not necessarily represent market clearing price and could include non-price items or other "packages". 5 Tr 769.

Even if Staff's assumption that "aggregated data can be made public" is correct, this would not provide a means to accurately evaluate and determine the price of service. It would be very difficult to determine critical terms and conditions. 5 Tr 767. Mr. Keyser testified:

> "Leaving aside the other problems, trying to determine what the 'market price' was for contracts would be a subjective, time consuming and speculative process. It would be virtually impossible to determine if comparisons were on an apples to apples basis." 5 Tr 769

Even to attempt to do so would require more than aggregated data.

Moreover, the retail market is not the appropriate market to use. Mr. Keyser testified:

> "The purpose of finding an appropriate measurement of MCP is to find a value which is reasonably representative of the price for which

> Consumers Energy will be able to sell power which it is no longer selling to its retail customers due to the commencement of ROA. Under current circumstances, the only market that is available to Consumers Energy for such sales is the wholesale market." 5 Tr 766.

The evidentiary record strongly supports the conclusion that retail power sales agreements are not an appropriate proxy to use for market clearing price.

b. <u>Use of Cinergy Hub Prices Is Not Appropriate</u>

Staff's suggestion that an assumed Cinergy hub price of $31.00 per MWh be used based on 1998 data and an assumed on-peak/off-peak ratio of 47/53 relies on numerous assumptions that may not be valid. Staff's witness Mr. Carlson acknowledged that the actual price would be affected by the seller's specific on-peak/off-peak ratio, losses and transmission costs, and the price that could actually be obtained. 5 Tr 816-817. He also noted the possibility that the market reflected in the Cinergy hub figures is not mature enough to be relied upon as an accurate indication of market clearing price. 5 Tr 816-817.

Price volatility would also be a consideration. The Commission noted at page 53 of its March 8, 1999 Order in Case No. U-11290, et al, that prices during the summer of 1998 far exceeded any previously experienced or projected. It noted that it was not known whether comparable price volatility would exist during 1999, but that the futures market at the Cinergy hub for May through October reflected prices ranging from $23.45 per MWh to $135 per MWh.

The Cinergy hub price would not reflect supply/demand of energy in Michigan, transmission costs from the quoted hub, the generation mix in Michigan at any given hour, the customer mix for the Company or the availability of curtailable load. 5 Tr 770. Use of the Cinergy hub price would not provide a good proxy of the price for which Consumers Energy will be able to sell power which it is no longer selling to retail customers.

c. Actual Sales to Utilities and Marketers Would Be the Most Appropriate Measure to Use

The goal in determining a market clearing price should be to find a value which is reasonably representative of the price for which Consumers Energy will be able to sell power which it is no longer selling to retail customers as a result of retail open access. 5 Tr 766. One of the alternatives mentioned by Staff's witness Paul Carlson was sales to external utilities. As noted above, the only market available Consumers Energy to sell the released power is the wholesale market. 5 Tr 766. The most appropriate measure to determine the market clearing price is to use actual sales by Consumers Energy to utilities and marketers of the power which must be sold as a result of retail open access. 5 Tr 769-770.

2. Stranded Cost Methodology

a. Overview

When the Commission determined the initial estimate of stranded costs, it used a methodology which estimated stranded costs, with reconciliations to actual amounts. Costs were calculated on a net present value basis. The method set forth by Consumers Energy's witness Francis A. Ernst (see 4 Tr 422-446, Exhibits ACE-20 through ACE-31) is consistent with the methodology used by the Commission when it determined the initial estimate of stranded costs. That method is discussed in Consumers Energy's initial brief at pages 24-30.

In Case No. U-11955, Staff has presented an alternative method. Staff acknowledges in its brief that the stranded cost methodology presented through its witness William J. Celio differs from the original method used by the Commission in determining the magnitude of stranded cost. Staff brief, p. 16.

Using an approach which is based on estimates, with reconciliation to actuals, as proposed by the Company, will provide an accurate and timely recovery of stranded costs. Mr. Celio indicated that he believed Staff's alternative method would result in a "reasonably accurate approximation of stranded cost on a trailing basis". 5 Tr 924. However, he noted there might be a possibility of significant over- or under- recovery. 5 Tr 925.

Consumers Energy is not at this time able to fully evaluate Mr. Celio's proposal due to various ambiguities and uncertainties concerning the methodology. If the Commission chooses to use the approach shown on Exhibit S-53, then some points of clarification would be necessary. Below the Company discusses various assumptions it is making regarding the process envisioned by Staff.

b. <u>Calculation of Stranded Cost Revenue Requirement</u>

Lines 1 through 3 of Exhibit S-53 are labeled "Stranded Cost Requirement." It is the Company's belief that these lines are intended to include the first three "buckets" of stranded costs (i.e., regulatory assets, capital costs of nuclear plants, and power purchase agreement contract capacity costs) identified at page 7 of the Commission's June 5, 1997 Order in Case No. U-11290. The Company believes that line 3 is intended to reflect the revenue requirement associated with recovery of stranded costs for these three categories. Consequently, it is the Company's assumption that stranded cost on line 1 and revenue requirement on line 3 would not include employee-related or other implementation costs and that those costs will be recovered through a separate charge.

It is important that it be clear how the revenue requirement for each of the three stranded cost categories would be determined. On Exhibit ACE-20, the Company (i) determined the revenue requirement for each of these categories on a category-by-category basis, (ii) determined the portion which it projected would be allocated to customer choice for each category, (iii) determined the net present value of the revenue requirement for the customer load portion for the period 1997 through 2007 for each of the three categories separately, and (iv) determined the present value of costs to be recovered on a total basis for the three categories together. It is the Company's belief that the intent of the approach summarized on lines 1-3 of Exhibit S-53 relates to the first of these four determinations.

Although Staff's exhibit does not specify that the revenue requirement for each of the three categories would be determined separately and then the revenue requirement for each of the three added to reach the overall revenue requirement on line 3, this appears to be the intent. It is the Company's belief that the intent is that the revenue requirement for a particular year would be calculated using the methodology that the Commission previously adopted and that is set forth on Exhibit ACE-20. In other words, it is the Company's assumption that the method for calculation of the transition cost revenue requirement on Exhibit ACE-20 for each of the three categories is the appropriate method of calculation for purposes of line 3 of Exhibit S-53.[1]

On Exhibit ACE-20, the calculation of the annual revenue requirements for capital costs of nuclear plants is set forth on lines 8 through 31, with the total revenue requirement set forth on line 31. The calculation of the annual revenue requirements for regulatory assets is set forth on lines 37 through 46, with the total revenue requirement set forth on line 46. The calculation of the annual revenue requirement for PPA costs is set forth on lines 52 through 59, with the total stranded cost revenue requirement set forth on line 59. It is the Company's belief that the revenue requirement on line 3 of Exhibit S-53 would equal the sum of the revenue requirements calculated

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[1]The return component on line 2 of Exhibit S-53 would not seem to be pertinent to the calculation of the revenue requirement for power purchase agreement ("PPA") amounts. The Company assumes that the Staff does not intend that the return referenced on line 2 would apply to PPAs.

using the methodology set forth on lines 8 through 31, lines 37 through 46, and line 53 of Exhibit A-20.[2]

As noted on line 50 of Exhibit ACE-20, the calculation of stranded costs for Consumers Energy of $1,755 million identified in the Commission's January 14, 1998 Order includes recovery of post-2007 production regulatory assets. There is no justification for excluding these regulatory assets from recovery. The Company assumes that Staff did not intend to foreclose such recovery. If Staff's approach were used, it would be necessary to clarify that post-2007 regulatory assets will be recovered.

c. Calculation of Stranded Cost Recovery

The Company assumes that the intent is that the totals for line 4 of Exhibit S-53 would be expressed in cents per kWh.[3] The Company believes that for purposes of the total sales calculation on line 5, the intent is that both bundled and retail open access sales would be included. In other words, it is the Company's belief that the "total sales" on line 5 would include the "sales to ROA" on line 6.

With regard to line 12 of Exhibit S-53, the Company assumes that the sales lost to ROA and the sales growth on line 12a are the cumulative amounts since the beginning of ROA. The Company believes that the reference to market price of power on line 12b is intended to represent

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[2]Line 59 of Exhibit ACE-20 reflects PPA capacity costs net of proceeds of released capacity. To the extent Staff intends that lines 4 and 12 of Exhibit S-53 reflect full capacity rates, then the full capacity cost which is shown on line 53 of Exhibit ACE-20 needs to be included on line 3 of Exhibit S-53 for consistency.

[3]Mr. Celio indicated at 5 Tr 927 that line 4 includes the generation component of bundled rates. At 5 Tr 932 he indicated that the term "hard asset" referred to the buckets of stranded costs that the Commission had defined in its order.

the market price of PPA contract capacity. Since line 1 only includes the capacity portion of the PPAs, it should follow that line 12b also only includes the capacity portion of the PPAs.

Line 16 does not specify how unrecovered stranded costs will be recovered. Based on Mr. Celio's testimony at 5 Tr 929, Consumers Energy assumes that Staff's approach envisions that unrecovered costs will be recovered in the subsequent year.

d. Summary

If the Company's assumptions and beliefs regarding the process envisioned by Staff are correct, and clarifications are made, the Company believes that the Exhibit S-53 approach could provide a reasonable characterization of an annual stranded cost true-up mechanism if the Commission wishes to use a "trailing" approach. However, if the Company's assumptions are incorrect and the approach envisioned by Staff is something different, then the Company is unclear as to the methodology envisioned and cannot, at this time, agree.

II. REPLY TO THE ATTORNEY GENERAL

The Attorney General's direct evidence consisted of the testimony and exhibits of Charles W. King. As will be discussed below, contrary to the assertions in her brief, that testimony does not provide a basis for any decisions in this proceeding.

A. Implementation Costs

The Attorney General's witness Mr. King testified that he had not reviewed Consumers Energy's implementation costs in sufficient detail to be able to offer any opinion regarding those costs:

> "I have not...had the opportunity to examine the detailed records of the utilities relating to these [implementation] costs, nor have I had any direct contact with the utilities to discuss the specifics of their implementation programs and the tasks, personnel and costs associated with them." 5 Tr 708

Further, although he suggested several standards be considered in evaluating implementation costs, he did not offer any opinion on whether the implementation costs incurred would meet those standards. Mr. King stated:

> "...I have not been able to analyze the utilities' costs in sufficient detail to render a judgement as to their propriety under these standards." 5 Tr 708.

Thus, the evidence of Mr. King does not provide any basis to exclude any of the implementation costs incurred by Consumers Energy during 1997 and 1998.

The Attorney General offers an opinion that Mr. Geml's proposed disallowances have not been refuted. However, as discussed in response to the Staff brief, the evidence supports rejection of Mr. Geml's proposed disallowances.

The Attorney General takes the position in her brief that implementation costs should only be charged to retail open access customers. The Attorney General states that the Commission's prior rulings represent the guiding principles. However, in its March 8, 1999 Order in Case No. U-11290, et al, page 28, the Commission raised the question:

> "How should implementation costs be allocated among and recovered from customers?"

The Company responded to this question. For the reasons discussed above in response to the Staff brief and for the reasons discussed in Consumers Energy's initial brief, at pages 19-22, it would be appropriate to charge implementation costs to all customers.

The Attorney General has not provided any support for her suggestion that what she refers to as Mr. King's "more specific limits on recovery of implementation costs" should be adopted. The standards which Mr. King seeks to impose are ill-defined and are neither necessary nor appropriate.

One of the standards proposed by Mr. King is that the implementation costs be incremental. Although the Attorney General does not raise the issue in the section of her brief on discussion of the issues, she notes in her summary of the Attorney General's direct evidence that Mr. King had speculated that labor costs for Consumers Energy in connection with development of an independent transmission system operator may not have been incremental, claiming that the Company's testimony does not say that any new employees were hired. This, however, is incorrect. Mr. Waits testified that an employee hired in May 1997 has spent 100 percent of his time on this effort. 4 Tr 158. This was clearly an incremental expenditure directly related to industry restructuring. 4 Tr 158. Further, the evidence shows that the portion of the time of Mr. Waits and his secretary allocated to development of an independent transmission system operator is also incremental. Mr. Waits indicated that he was compelled to delegate certain management responsibilities to another employee in order to accommodate the RTO-related work. 4 Tr 158. His secretary, who used to work for two Company executives, now only has time to work for Mr. Waits as a result of his RTO-related work. 4 Tr 158.

The Attorney General's witness admitted he did not analyze if the costs were incremental. 5 Tr 708. Mr. Waits testified the labor costs were incremental. 4 Tr 158. The speculation of the Attorney General in her brief that the labor costs may not have been incremental is without merit and is refuted by the evidence in this case. The implementation costs for which Consumers Energy is seeking recovery in this case are consistent with prior Commission determinations, are supported by record evidence, are incremental and are related to the implementation of retail open access.

B. Stranded Costs

1. The Attorney General Has Not Established There Will Be "Stranded Benefits"

The Attorney General's witness Charles W. King contended that there will be "stranded benefits" as a result of retail open access. At page 43 of her brief, the Attorney General refers to the analysis which Mr. King presented in an effort to support this proposition as a "rough model" and suggests that "the MPSC need not review the details in this case." She acknowledges that Mr. Leja opposed the stranded benefit model presented by Mr. King.

The Attorney General attempts to sidestep the deficiencies in her witness's analysis by suggesting that the MPSC should determine that a stranded benefits analysis be considered in the future. However, the premise underlying the claim that such an analysis is needed in the future is the "rough analysis" that the Attorney General proposes not be reviewed. The Attorney General has not provided any valid basis for reaching the conclusion she advocates.

The Attorney General's suggestion that Mr. King's "rough model" not be reviewed is not surprising. The Company identified numerous defects in Mr. King's analysis through the rebuttal testimony of its witness Wayne M. Leja (see 5 Tr 838-849) and through its cross examination of Mr. King (see 5 Tr 737-756). Mr. King's analysis is entitled to no weight in this case. It cannot serve as the basis for reaching any conclusions on the value of generation assets or for making any decision that a stranded benefits analysis be considered in future true-up proceedings.

Mr. King's analysis was superficial and incomplete. Mr. King purported to do an analysis of the market value of generating assets based on various sales of generating assets which have taken place. However, he admitted that he did not have access to the actual sales contracts. 5 Tr 740. His information was based primarily on public information found in press releases, which he acknowledged did not have all the details of the sales. 5 Tr 753.

Mr. King made no studies of environmental issues that might affect the plants. 5 Tr 740. He did not undertake any engineering review of the physical structure of various plants which he included in his analysis. 5 Tr 741-742. Nor did he perform an econometric analysis of non-nuclear generating assets segregated by type of plant. 5 Tr 742.

Mr. King did not know whether any of the purchasing companies had prior partial ownership in the generating plants being purchased. 5 Tr 754. He did not evaluate the generation asset portfolios of the buyers before the purchases occurred. 5 Tr 754.

Mr. King sought to determine the relationship between the sale price of non-nuclear generating plants and the book value of the plants. However, the values are not comparable. The net book value amounts reported in the FERC Form 1, which Mr. King used to determine the book value of plants, represent the generating plants themselves. Mr. King admitted that the purchase price amounts which he used in his regression analysis included items in addition to the generating plants. 5 Tr 742. Purchase prices which he used as inputs in his analysis included, at least in some instances, fuel inventories, spare parts inventories, substations, and transmission equipment. 5 Tr 743. Further, the prices which he used were for groups of plants, not individual plants. 5 Tr 742. For example, sale number one on his list was comprised of the sale of 21 plants, as a group. 5 Tr 742. He acknowledged that the sales involved mixes of different types of plants. 5 Tr 742.

Mr. King admitted he was not privy to the details of the sales he sought to evaluate:

> “Q Mr. King, is there data which is relevant to the sales which are used in your regression models which are not publicly available?
>
> A Possibly yes.

Q Do any of the transactions that you have identified and then utilized in your regression models include associated side payments that have been unreported?

A I just don't know. If it had been unrecorded and unreported, I cannot say one way or the other...We are not privy to the details of each of these sales.

. . .

Q Do some of the sales which are reflected in your regression model include power purchase agreements as part of the package?

A They might. I cannot tell you right this minute whether they do or don't, but they might." 5 Tr 753-754.

This is hardly the type of evidence that a reasonably prudent person would rely upon in the conduct of his or her affairs.

If a comparison were going to be attempted, the sales price should have been adjusted to reflect only the value of the generating plant itself. 5 Tr 848. The value of additional items such as fuel inventory, supplies or transmission equipment should have been removed. 5 Tr 848. Mr. King did not do so. Nor could he have done so based on the information available to him. The numbers Mr. King used for comparison purposes are not comparable.

Further, there were numerous deficiencies in Mr. King's regression analysis modeling. Thirty-eight groups of sales formed the basis for Mr. King's regression analysis. However, none of these were in East Central Area Reliability ("ECAR") region, the region of the country in which Consumers Energy's generating plants are located. 5 Tr 844. All of Mr. King's data was from other regions. Mr. Leja explained:

> "Because of this, the analysis would not include the impact of geographic factors such as transmission/market access, emissions requirements (existing & future), supply/demand, etc., on the market price of generation plants." 5 Tr 844

This would be like gathering data on 38 sales of houses that recently sold over a large area and then trying to use the data to estimate the value of houses in a particular neighborhood not in the sample.

An estimating equation is only valid over the same range as the one from which the sample was taken initially. 5 Tr 845. Mr. King stated that the expected reduction in in-region capacity margin was one of the most significant variables in his analysis. 5 Tr 703. The projected change in the ECAR capacity margin was well outside of the range of the observed data for the same time period and therefore the estimating equation used is not valid. 5 Tr 845.

Furthermore, the underlying in-region capacity margin data relied on by Mr. King was outdated. 5 Tr 733, 738. In some regions (e.g., NPCC-NY), updated projected reserve margins showed a significant increase; while in other regions (e.g, NPCC-NE) significant decreases from earlier numbers were projected. 5 Tr 739, Exhibit I-40, Attachment C. Thus, underlying data for what Mr. King viewed as one of the most significant variables which was used in developing the underlying model had changed significantly from the values used in developing the model.

Additionally, Mr. King's use of "dummy variables" in his multiple regression model was highly subjective and inappropriate. 5 Tr 845. Two of the five variables used by Mr. King were dummy variables -- one for positive qualitative market value and one for negative qualitative market value. There is no clear definition as to what constitutes positive or negative qualitative market value. 5 Tr 845. Although age was listed as one consideration, a negative value was assigned to only two sales, even though there were six other sales with weighted average ages approximately equal to or greater than the sales which were assigned a negative value. 5 Tr 846. It appears Mr. King applied the dummy variables based on how fitted predictive values compare to observed values. 5 Tr 846. The values which the model did not predict were subjectively adjusted.

The impact of the dummy variables on the statistical results of the regression analysis is considerable. The independent variables in the regression analysis, without the dummy variables, explain only 64%of the changes in market value (the R-squared value) and have a standard error (the measure of the scatter of observed market values around the regression line) of 157.65. 5 Tr 846-847. The significant impact of the use of the dummy variables creates considerable doubt about the statistical validity of Mr. King's analysis. 5 Tr 847.

Additional problems with Mr. King's regression analysis include problems with the confidence intervals calculated by Mr. King and the failure to consider the impact of prior sales in a region. 5 Tr 847-848. Further, Mr. King's analysis contains computational errors. For example, inserting the numbers shown for sale number 10 and sale number 15 into the regression model do not result in the correct dollar amount per kilowatt. See 5 Tr 749-750, Exhibit I-40, Attachment B1.

Mr. King's further attempt to evaluate the value of Consumers Energy's Palisades Nuclear plant was similarly defective. Mr. King's knowledge of Consumers Energy's generating plants appeared to be limited. He believed that Consumers Energy is only a partial owner of the Palisades plant, did not know the year in which the plant's operating license will expire, and did not know if the Palisades plant is a pressurized water reactor ("PWR") or boiling water reactor ("BWR") plant. 5 Tr 744-745. Further, the sale prices he used as input data for nuclear plant sales in his nuclear plant analysis were not valid. For example, the sale price for the Three Mile Island reactor was less than one-fourth of the price he listed. 5 Tr 754-755. The sale price for the Oyster Creek plant was $10 million, rather than the $94 million Mr. King assumed. 5 Tr 755-756. The $84 million difference was an amount which the <u>seller</u> agreed to pay. 5 Tr 758.

Mr. King testified that he believes we are a long way from when regulation of the price of power at the point of generation will become unnecessary. 5 Tr 746. He indicated that he was not proposing that Consumers Energy or Detroit Edison be relieved of the obligation to provide generation service to customers. 5 Tr 746. These statements are inconsistent with the positions he takes in his testimony.

In sum, the analysis of Mr. King is not reliable and can be given no credibility in this case. Mr. King's analysis does not provide a valid basis to conclude that stranded benefits exist or that a stranded benefit analysis should be undertaken in the future.

2. Market Clearing Price

The Attorney General advocates use of the retail price of power as a proxy for market clearing price, claiming if costs were not above this price, customers would not be lost. This logic fails to recognize that investments were made during a period in which a different regulatory model was in place. In its June 5, 1997 Order, the Commission stated:

> "Stranded cost recovery is an important element of electric restructuring... Electric utilities in Michigan have made significant investments in order to meet their obligations to serve customers residing in their franchised service territories. Those investments were made during a period when customers had no choice of electric suppliers. This model provided for mutual obligations between utilities and their customers. Utilities were obligated to provide service in exchange for rates that provided an opportunity to earn a reasonable return on investment. Customers were limited to buying from a single monopoly provider, but were assured that the rates charged would not be excessive in relation to the required investment." June 5 Order, pp. 11-12.

Utilities should not be held liable for the effects of the significant regulatory changes on past decisions. The retail market is not the market which is available to Consumers Energy for sale of stranded power. The appropriate market, as discussed above in reply to Staff, is the wholesale power market.

C. Metering and Billing Services

The Attorney General states that she is taking no position with regard to this issue. Consumers Energy set forth its position in its initial brief at pages 30-33.

III. REPLY TO ABATE

A. MPSC Authority

ABATE states in its brief that it feels "compelled" to include a summary of its ongoing challenge of the Commission's authority to implement a voluntary program. As noted previously, the issue it raises is one that has previously been briefed by the parties and addressed by this Commission. In its August 17, 1999 Order in Case No. U-11290, et al, the Commission concluded that it could approve a voluntary program. ABATE has filed a claim of appeal from that order, as has the Attorney General. Parties have filed briefs in that appeal and the matter is currently pending before the Court of Appeals.

Consumers Energy does not agree with ABATE's assessment or conclusions. However, it is neither necessary nor appropriate to revisit the issue at this time. Various of the scenarios ABATE references have not arisen and may never arise. If and when they do, they can be addressed at that time. If a voluntary retail open access program is going to be implemented consistent with the schedule which the Commission has set forth, then it is imperative that the Commission grant authority for timely recovery of the prudently incurred implementation costs in this case and approve the stranded cost true-up methodology. The Commission's jurisdiction is not an issue which needs to be, or should be, revisited at this point in time.

B. Implementation Costs

ABATE claims that the Commission should not review the implementation costs which were incurred in 1997 and 1998 by Consumers Energy, arguing that Staff's review was inadequate and that a "full audit" must first be performed. ABATE's argument is without merit and must be rejected.

Staff witness Gerald F. Geml testified that Staff performed an on-site audit of the implementation costs for both Detroit Edison and Consumers Energy. 5 Tr 828. During the audit, Staff reviewed contractor invoices, company-related labor and expense, and the overall reasonableness of the charges recorded on the companies' books and records as they related to the open access program. 5 Tr 828.

Staff undertook the level of review of the implementation costs which it thought appropriate. If ABATE wished to undertake a further review of the implementation costs in the context of this proceeding it could have done so. ABATE did not present any testimony that implementation costs were imprudently incurred.

ABATE disputes use of a uniform charge to recover implementation costs from customers. It proposes that costs be allocated based on number of customers in each class. Use of a per kWh surcharge of $.000580, discussed by Consumers Energy's witness Mr. Rasmussen, would increase the monthly bill for a 500 kWh customer by approximately 29 cents. 4 Tr 562. The approach advocated by ABATE would shift additional costs to residential customers who choose to participate and could discourage residential participation.

In addition, the bigger a customer is, the more it can potentially save. Customers with larger loads potentially will see a larger benefit from retail open access than customers with smaller loads. The approach advocated by Consumers Energy for recovery of implementation costs is consistent with the goal of widespread participation in retail open access and is also consistent with costs being allocated to customers in a manner which reflects the potential benefit to those customers.

C. Stranded Costs

Consumers Energy has consistently presented stranded cost analysis and recovery approaches which developed a uniform transition surcharge. ABATE argues that a customer class specific surcharge should be developed, and Detroit Edison supports that contention. While the Company believes that the approach it has presented is reasonable, Consumers Energy does not oppose using class specific surcharges for stranded cost recovery if the Commission determines that their use would be appropriate.

ABATE argues in favor of relying upon the prices in retail open access contracts between suppliers and customers to determine the market price to be used for true-up purposes. For the reasons set forth in Consumers Energy's initial brief at pages 27-29 and in this reply brief in response to the Staff and Attorney General, the Company believes the use of retail prices would be administratively difficult, if not impossible, and would not be reflective of the actual prices that the utilities could receive for the displaced power.

ABATE emphasizes the importance of including the concept of "netting" in any true-up mechanism. As explained at pages 28-29 of Consumers Energy's brief, the true-up methodology adopted by the Commission and set forth in Consumers Energy's exhibits does incorporate netting. It is important to recognize that, whatever technique is used to incorporate netting in the true-up mechanism, it must have some basis in reality. That is, a calculation of the market value of generating units for use in the true-up mechanism must be coupled with the actual ability to sell power from those units at market-based prices. If that ability does not exist, then the "netting" adjustment is inappropriate.

ABATE suggests that Consumers Energy and Detroit Edison be required to file as part of the annual true-up proceeding the amount of available transmission capacity ("ATC") on both systems. This clearly has nothing to do with the true-up mechanism. In addition, ABATE and any other interested person can, at any time, readily identify the amount of ATC by accessing the Open Access Same-Time Information System ("OASIS") which FERC requires be maintained by transmitting utilities.

D. Metering and Billing

ABATE offers a conclusory statement that the Commission should establish a task force to investigate if it is economically advantageous to have metering and billing services competitively bid. ABATE offers no evidence in support of its position. In contrast, Consumers Energy presented numerous reasons why metering and billing should not be considered competitive market services. See 4 Tr 505-521. This issue is discussed at pages 30-33 of the Company's initial brief. ABATE's proposal should be rejected and the Commission should find that metering and billing functions should be limited to utilities.

IV. REPLY TO MIPPA

MIPPA again requests the Commission to affirm that post-2007 stranded costs incurred in connection with power purchase agreements will be recoverable by electric utilities. Consumers Energy agrees, and believes that the Commission has never indicated otherwise.

MIPPA contends that relying upon retail ROA transactions to establish the market price for true-up purposes will be difficult and will not reflect the market value the utilities are actually able to realize for this power. Consumers Energy agrees. See the Company's initial brief at pages 27-29 and Sections I.C.1 and II.B.2. of this reply brief.

V. REPLY TO MPA/MACS

The MPA/MACS make an extended argument that the Commission should defer action in this case. A review of their brief, however, indicates that, rather than a deferral of action, MPA/MACS is really requesting a reversal of the Commission's prior orders finding that stranded costs would be recoverable from customers. MPA/MACS asserts that stranded costs may not exist, and that the Commission may not be required to allow recovery if they do exist. MPA/MACS also claims that the Supreme Court decision in Consumers Power v Public Service Commission, 460 Mich 148; 596 NW2d 126 (1999), renders the Commission's ability to act in this case legally suspect.

The Commission should not in this case reconsider fundamental elements of its prior restructuring orders. In its June 5, 1997 Order in Case No. U-11290, the Commission stated:

> "Stranded cost recovery is an important element of electric restructuring and is needed to protect the interests not only of the utility, but also of those who wish to remain traditional sales customers of the serving utility. Electric utilities in Michigan have made significant investments in order to meet their obligations to serve customers residing in their franchised service territories. Those investments were made during a period when customers had no choice of electric suppliers. This model provided for mutual obligations between utilities and their customers. Utilities were obligated to provide service in exchange for rates that provided an opportunity to earn a reasonable return on investment. Customers were limited to buying from a single monopoly provider, but were assured that the rates charged would not be excessive in relation to the required investment." June 5, 1997 Order, U-11290, pp. 11-12.

The Commission reaffirmed the basic finding that stranded cost recovery was an essential element of the restructuring process in every order issued subsequent to the June 5, 1997 Order. There is no justification for reopening this finding at this stage.

The MPA/MACS' claim that the Supreme Court decision in Consumers Power v Public Service Commission, supra, means that the Commission should defer any action in this case pending the enactment of electric restructuring legislation should also be rejected. The Commission concluded in its August 17, 1999 Order in Case U-11290, et al, that a voluntary open access program could proceed in spite of the Supreme Court decision, and there is no reason for reversal of that conclusion at this time. For open access to proceed on the terms found to be reasonable by the Commission, the finalization of the development of a stranded cost true-up mechanism should not be deferred any further.

The MPA/MACS state that the Commission should "reduce or delay" the recovery of implementation costs, but offers no justification for such action. MPA/MACS alleges that the costs are "bloated, and in part, speculative", but never offers any support for this statement. They state that the costs for which recovery is sought "include activities that should not even be presumed to be undertaken" by the utilities, but MPA/MACS never identifies the activities to which it is referring. They also state that costs such as education efforts "may be unnecessary" or should be borne by other participants in the competitive market, but never identify which costs it thinks are unnecessary, or that should be borne by others. In short, MPA/MACS offers nothing specific enough for the Commission to adopt, even if it were inclined to do so.

VI. <u>REPLY TO ENERGY MICHIGAN</u>

Energy Michigan has filed a brief that has virtually no record support whatsoever. Rather than brief the evidence that was actually presented by its witness, Theodore Kuhn, Energy Michigan chose to present arguments, formulas and calculations which do not appear in the evidentiary record. For example, the formula at page 3 (repeated at page 14) of Energy Michigan's brief which is represented to be "the Commission's" market clearing price adjustment, does not appear anywhere in the record. Similarly, the formula at page 7 (repeated at page 37) of Energy Michigan's brief, which is represented as "Energy Michigan's" true-up approach, also does not appear anywhere in the evidentiary record. There are numerous other examples of arguments, formulas and calculations which lack evidentiary support. See, e.g., page 10 regarding alleged State Tax Tribunal actions, Table 1 on page 18, and the formula on page 33. While Energy Michigan will undoubtedly argue that its brief merely takes issues which were discussed by Mr. Kuhn, and translates them into formulas and calculations, there is an enormous gulf between the testimony and the brief that is highly prejudicial to Consumers Energy and the other parties. Much of Mr. Kuhn's testimony was virtually incomprehensible; for Energy Michigan to now offer what is effectively new testimony in an effort to explain what he "really meant" is grossly unfair. It would be unlawful for the Commission to base a decision on the arguments, formulas and calculations in the Energy Michigan brief.

Notwithstanding the lack of record support for much in Energy Michigan's brief, Consumers Energy will address some of the more glaring defects in those arguments. Energy Michigan represents that the formula on page 3 (repeated at page 14) of its brief depicts "the Commission's" process for adjusting transition charges to reflect changes in market price. Energy Michigan claims that this formula does not work because it will always produce a total combined cost of market price of power and transition charge which starts at 4.1 cents per kWh and increases 3% per year. This would be a fine argument except for one important point: the formula identified by Energy Michigan is not what the Commission adopted.

As explained at pages 29-30 of the Company's initial brief, Exhibit ACE-23 is more accurate representation of the market clearing price adjustment adopted by the Commission. As can be seen from a review of that exhibit, it adjusts the total amount of recoverable stranded costs in terms of <u>dollars</u>, rather than in terms of a per kWh <u>rate</u>. The adjustment can either increase or decrease the total dollar amount of stranded costs. Performing the market clearing price adjustment in this manner is consistent with the Commission's prior orders, and eliminates the issue that Energy Michigan tries to create through its misrepresentation of "the Commission's" process. This is also consistent with the adjustment advocated by the Staff on Exhibit S-53.

Energy Michigan makes the remarkable allegation that the "root cause of the problems associated with the Commission true-up plan can be found in the failure to incorporate mitigation." Energy Michigan brief, p. 15. This is another mischaracterization of the Commission's prior orders on this subject. The Commission's orders, and Consumers Energy's true-up methodology presented in this case, require substantial mitigation of stranded costs by imposing a reduction in stranded costs equal to the market value of the power sales displaced by ROA. Consumers Energy is required to mitigate stranded costs by re-marketing the power represented by those displaced sales.

To "correct" the Commission's "failure" to incorporate mitigation in the true-up adjustment, Energy Michigan proposes a scheme which would decrease the market clearing price "base" of 2.9 cents per kWh by 1% per year. According to Energy Michigan, this would have the impact of reflecting assumed decreases in the cost of production at utility generating units. There are a number of problems with this proposal. First, it is correcting a problem which, as seen above, does not exist with the Commission's approach. Second, the adjustment which Energy Michigan wants to make is based upon the market clearing price formula which Energy Michigan attributes to the Commission, but which, also as explained above, does not comport with the Commission's actual adopted approach. Third, the proposal is based on an assumed decrease in a cost that is not properly part of the stranded cost true-up process. The adjustment would have the effect of arbitrarily assuming a reduction in a base rate cost without a rate case proceeding. The adjustment is not really mitigation and is not a proper issue for stranded cost recovery. Fourth, the proposal appears to be a scheme to reintroduce an idea which Energy Michigan attempted to promote in prior Commission proceedings that was rejected.

In the October 29, 1997 Order issued in Case No. U-11454, the Commission noted Energy Michigan's proposal to "compare the market price of power with the calculated revenue requirements for generation." October 29, 1997 Order, U-11454, p. 15. The Commission rejected the proposal, stating that it "would needlessly involve the Commission in what would effectively amount to an annual rate case for each utility, a process that is not warranted under the circumstances." Id. The proposal Energy Michigan is making in this U-11955 proceeding is essentially a slightly re-packaged, but even worse, version of the proposal previously rejected. In this version, Energy Michigan is still attempting to compare market prices to the generation asset revenue requirement, but is simply adopting a proxy for actual revenue requirements that may bear no resemblance to those actual revenue requirements. While the Commission can perhaps award points for ingenuity and persistence to Energy Michigan, it should nevertheless reject this proposal one more time.

Energy Michigan argues that several major disallowances from the stranded costs included in Consumers Energy's exhibits should be ordered. First, Energy Michigan contends that nuclear generating plant additions added after 1998 should not be included in stranded cost calculations. In his direct testimony, Consumers Energy witness Mr. Ernst noted that the stranded cost calculations which had been preliminarily adopted in the January 14, 1998 Order used nuclear plant balances as of year end 1997. 4 Tr 435. He further testified that it would be proper to update those figures to reflect plant balances as of a time reasonably concurrent with the commencement of retail open access; i.e., year end 1999. Id. Detroit Edison took the further position that capital additions until 2007 should also be included in stranded cost calculations. The Company believes that, at a minimum, the plant balances should be updated to year end 1999 to match the approximate date that open access commences. If the Commission agrees with Detroit Edison and determines that it is appropriate to include plant additions through 2007, then that treatment should be the same among utilities.

Energy Michigan alleges that the market value of power purchase agreement capacity is understated on Mr. Ernst's Exhibit ACE-20. In connection with this allegation, Energy Michigan first claims that the output of the displaced PPA capacity is understated. In response, Energy Michigan clearly does not understand Mr. Ernst's presentation or even the purpose of this adjustment. The purpose of the adjustment is to identify the market value of the PPA capacity. That market value, by definition, must be based upon how the associated plants would operate if they were being used to make market-based sales. Thus, for purposes of Mr. Ernst's exhibit, he assumed that the plants would be economically dispatched to the extent permissible under the terms of the PPA's based upon the on and off peak energy prices specified in the PPA's. It would be wholly improper to perform this adjustment as Energy Michigan is apparently suggesting, and assume that these plants would, in a market-based environment, run at some level approaching their availability factors. Performing the adjustment in that manner would drastically overstate the PPA capacity's market value. Putting this in the context of the PECO transaction, if PECO was required to operate the MCV in the manner advocated by Energy Michigan, PECO would have significantly decreased the amount it was willing to bid for the rights to the capacity. Energy Michigan's allegation appears to be an attempt to "game" the true-up mechanism in defiance of actual market realities.

Energy Michigan also alleges that Mr. Ernst's presentation is defective because he did not assume increases in the market price of PPA capacity in his Exhibit ACE-20. In response, the record is unrefuted that the methodology reflected on Mr. Ernst's exhibits matches that adopted by the Commission in the January 14, 1998 Order in U-11290. See 4 Tr 434-435. The Commission adopted a methodology which did not need to and did not escalate the market value of PPA capacity.

Energy Michigan claims that "the PECO transaction contains excess costs" which can be reduced by "requiring a higher price from PECO." This claim is simply ridiculous. The PECO transaction was the result of a competitive auction in which PECO was the high bidder. Proposing that the Commission "require a higher price from PECO" makes no sense.

Energy Michigan complains that Mr. Ernst included post-2007 generation-related costs associated with FAS 106 and 109 in his presentation. These costs were included in the Commission's calculation adopted in the January 14, 1998 U-11290 Order. There is no justification for excluding these regulatory assets from recovery.

Energy Michigan argues that Consumers Energy (and Detroit Edison) "used only retail sales to spread [stranded] costs." This is incorrect. As explained by Mr. Ernst, the Company' presentation spreads the costs over retail and wholesale sales. See 4 Tr 451-452.

Energy Michigan contends that the Consumers Energy presentation is flawed because it allocates a portion of nuclear, PPA and regulatory assets to open access customers on a pro-rata basis regardless of total sales levels. This approach is consistent with that adopted by the Commission in the January 14, 1998 Case U-11290 Order. Furthermore, Energy Michigan's approach is simply unfair, and would effectively require full, bundled service customers to subsidize open access customers. The costs which will be stranded were incurred to serve all customers, including open access customers who depart for alternative suppliers. The remaining customers should not be required to bear 100% of these costs. This is a rate design/fairness issue.

VII. CONCLUSION

Consumers Energy requests that the Commission issue an order in this proceeding which is consistent with the positions set forth by the Company in its initial brief and in this reply brief.

Respectfully submitted,

CONSUMERS ENERGY COMPANY

Dated: February 11, 2000

By: Richard Chambers

Jon R. Robinson
H. Richard Chambers
Raymond E. McQuillan
212 West Michigan Avenue
Jackson, Michigan 49201
Attorneys for Consumers Energy Company
(517) 788-0698

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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-11955
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-11956

PROOF OF SERVICE

STATE OF MICHIGAN)
) SS
COUNTY OF JACKSON)

Sammie B. Dalton, being first duly sworn, deposes and says that she is employed in the Legal Department of Consumers Energy Company; that she served a copy of the "**Reply Brief of Consumers Energy Company**" upon the persons listed in Attachment 1 hereto, electronically (in a PDF format) at the e-mail addresses listed therein and by first-class mail at the addresses listed therein by depositing the same on February 11, 2000, in the United States mail in the City of Jackson, Michigan with first-class postage thereon fully paid.

Sammie B. Dalton

Subscribed and sworn to before me this 11th day of February, 2000.

Susan C. Milligan
Susan C. Milligan
Notary Public, Jackson County, Michigan
My Commission Expires: May 18, 2004

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ATTACHMENT 1 -- to Case Nos. U-11955 and U-11956

Administrative Law Judge

Hon. James N. Rigas, ALJ
Michigan Public Service Commission
6545 Mercantile Way, Suite 14
P. O. Box 30221
Lansing, MI 48909-7721
E-Mail: james.n.rigas@cis.state.mi.us
Facsimile No.: (517) 334-6398 [SD #20]

Counsel for Energy Michigan, Inc.

Eric J. Schneidewind, Esq.
Varnum, Riddering, Schmidt & Howlett
The Victor Center, Suite 810
201 N. Washington Square
Lansing, MI 48933
E-Mail: ejschneidewind@vrsh.com
Facsimile No.: (517) 482-6937 [SD #41]

Counsel for the Michigan Public Service Commission Staff

Steven Hughey, Esq.
Assistant Attorney General
Public Service Division
6545 Mercantile Way, Suite 15
Lansing, MI 48911
E-Mail: hugheys@ag.state.mi.us
bibbst@ag.state.mi.us
Facsimile No.: (517) 241-6678 [SD #13]

Counsel for Michigan Power Limited Partnership

David E.S. Marvin, Esq.
Michael Ashton, Esq.
Fraser, Trebilcock, Davis & Foster
1000 Michigan National Tower
Lansing, MI 48933
E-Mail: mashton@ftdf.com
dmarvin@ftdf.com
Facsimile No.: (517) 482-0887 [SD #46]

Counsel for the Attorney General, Jennifer M. Granholm

Donald E. Erickson, Esq.
Assistant Attorney General
6520 Mercantile Way, Suite 2
P. O. Box 30218
Lansing, MI 48909
E-Mail: ericksond@ag.state.mi.us
Facsimile No.: (517) 373-9860 [SD #07]

Counsel for Cadillac Renewable Energy, L.L.C. and Central Wayne Energy Recovery Limited Partnership

Thomas J. Waters, Esq.
Fraser, Trebilcock, Davis & Foster, P.C.
1000 Michigan National Tower
Lansing, MI 48933
E-Mail: twaters@ftdf.com
Facsimile No.: (517) 482-4717

Counsel for the National Energy Marketers Association

John M. Dempsey, Esq.
Dickinson Wright PLLC
215 S. Washington Square, Suite 200
Lansing, MI 48933
E-Mail: jdempsey@dickinson-wright.com
Facsimile No.: (517) 487-4700 [SD #38]

Counsel for the Association of Businesses Advocating Tariff Equity (“ABATE”)

Thomas E. Maier, Esq.
Clark Hill PLC
2455 Woodlake Circle
Okemos, MI 48864-5941
E-Mail: tmaier@clarkhill.com
rcoy@clarkhill.com
jtselecky@consultbai.com
Facsimile No.: (517) 381-0268 [SD #14]

Counsel for the Michigan Independent Power Producers Association

Ronald E. Russell, Esq.
Russell & Russell, P.C.
525 Okemos Street, Suite B
Mason, MI 48854
E-Mail: rrussell@enstarenergy.com
Facsimile No.: (517) 676-3544

Counsel for the Michigan Petroleum Association/Michigan Association of Convenience Stores

Don L. Keskey, Esq.
Knaggs, Harter, Brake & Schneider, P.C.
1375 S. Washington Ave., Suite 300
Lansing, MI 48910
E-Mail: khblaw@voyager.net
Facsimile No.: (517) 482-2689

Counsel For Michigan Community Action Association

Brian W. Coyer, Esq.
Knaggs, Harter, Brake & Schneider, P.C.
1375 S. Washington Ave., Suite 300
Lansing, MI 48910
E-Mail: khblaw@voyager.net
Facsimile No.: (517) 482-2689

Counsel for The Detroit Edison Company

Bruce R. Maters, Esq.
The Detroit Edison Co.
688 Walker Cisler Bldg.
2000 Second Ave.
Detroit, MI 48226
E-Mail: matersb@detroitedison.com
mpscfilings@detroitedison.com
Facsimile No.: (313) 235-8500 [SD #74]