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April 30, 2001

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

Re: Case No. U-12358

Dear Ms. Wideman:

Enclosed for filing in the above referenced matter are an original and 4 copies of the "Consumers Energy Company's Reply to Exceptions." In addition, an electronic copy is being filed with the Commission in the portable document format (PDF). I have also enclosed an original Proof of Service.

Sincerely,



H. Richard Chambers

cc: Per Attachment 1
to Proof of Service

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
to recover implementation costs for)
the period ended December 31, 1999)
_____)

Case No. U-12358

CONSUMERS ENERGY COMPANY'S
REPLY TO EXCEPTIONS

April 30, 2001

TABLE OF CONTENTS

I.	REPLY TO THE STAFF.....	1
A.	Staff’s Proposed Disallowance Is Not Supported by the Record in this Case and Should be Rejected.....	2
B.	The ALJ Correctly Rejected Staff’s Adjustments	3
C.	Staff Does Not Establish a Valid Basis to Disallow Labor Costs	4
1.	Staff’s Proposed Disallowance of Labor Costs Should Be Rejected	4
2.	Staff’s Presumption That Labor Costs Are Not Incremental Is In Error.....	6
D.	Staff Does Not Establish a Valid Basis to Disallow Employee Impact Costs	9
E.	The PFD is Fully Consistent With the Commission’s Decision in Case Nos. U-11955, U-11956	11
F.	Taking Notice of the Three Non-Record Documents Staff Attaches to its Exceptions Would Not be Appropriate; Further, the Documents Do Not Support Staff’s Conclusions In Any Event.....	12
II.	REPLY TO ABATE	14
A.	The ALJ Correctly Concluded that the Commission Should Address the Methodology for Recovery of Implementation Costs in this Proceeding	15
B.	The ALJ Correctly Concluded that Collecting Implementation Charges Through Use of a Uniform Energy Charge is Reasonable	18
C.	The ALJ Correctly Concluded that Recovery of Prudently Incurred Implementation Costs in this Case Should Not Be Conditional.....	22
III.	CONCLUSION.....	28
ATTACHMENT A: Excerpts from the Brief of Consumers Energy Company dated January 31, 2001		

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
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Case No. U-12358

CONSUMERS ENERGY COMPANY'S
REPLY TO EXCEPTIONS

Consumers Energy Company ("Consumers Energy" or the "Company") files the following reply to the exceptions filed in this proceeding by the Michigan Public Service Commission Staff and the Association of Businesses Advocating Tariff Equity ("ABATE"). This reply is being filed in accordance with the schedule established by the Administrative Law Judge ("ALJ") in his Proposal for Decision ("PFD"). As set forth in this reply, the decision of the ALJ in this proceeding should be adopted in its entirety.

I. REPLY TO THE STAFF

Staff in its exceptions erroneously claims that allowing Consumers Energy to recover labor costs and employee impact costs prudently incurred in 1999 for implementation of retail open access will result in recovery of these costs twice. Staff is incorrect. Its exceptions are conclusory in nature and disregard the evidence in this case. The ALJ correctly rejected Staff's recommendation that \$4.996 million of implementation costs incurred in 1999 be disallowed. To do otherwise would have been contrary to the evidence and error. The evidence in this case compels rejection of Staff's claim.

A. Staff's Proposed Disallowance Is Not Supported by the Record in this Case and Should be Rejected

While Staff makes generalized references in its exceptions to the testimony and exhibits of its witness Mr. Kusiak, it does not directly cite to any specific evidence in this proceeding.¹ Staff completely ignores the extensive, and compelling, evidence presented by Consumers Energy in opposition to the Staff's position. As will be discussed in more detail below, the evidentiary record in this case does not support Staff's conclusion.

Staff, relying on the testimony of its witness William A. Kusiak, recommended disallowance of \$4.996 million of implementation costs which were prudently incurred in 1999. This is comprised of (i) \$3.369 million of labor costs that are not associated with employee impacts, (ii) \$1.481 million of employee impact costs, and (iii) \$0.146 million of associated carrying costs. 3 Tr 61.

The Company presented evidence that the costs being challenged were directly related to implementation of retail open access. 3 Tr 46-71, Exhibits A-2, A-3. Further, the Company presented evidence that the implementation plan which the Company is pursuing has been prudently designed, developed and implemented. 3 Tr 47, 57, 60, 83. Staff did not challenge these conclusions. The uncontroverted evidence in this proceeding establishes that the labor expenses and employee impact costs which the Company seeks the authority to recover were prudently incurred.

¹ Staff, perhaps due to the weakness of its evidence, attempts in its exceptions to rely upon three documents that are not part of the record in the case claiming the Commission can take notice of this non-record information. As will be discussed below, taking notice would not be appropriate.

Furthermore, the evidence establishes that the costs which Staff seeks to disallow were incremental costs which would not have been incurred but for restructuring and are in addition to costs that would typically be incurred in providing electric service in a reasonable, efficient manner. 3 Tr 62. The Company disagrees with both the methodology used by Staff in evaluating these costs and the conclusions that Staff reached. Staff has failed to support its proposed disallowance and the proposed disallowance must be rejected in its entirety.

Rule 341 of the Commission's Rules of Practice and Procedure, R460.17341, states that exceptions shall be supported by a reasoned discussion of the evidence and the law and that factual allegations claimed to be established by evidence shall include a specific reference to portions of the record where the evidence may be found. Staff's exceptions do not satisfy these criteria.

B. The ALJ Correctly Rejected Staff's Adjustments

The ALJ, after setting forth Staff's position and summarizing Staff's arguments stated with regard to the labor costs which Staff seeks to disallow:

"In its October 24, 2000 Order in Case Nos. U-11955 and U-11956, the Commission adopted a two-prong test for evaluating if labor costs were incremental. The first test is whether the cost would not have been incurred but for restructuring. The second test is whether the cost represents a task or activity that would not have been performed but for restructuring. Exhibit A-2 shows Consumers' analysis of the specific labor hours for the actual employees that charged time to electric restructuring in 1999. The evidence shows that labor expenses incurred in 1999 are attributable to incremental labor expenses. The Administrative Law Judge finds that this evidence demonstrates that the labor costs which Staff seeks to disallow were incremental costs which would not have been incurred but for restructuring and are in addition to costs that would typically be incurred in providing electric service. The writer is persuaded that this showing satisfies both of the Commission's criteria." PFD, pp 8-9 (Emphasis added)

As will be discussed below, this conclusion is fully supported by the evidence.

With regard to the employee-impact costs that Staff seeks to disallow, the ALJ stated:

“Staff has proposed to disallow \$1.481 million of employee impact costs for 1999....Consumers has shown these costs relate to two initiatives....

“Based upon the record presented the Administrative Law Judge finds that both of the employee impact-related initiatives were directly related to electric restructuring and these costs would not have been incurred but for restructuring and are in addition to costs that would typically be incurred in providing electric service. No evidence has been presented to the contrary. These expenses are therefore properly recoverable as implementation costs.” PFD, pp 9-10 (Emphasis added)

As will be discussed below, this conclusion is also fully supported by the evidence.

The ALJ also found:

“Having determined that Staff’s proposed disallowance of labor and employee impact costs should be rejected, Staff’s proposed disallowance of the associated carrying costs should, therefore, also be rejected.” (PFD, p 10)

Thus, after careful review of the evidence, the ALJ rejected each of the Staff’s proposed disallowances. These conclusions should be adopted by the Commission. The evidence which supports these conclusions is discussed further below.

C. Staff Does Not Establish a Valid Basis to Disallow Labor Costs

1. Staff’s Proposed Disallowance of Labor Costs Should Be Rejected

Staff’s rationale for the proposed disallowance of labor expenses is that the labor expenses must not have been incremental since Other Operation and Maintenance (“Other O&M”) expense and overall employee levels in 1999 were lower than the amounts used in developing base rates in the Company’s last general rate case. However, this focus is misplaced.

Staff's proxy method of evaluating whether costs are incremental must be rejected in favor of Consumers Energy's more detailed, fact-specific analysis.

Staff's proxy analysis relies upon speculation. The Company's fact-specific analysis looks at the specific labor hours for the actual employees that charged time to electric restructuring in 1999. The 1999 labor hours charged to electric restructuring are summarized on Exhibit A-2. The evidence shows that labor expenses incurred in 1999 are attributable to incremental labor expenses. For example, 10% of the labor hours were attributable to new employees that were added to fill new positions created by the electric restructuring. 3 Tr 63, Exhibit A-2. An additional 26.4% were attributable to employees who either filled a new position within electric restructuring or worked on electric restructuring and had their prior responsibilities filled through use of new employees. 3 Tr 64, Exhibit A-2. Another 33.8% were attributable to chargeback services, which Mr. Gilzow explained are essentially the same as outside consulting services. 3 Tr 65, Exhibit A-2. The incremental nature of these and the other categories shown on Exhibit A-2 for labor hours incurred in 1999 are discussed in the Company's initial brief at pages 14-26, which the Company incorporates herein by reference. See Attachment A.² Mr. Gilzow addressed the incremental nature of these expenditures in detail in his rebuttal testimony, which appears in the record at 3 Tr 58-71. Staff does not reference the testimony or the exhibits presented by the Company in rebuttal.

² Rule 341(3) of the Commission's Rules of Practice and Procedure, R460.17401(3) states that materials incorporated by reference should be attached. Staff and ABATE have sought in their exceptions to incorporate various portions of briefs and reply briefs, but have not attached those portions to their exceptions. To the extent the Commission nevertheless chooses to make reference to the portions sought by Staff or ABATE to be incorporated by reference, Consumers Energy requests the Commission also review the corresponding sections of Consumers Energy's brief and reply brief.

Staff's proposed disallowance of labor costs should be rejected. Staff's proposed disallowance of the associated carrying costs should also, therefore, be rejected. Staff's arguments on this issue are discussed further in Section I.C.2, below.

2. Staff's Presumption That Labor Costs Are Not Incremental Is In Error

Staff assumes that labor costs can never be incremental unless they are at levels greater than at the time base rates were last established. Such a conclusion is contrary to Commission statements in the Commission's October 24, 2000 Order in Case Nos. U-11955, U-11956 identifying ways in which the incremental nature of such costs could be established. It is also contrary to the prohibition against retroactive ratemaking. Further, it fails to recognize that the number of employees was higher at the end of 1999 than at the end of 1998.

The Company has undertaken and presented an analysis which is specific to the actual employees that charged time to electric restructuring in 1999. The evidence presented by the Company shows that the labor expenditures were directly related to electric restructuring and were incremental to expenses that would have been incurred absent electric restructuring.

The Commission stated at page 13 of its June 5, 1997 Order in Case No. U-11290 with regard to implementation costs:

"If the costs are prudently incurred, it would also be inappropriate to disallow recovery by the utility."

In its October 24, 2000 Order in Case Nos. U-11955, U-11956 the Commission adopted Staff's proposed disallowance of labor costs incurred in 1997-1998 on the basis that Consumers Energy and Detroit Edison had not made "an adequate showing that those costs were in addition to employee-related costs typically incurred by a utility operation in providing electric service in a reasonable, efficient manner." Order, p 9 (Emphasis added).

The Commission set forth, at page 9 of its October 24 Order, a two-prong test, which is referred to by the ALJ in his PFD, for evaluating if labor costs are incremental. The first prong is whether the cost would not have been incurred but for restructuring. The second is whether the cost represents a task or activity that would not have been performed but for restructuring. The ALJ applied this test to the evidence. Staff does not even mention the test.

The Commission concluded that the record in Case No. U-11955 did not establish that the labor costs subject to the proposed disallowance were incremental. In the present case, Consumers Energy by introducing new evidence has made a showing that costs were in addition to costs that would typically be incurred.

In seeking to support his proposed disallowance, Staff's witness Mr. Kusiak indicated that Other O&M levels were lower in 1999 than at the time of the last rate case. He stated it "would therefore appear" base rates allow for the level of spending. 3 Tr 137. However, he does not directly address whether the labor costs are incremental. Other O&M is comprised of a number of components. Changes in the overall Other O&M level are not necessarily indicative of changes in labor expense, let alone whether the labor expense incurred in connection with electric restructuring is incremental. The labor-hour specific analysis presented by the Company shows that, in this instance, Staff's proxy method resulted in an incomplete and inaccurate view.

Pursuant to 2000 PA 141; MCL 460.10 et seq.; MSA 22.13(10) set seq., electric rates are currently frozen. Pursuant to prior orders of the Commission and 2000 PA 141, implementation costs are recoverable costs. Labor costs which were prudently incurred in 1999 for purposes of implementation, and which are incremental to costs which would have been incurred in the absence of electric restructuring, are recoverable implementation costs. To deny

recovery of such costs would have the effect of requiring implementation costs, which would not otherwise have been incurred, to be recovered through base rates, thereby having the result of retroactively reducing base rates previously approved by the Commission by the amount of the incremental labor expense. A retroactive adjustment of 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).

Mr. Kusiak cited employee levels in an effort to validate his proposed disallowance. He stated that at December 31, 1999 the employee count was 8,736 and compared this to levels in 1996. 3 Tr 137. He stated that, based on this comparison, “one could conclude” the Company did not incur incremental labor costs. This, however, does not address the question of whether there has been an incremental increase in employees due to restructuring. The Company’s labor hour analysis shows that a conclusion that the Company did not incur incremental labor costs would be in error.

During 1999, 57 employees charged all or some of their time to electric restructuring. 3 Tr 62. The breakdown of the number of employees by activity is shown on column (A) of Exhibit A-2. Mr. Gilzow noted that the number of employees of 8,736 at the end of 1999 that Mr. Kusiak cited was higher by 133 than the number of employees at the end of 1998. 3 Tr 67. This increase more than covers the number of employees whose labor has been classified by the Company as being attributable to restructuring. 3 Tr 67.

A better approach than Staff’s proxy method for determining whether such labor expenses are incremental would be to examine whether the costs would have been incurred and whether activities would have been performed but for restructuring, as was done by the

Company. However, if employee numbers are examined, the increase in the number of employees between the end of 1998 and the end of 1999 provides support for the conclusion that labor costs incurred in 1999 for the implementation of retail open access were incremental.

D. Staff Does Not Establish a Valid Basis to Disallow Employee Impact Costs

Staff, without any discussion or analysis of the employee impact costs, recommends all such costs be disallowed. The employee impact costs for 1999 total \$1.481 million. This includes \$1.150 million of labor-related costs and \$0.331 million of non-labor related costs. 3 Tr 67. These are types of costs which Commission orders and 2000 PA 141; MCL 460.10 et seq.; MSA 22.13(10) et seq., envisioned would be recoverable.

These costs relate to two initiatives. Costs associated with both of these initiatives are properly recoverable from customers. Staff's witness did not even mention the initiatives. Nor does Staff mention the initiatives in its exceptions. Staff has not supported disallowing any employee impact costs incurred in 1999.

The uncontested evidence shows that employee impact costs which are related to the elimination of the Traveling Repair Crew, the first of the two initiatives, are directly related to electric restructuring. 3 Tr 69. The Company incurred \$899,000 for labor, materials and associated expenses associated with retraining the employees. 3 Tr 69. An additional \$25,000 was incurred for relocation and other related employee expenditures. 3 Tr 69.

In its Staff Report on Electric Industry Restructuring, which was issued on December 19, 1996, Staff stated that employee-related restructuring costs should be recoverable. The Commission quoted this language at page 8 of its June 5, 1997 Order in Case No. U-11290:

“The fourth category is employee related restructuring costs. Staff recommends that audited and verified costs incurred to transition the work force as a result of industry restructuring should be

included. These costs would not be incurred absent restructuring. Promoting the retraining of employees, for example, is good public policy, will improve the Michigan economy by retaining a well-trained work force, and is consistent with the approach taken in other states” (Emphasis added)

At page 11 of its Order, the Commission concluded that the Staff report provided a reasonable basis for determining stranded costs.

Staff does not dispute that virtually all of the costs related to the first initiative are associated with retraining employees. Staff does not claim that the costs were imprudent. The Commission has previously recognized that retraining costs are recoverable costs and are, by their very nature, incremental. Section 10p(2) of 2000 PA 141; MCL 460.10p(2); MSA 22.13(10p)(2), reaffirms this conclusion, stating in part:

“Stranded costs shall include audited and verified employee-related restructuring costs...including employee retraining programs...and similar costs and programs that have been approved and found to be prudently incurred by the commission.”

Staff has presented no valid basis to disallow the costs associated with the first initiative.

The evidence shows that the costs related to the second initiative, which involves retaining critical employees at the Michigan Electric Power Coordination Center, are also directly related to electric restructuring. 3 Tr 69-70. The affected employees’ jobs and skills are critical to the function of the Power Coordination Center. 3 Tr 70. The payout in 1999 for retaining this well-trained work force was \$344,000. 3 Tr 70. As with the first initiative, Staff does not even address this initiative. Staff has presented no valid reason to disallow costs associated with the second initiative.

The remainder of the employee impact costs is attributable to materials and expenses related to the two initiatives described above. 3 Tr 71. As with the expenses for the two initiatives discussed above, these expenses are properly recoverable as implementation costs.

Staff's Exhibit S-6 groups the labor portion of the employee impact costs with other labor. The remaining \$331,000, which is the non-labor portion (3 Tr 61, 67), is referenced on the Staff exhibit as "Employee Impact Related Costs" without further explanation. The \$331,000 does not represent labor or overhead. See 3 Tr 68, 71. Staff has not presented any valid justification for disallowing the non-labor portion of employee impact costs.

The Company has presented evidence that both of the employee impact-related initiatives were directly related to electric restructuring. These costs would not have been incurred but for restructuring and are in addition to costs that would typically be incurred in providing electric service. No party has presented evidence to the contrary. Staff has not supported disallowing either the labor portion or the non-labor portion of employee-impact costs. Staff's proposed disallowance of the employee impact costs should be rejected in its entirety.

E. The PFD is Fully Consistent With the Commission's Decision in Case Nos. U-11955, U-11956

At page 2 of its exceptions Staff makes the erroneous assertion that "The PFD is also inconsistent with this Commission's October 24, 2000 decision in Case Nos. U-11955/11956 (recovery of 1998 implementation costs.)" To the contrary, it is the Staff's proposed disallowance that is not consistent with the Commission's October 24 Order. The PFD is fully consistent with that Order.

Staff's apparent rationale is that because the Commission found that Staff's proposed disallowances of labor costs should be adopted in Case Nos. U-11955, U-11956, the Commission should disallow all labor costs in the present case. The logic is defective. The Commission's decision in Case Nos. U-11955, U-11956 was based on the record in that case. The Commission concluded that the record in that case did not establish the labor costs in

question were incremental. It was a fact-specific determination, not a mandate that no labor costs could ever be recovered.³

The Commission in Case Nos. U-11955, U-11956 gave guidance on what would be sufficient to recover labor costs and to overcome what it perceived to be shortcomings in the evidentiary record in the earlier proceeding. Case No. U-12358 must be evaluated based on the evidentiary record in this proceeding, not the evidentiary record in an earlier proceeding.

As discussed above, the Commission has set forth a two-prong test for evaluating if labor costs are incremental. The evidence presented by the Company meets the criteria established.

F. Taking Notice of the Three Non-Record Documents Staff Attaches to its Exceptions Would Not be Appropriate; Further, the Documents Do Not Support Staff's Conclusions In Any Event

Staff attaches three non-record documents to its exceptions. It requests the Commission take notice of what it portrays as “certain facts” pursuant to Rule 327 of the Commission’s Rules of Practice and Procedure, R460.17327. Taking notice of these facts would not be appropriate. Consumers Energy disputes these facts, insofar as Staff seeks to use them in this proceeding, and their materiality.

The record in this case was closed on January 10, 2001. 3 Tr 138. Staff did not seek to have notice taken of any of the documents it attaches to its exceptions at or before the close of the record. These are not the types of documents for which official notice is appropriate.

³ Indeed, the Commission has held that incremental labor costs are recoverable and allowed recovery in that case of certain Detroit Edison labor costs that were deemed incremental.

Only one of the documents relates to 1999. Staff's Appendix A is an excerpt from the Company's Form P-521 annual report to the Commission for 1999. That document was in existence and could have been offered prior to the close of the record if Staff so desired.

The impropriety of taking notice is reflected by the fact that Staff is attempting to use the Appendix A data in a way that contradicts Staff's own witness. Staff witness Kusiak testified that at December 31, 1999 the employee count was 8,736, which he then compared to a 1996 rate case employee count number of 8,938. 3 Tr 137. Staff using Appendix A claims in footnote 1 to its exceptions that the December 31, 1999 employee count of 5,799 shown on Appendix A should be compared to 8,938. Staff's claim is impeached by the testimony of its own witness. The testimony of Staff's own witness shows that the number of 5,799 (electric department) is not comparable to the number of 8,983 (total company). Staff in its exceptions is comparing two non-comparable numbers.

Mr. Gilzow, using numbers comparable to those used by Mr. Kusiak, points out that the number of employees at the end of 1999 was higher by 133 than the number of employees at the end of 1998. 3 Tr 67. Further, Staff's proxy approach does not validate its conclusions in any event. This is discussed in section I.C.2, above. Thus, neither the "facts" nor their materiality have been established and official notice of Exhibit A would be inappropriate.

The other two documents which Staff attaches to its exceptions do not even relate to the time period at issue in this proceeding. Case No. U-12358 involves implementation costs incurred in 1999. Staff's Appendix B purports to be information for the year 2000. Appendix C is for the 12-months ended February 28, 2001. Regardless of what these documents may indicate, they are clearly not relevant or material to the year 1999.

Staff's attempt to compare the return on equity used in developing electric rates with numbers on Appendix B and Appendix C to its exceptions results in comparisons that, even if the numbers were comparable, would not be meaningful for purposes of this case. Here, the numbers are neither meaningful nor comparable.

The documents contain various calculations and numbers that were not sponsored by any witness in the proceeding and which would constitute hearsay. The assumptions used are not stated. To put numbers on a comparable basis, numbers would have to be normalized and adjusted. Even then the numbers, as stated previously, would not be relevant or material to this proceeding.

Staff's apparent rationale is that if the earned return on equity is above the authorized return this must mean that the labor costs which Staff seeks to disallow are not incremental. However, Staff provides no support for reaching such a conclusion. Denying recovery of prudently incurred implementation costs in order to offset general rates would constitute an unlawful retroactive rate decrease. Further, the attempt to compare documents with different sources and prepared for different purposes does not result in an appropriate comparison. Nor does it take into consideration that various adjustments would be necessary to earned returns on equity in any event. Thus, neither the "facts" nor their materiality have been established.

II. REPLY TO ABATE

ABATE in its exceptions erroneously claims that the ALJ (i) erred in recommending a recovery methodology for implementation costs, (ii) erred in recommending a uniform surcharge for recovery of implementation costs, and (iii) erred by not making recovery of implementation costs conditional. Each of ABATE's conclusions is erroneous. The ALJ's

rulings in these areas are reasonable and appropriate and are supported by the record evidence in this proceeding.

A. The ALJ Correctly Concluded that the Commission Should Address the Methodology for Recovery of Implementation Costs in this Proceeding

ABATE takes the position in its exceptions that the ALJ should have deferred, and not made a recommendation regarding, the methodology for recovery of implementation costs. The primary rationale for this conclusion is that the Commission has previously deferred making such a determination and that Case No. U-12639, a net stranded cost proceeding, is pending.

In rejecting ABATE's arguments, the ALJ stated:

“ABATE has taken the position that the Commission should defer consideration of any issues related to the surcharge methodology until Case No. U-12639 is complete. Consumers has noted that Case No. U-12639 was initiated to address implementation of the provisions of Section 10a(10) of Act 141. Section 10a(10) requires the Commission to consider the reasonableness and appropriateness of various methods to determine net stranded costs. The writer is persuaded that consideration of the proper method to determine net stranded costs should not preclude the Commission from addressing proposals related to surcharge methodology. The Administrative Law Judge therefore recommends that the Commission reject ABATE's proposal to defer this proceeding.” PFD, p 7.

The recommendation of the ALJ should be adopted.

As set forth by the ALJ, Case No. U-12639 was initiated to address the implementation of Section 10a(10) of the Customer Choice and Electricity Reliability Act, 2000 PA 141. Consideration of the reasonableness and appropriateness of various methods to determine net stranded costs in Case No. U-12639 does not preclude rejection in this proceeding of ABATE's position that a uniform energy charge not be used (which is discussed below). Nor

does it preclude consideration in the instant proceeding of the Company's proposal regarding recovery of implementation costs.

ABATE's primary rationale is that the Commission deferred consideration of this issue in Case Nos. U-11955, U-11956 and in Case No. U-12359. Neither of those proceedings is determinative of whether it is appropriate to address the methodology for recovery of implementation costs in the instant proceeding.

The record in Case Nos. U-11955, U-11956 was closed prior to 2000 PA 141 and 2000 PA 142 being enacted. The Commission stated in that proceeding:

“Although the parties proposed surcharges to recover the approved implementation costs, their proposals do not take into account the changes required by Acts 141 and 142.” Order, p 12

The Commission, noting the commencement of Case No. U-12639, concluded that instead of deciding how to reflect the recovery of 1998 implementation costs in that order, it would defer the means of recovery until pending questions regarding the stranded cost recovery mechanism are resolved. Order, p 12.

Information is now available that was not available at the time the record was developed in Case Nos. U-11955, U-11956. In Case No. U-12358, unlike Case Nos. U-11955, U-11956, the effect of the legislation enacted in 2000 has been taken into account.

Mr. Ernst stated that Consumers Energy had not sought to securitize implementation costs under the provisions of 2000 PA 142:

“Q Does the amount which the Company has requested to securitize in Case No. U-12505 include amounts for implementation costs?

“A Consumers Energy has not sought at this time to securitize retail open access implementation costs or future implementation costs...” 3 Tr 92.

Mr. Ernst proposed that a surcharge be used for recovery of implementation costs to the extent savings from securitization are either not sufficient to allow for full recovery of implementation costs or are not applied to implementation costs. 3 Tr 93. He recommended a methodology for adjusting the surcharge if any savings from securitization are applied to the implementation costs and for reconciliation of implementation costs and amounts collected. 3 Tr 93-94. These conclusions take into consideration the effects of legislation and of securitization. There is no need to defer addressing the methodology for recovery of implementation costs, nor to defer evaluating the methodology that Mr. Ernst presented.

The situation with regard to Detroit Edison is distinguishable. Unlike the approach used by Consumers Energy with respect to implementation costs, Detroit Edison in Case No. U-12478 sought to securitize implementation costs themselves. The Commission in that case approved securitization of Detroit Edison's 1998 and 1999 implementation costs. See November 2, 2000 Case No. U-12478 Order, pp 10-11. In Case No. U-12359, which involved implementation costs incurred by Detroit Edison in 1999, no party opposed deferring consideration of methodology for recovery of the implementation costs. See March 29, 2001 Case No. U-12359 Order, p 2.

Case No. U-12359 was a separate proceeding with a separate record. Contrary to ABATE's arguments, the recovery mechanisms for Consumers Energy and Detroit Edison will not be identical due to the differing approaches being used with regard to securitization of implementation costs. These differences support addressing a methodology for recovery of Consumers Energy's implementation costs in the instant case.

There is no need to defer consideration of a recovery methodology for implementation costs incurred by Consumers Energy until Case No. U-12639 is completed. The

Commission in its October 24, 2000 Order in Case Nos. U-11955, U-11956 recognized that cases have largely distinguished between implementation costs (which it indicated would include retraining costs as well as other implementation costs) and the three other categories of costs associated with electric restructuring that it previously determined were recoverable. U-11955 Order, pp 2-3. Act 141 recognizes that a distinction exists as well, separately mentioning stranded costs and implementation costs. For example, Section 10(1); MCL460.10a(19); MSA 22.13(10a)(1), provides that Commission orders “shall provide for full recovery of a utility’s net stranded costs and implementation costs as determined by the commission.” (Emphasis added)

ABATE’s exception should be rejected. The Commission should consider a methodology for recovery of implementation costs incurred by Consumers Energy in 1999 based on the record evidence in this proceeding. As discussed below, that evidence supports recovery using a uniform energy charge for collection of the implementation costs.

B. The ALJ Correctly Concluded that Collecting Implementation Charges Through Use of a Uniform Energy Charge is Reasonable

ABATE states that if the Commission considers a methodology for recovery of implementation costs, it should reject the ALJ’s conclusion that implementation costs should be recovered through a separate energy charge which is uniform for all rate classes. ABATE’s exception should be rejected. The ALJ’s conclusion is supported by the record and, as discussed above, can be made independently of Case No. U-12639.

Each of the arguments which ABATE raises in support of its position is defective and was properly rejected by the ALJ. The evidence presented by Consumers Energy shows that recovery of implementation costs through a uniform energy charge across all classes of retail customers is appropriate and should be approved. See 3 Tr 95, 98-104.

The argument first raised by ABATE in its exceptions takes the findings of the ALJ out of context. ABATE fails to mention that the ALJ's statement, that the Commission had previously recognized the appropriateness of using a uniform energy charge, was in direct response to a claim by ABATE that a uniform energy charge was not reflective of a methodology used in the past.

In this regard, the ALJ stated:

“ABATE has also argued that a uniform energy charge is not reflective of the methodology that the Commission has used in the past. The Commission has previously recognized the appropriateness of using a uniform energy charge for recovery of stranded costs and for purposes of securitization charges. Furthermore, Section 10a(5) of Act 141 ratifies prior Commission orders, including the Commission's determination in its January 14, 1998 Order in Case No. U-11290 of recoverable stranded costs via a uniform per kWh charge. The Administrative Law Judge, therefore, finds the approach advocated by Consumers is consistent with the Commission's previous expression of recoverable stranded costs through a uniform per kWh charge.” PFD, p 11.

The conclusions of the ALJ are valid and support rejecting ABATE's claim.

In addition to using a uniform energy charge for purposes of recovery of stranded costs and for purposes of securitization charges, the Commission has also used such an approach in other instances as well. Mr. Ernst identified several additional instances in which the MPSC has approved recovery of costs previously using uniform energy charges. 3 Tr 100. Contrary to the claims of ABATE, the Commission has in the past used a uniform per kWh charge for purposes of rate design.

ABATE's claim that a uniform charge does not reflect cost causation is also incorrect. The evidence shows that costs and benefits of open access vary closely with a customer's energy usage. 3 Tr 101. Mr. Ernst testified:

“The approach advocated by ABATE would shift additional costs to residential customers and could discourage residential participation. In addition, the more kWh a customer uses, the more it can potentially save....The approach advocated by the Company allocates costs in a manner which reflects the potential benefit to those customers. Furthermore, because annual true-up proceedings are required, a simple, administratively efficient, uniform energy charge would be preferred.” 3 Tr 103-104

Using a uniform per kWh charge appropriately allocates implementation costs to customers.

3 Tr 101.

The ALJ correctly rejected ABATE’s assertion that the Company’s proposal did not reflect cost causation:

“ABATE has argued that a uniform charge does not reflect cost causation. Consumers has demonstrated that the costs and benefits of open access vary with a customer’s energy usage. The more kWh a customer uses, the more they can potentially save, so that customers with larger loads potentially may see a larger benefit from retail open access than customers with smaller loads. The writer finds that the approach advocated by Consumers allocates costs in a manner which reflects the potential benefits to those customers.” PFD, pp 10-11.

ABATE’s claim that costs should be allocated to classes based on number of customers in each class is incorrect.

The ALJ also correctly rejected ABATE’s claim that use of a uniform energy charge would be inconsistent with Section 10d(5) of 2000 PA 141; MCL 460.10d(5); MSA 22.13(10d)(5):

“ABATE first argues that Consumers’ proposal is inconsistent with section 10d(5) of Act 141....The Administrative Law Judge... finds Consumers’ proposal to use a uniform energy charge is not inconsistent with Section 10d(5) of Act 141.” PFD, p 10

That finding should be adopted by the Commission.

Using a uniform per kWh surcharge, as recommended by the ALJ, is consistent with section 10d(5) of 2000 PA 141. Mr. Ernst explained:

“Contrary to the claims of Mr. Phillips, the uniform charge is consistent with PA 141. First, it is consistent because it does not result in a reallocation of cost responsibility. Second it is in compliance with PA 141 by virtue of Section 10a(5). In PA 141 § 10a(5), the Legislature specifically addressed the ‘grandfathering’ of prior Commission restructuring orders, including those that determine the recovery of stranded costs. Prior restructuring orders are in compliance with PA 141 and enforceable by the Commission. Third, it is consistent with the method used for allocating other restructuring costs.” 3 Tr 100.

The Company’s proposal to use a uniform energy charge is consistent with 2000 PA 141.

Contrary to the claims of ABATE in its exceptions, using a uniform charge would not result in “an illegal reallocation.” Mr. Ernst explained:

“Implementation costs are not currently being recovered by Consumers Energy from its customers. Since implementation costs are not currently included in the rates being charged customers, there is no basis for claiming that recovering such costs through a uniform per kWh charge would result in a reallocation of cost responsibility. In other words, there is no existing cost responsibility for these items included in the rates currently being charged and, therefore, no cost recovery in rates to shift.

“Further, the approach advocated by the Company is consistent with the Commission’s previous expression of recoverable stranded costs in terms of a uniform per kWh charge. The customer derived approach advocated by Mr. Phillips is not consistent.” 3 Tr 101

Section 10a(5) of 2000 PA 141 ratifies prior Commission orders, including the Commission’s previous expression in its January 14, 1998 Order in Case No. U-11290 of recoverable stranded costs in terms of a uniform per kWh charge.⁴

⁴ ABATE purports to incorporate various section of its brief and reply brief by reference. The attempted reliance by ABATE’s witness on the Commission Order Case No. U-10685 in the quotation set forth on page 6 of ABATE’s brief as support for his position on rate design is

ABATE does not make a specific proposal for recovery of implementation costs. It is not entirely clear precisely what approach ABATE would prefer to use in designing rates for recovery of implementation costs. However, regardless of what approach ABATE prefers, ABATE has not established that the approach recommended by the ALJ, and which is consistent with prior Commission determinations related to stranded costs, is unreasonable. The evidence presented by the Company supports a conclusion that such a methodology is appropriate, legal, and consistent with proper rate design.

C. The ALJ Correctly Concluded that Recovery of Prudently Incurred Implementation Costs in this Case Should Not Be Conditional

In its arguments to the ALJ, ABATE took the position that the recovery of implementation costs incurred in 1999 should either (i) be disallowed pending a showing that a workable program had been created or (ii) be made conditional. The ALJ rejected both these claims. In its exceptions, ABATE abandons the first claim, but continues to maintain the second.

ABATE quotes from the Commission's decision in Case Nos. U-11955, U-11956 in an effort to support its position. The Commission's decision in Case Nos. U-11955, U-11956 to use a conditional approach was explicitly based on the circumstances of that case and would not be appropriate in Case No. U-12358. The Commission stated in the excerpts from pages 4-5 of the Order quoted by ABATE:

“[I]t is difficult for the Commission to judge the effectiveness of Consumers’ and Detroit Edison’s implementation programs at this time.” (Emphasis added)

“For purposes of the present case, the Commission has reviewed the expenditures on the record and has granted deferred recovery

misplaced. The rate design ordered in Case No. U-10685 in 1996 is irrelevant given the Commission’s Order in Case No. U-11290, 2000 PA 141, and the costs involved. 3 Tr 102.

as appropriate. However, it would caution the parties that these findings are conditional.” (Emphasis added)

The Commission made clear that its determinations that the findings were conditional was specific to Case Nos. U-11955, U-11956. The fact that the Commission took a similar approach in Detroit Edison Case No. U-12359 is irrelevant. That was a different case with different evidence. Further, in Case No. U-12359 the issue appears to have been uncontested.

In the present case Consumers Energy contested ABATE’s position and the ALJ found that ABATE’s arguments should be rejected. ABATE’s claim that because the Commission took such an approach in Case Nos. U-11955, 11956 it should do so here cannot be supported by the law or the evidence. In the present proceeding, undisputed evidence establishes that the implementation costs were prudent and in furtherance of retail open access.

The ALJ correctly rejected ABATE’s claims in his PFD:

“The Commission in its June 5, 1997 Order in Case No. U-11290 provided that the standard against which implementation costs will be evaluated is a prudence standard. This standard requires that decisions be evaluated based on what was known at the time the decisions were made, not on circumstances that become known after the fact. The Administrative Law Judge finds Consumers has presented evidence that the decisions made and costs incurred for implementation in 1999 were prudent. The evidence shows that these expenditures were in furtherance of the implementation plan which the Commission approved and allowed implementation of retail open access to proceed to the point at which retail open access customers are now being served. No evidence was presented to the contrary.” PFD, pp 7-8 (Emphasis added)

ABATE’s exception must be rejected.

ABATE is asking the Commission to do indirectly what it cannot lawfully do directly and to retroactively change the rules after expenditures have been made. ABATE’s position misconstrues prior Commission orders and ignores statutory provisions which provide for recovery to occur.

While ABATE does not mention specifics, other than to quote excerpts from the Commission's October Order in Case Nos. U-11955, U-11956, the implication of ABATE's position is that the Commission should, in essence, remove all certainty of recovery for implementation costs. ABATE has misconstrued the Commission's earlier Order. The Commission should take this opportunity to affirm that it is not intending to renege on prior commitments to allow full recovery of prudently incurred implementation costs.

ABATE seems to envision some sort of future review of expenditures which uses a "used and useful" criteria. Any such after-the-fact review would be unlawful and unreasonable. The Commission has stated that the standard against which the implementation costs will be evaluated is a prudence standard. Prudence requires that decisions be evaluated based on what was known at the time the decisions were made, not based on circumstances that become known after the fact.

As noted above, the Commission stated at page 13 of its June 5, 1997 Order in Case Nos. U-11290 with regard to implementation costs:

"If the costs are prudently incurred, it would also be inappropriate to disallow recovery by the utility."

Section 10a(5) of 2000 PA 141, MCL 460.10(5); MSA 22.13(10a)(5), states:

"The orders issued by the commission before the effective date of the amendatory act that added this section that allow customers of an electric utility to choose an alternative electric supplier, including orders that determine and authorize recovery of ...implementation costs and that confirm any voluntary commitments of electric utilities are in compliance with this act and enforceable by the commission." (Emphasis added)

The Commission's order which authorized recovery of prudently incurred costs is one such order. The March 8, 1999 Order in Case Nos. U-11290 et al which approved the Company's proposed implementation plan is another such order.

Consumers Energy has acted in reliance on the Commission's prior orders. 3 Tr 47, 59, 61. It would be unlawful and unreasonable to change the rules after implementation costs have been incurred and deny recovery of such costs. Furthermore, to do so would be in violation of Consumers Energy's due process rights and would result in an unconstitutional confiscation of property. United States Constitution, Fifth and Fourteenth Amendments; Michigan Constitution, 1963, art 1, ' 17; art 10 ' 2; Michigan Consolidated Gas Company v Public Service Commission, 389 Mich 624, 638; 209 NW2d 210 (1973). The standard which must be applied is the prudence standard, not a used and useful standard.

The United States Supreme Court defined the prudence standard in the following manner in Duquesne Light Co. v Barasch, 488 US 299; 102 LEd 2d 646; 109 SCt 609 (1989):

“Under the prudent investment rule, the utility is compensated for all prudent investments at their actual cost when made (their ‘historical’ cost), irrespective of whether individual investments are deemed necessary or beneficial in hindsight.” 488 US at 309.

The Michigan Court of Appeals in ABATE v Public Service Commission, 208 Mich App 248; 527 NW2d 533 (1994) reiterated that when the prudence test is used the end result is not determinative:

“The Attorney General's argument is inconsistent with the prudent investment test under which the end result of a utility's efforts do not determine how much is recoverable. Rather utilities are compensated for prudent investments at their actual costs when made regardless of whether the investments are deemed necessary or beneficial in hindsight.” 208 Mich App 260.

Similarly, in the instant proceeding, ABATE's argument is inconsistent with the prudent investment test. A prudent investment is not made imprudent by subsequent events; the end result does not dictate what can be recovered. ABATE v Public Service Commission, supra, 208 Mich App at 267.

Consumers Energy presented evidence that the decisions made and costs incurred for implementation in 1999 were prudent. ABATE did not present any evidence to the contrary. Nor did any other party. ABATE should not be allowed to have a second chance to challenge, at some undefined future point in time and using some undefined subjective standard for evaluating success, the expenditures that were at issue in this proceeding.

At every stage of the retail open access process, Consumers Energy has sought Commission guidance and concurrence for its proposed implementation plans. The Staff Report supported recovery of such implementation costs. The Commission found that the Staff Report presented a reasonable basis for determining stranded costs. June 5, 1997 Case No. U-11290 Order, p 11. In its March 8, 1999 Order in Case Nos. U-11290 et al the Commission approved the Company's proposed implementation plan.

The expenditures for which the Company is requesting recovery in this proceeding were incurred in support of the implementation plan approved by the Commission. 3 Tr 46. Mr. Gilzow testified with regard to the 1999 implementation costs:

“These expenses were incurred in response to, and in reliance on, the MPSC's orders on electric restructuring. The types of costs incurred are consistent with categories of costs the Commission has previously identified and were reasonably and prudently incurred.” 3 Tr 56.

Consumers Energy has incurred substantial costs in reliance on prior Commission determinations that such costs would be recovered if prudently incurred.

The evidence presented in this case shows that expenditures for which the Company seeks recovery were reasonably and prudently incurred. The Company has presented evidence showing the effectiveness of the expenditures. The evidence shows that these expenditures were in furtherance of the implementation plan which the Commission approved

and allowed implementation of retail open access to proceed to the point at which retail open access customers are now being served. 3 Tr 46-57.

The Staff performed an audit to determine if implementation costs were prudently incurred. Staff's witness Mr. Kusiak testified:

"The purpose of my testimony in this proceeding is to present Staff's audit results for the Electric Restructuring Implementation costs and the prudence of these costs." 3 Tr 136.

Mr. Kusiak did not identify any expenditures which the Staff concluded were imprudently incurred.

ABATE's proposal that the Commission make any recovery of such costs conditional should be rejected. Section 10a(1) of 2000 PA 141 provides that the Commission:

"shall provide for full recovery of a utility's...implementation costs as determined by the commission." (Emphasis added)

In this case the Commission should approve full recovery of the \$30.152 million of implementation costs incurred in 1999.

III. CONCLUSION

Consumers Energy requests the Commission issue an Order in this proceeding adopting the recommendations of the Administrative Law Judge in their entirety and that it approve recovery of the full \$30.152 million of implementation costs incurred in 1999. Consumers Energy requests the Commission approve recovery of these costs, along with appropriate carrying costs using the methodology recommended by the Administrative Law Judge.

Respectfully submitted,

CONSUMERS ENERGY COMPANY

Dated: April 30, 2001

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ATTACHMENT A

Excerpts from the Brief of Consumers Energy Company
dated January 31, 2001

C. **Carrying Costs Must Be Added So That Consumers Energy is Made Whole**

Consumers Energy's 1999 implementation cost total of \$30.152 million includes \$882,000 of carrying costs. The purpose of these costs is to recognize the time value of money between when the costs were incurred and when they will be recovered from customers. 3 Tr 56. The \$882,000 represents cumulative carrying costs incurred through December 31, 1999 on costs incurred in 1999. 3 Tr 56. These carrying costs were calculated at the rate of 7%, which is consistent with the discount rate used by the Commission in the calculation of stranded costs. 3 Tr 56. The Commission found in Case Nos. U-11955, U-11956 that use of a 7% rate for computing carrying charges is appropriate. October 24, 2000 Order, p 11.

Carrying costs will continue to grow until the 1999 costs are fully recovered. 3 Tr 56. The Company is proposing that implementation costs be increased at a rate of 7% per year until recovery to reflect the added carrying costs. 3 Tr 93.

IV. **THE LABOR AND EMPLOYEE IMPACT-RELATED COSTS INCURRED IN 1999 ARE PROPERLY RECOVERABLE AS IMPLEMENTATION COSTS**

Implementation costs incurred by Consumers Energy in 1999 were incurred in reliance on the Commission's statement in its June 5, 1997 Order in Case No. U-11290 that prudently incurred costs would be recoverable from customers. Mr. Gilzow testified:

"Without the expectation of recoverability of prudent costs, the costs incurred to implement the metering information, customer and retailer billing, energy scheduling, customer education/information, employee impact, and regional transmission organization programs would not have been made. All of the expenses associated with carrying out these efforts are directly the result of electric restructuring." 3 Tr 61.

The full \$30.2 million in 1999 electric restructuring costs which the Company is seeking to recover are both prudent and incremental. 3 Tr 60.

In testimony presented by its witness William J. Kusiak, Staff recommended reducing the 1999 implementation cost total by \$4.996 million. This proposed reduction is comprised of (i) all labor costs incurred in 1999 in connection with implementation of retail open access, (ii) all employee impact-related costs incurred in 1999 in connection with electric restructuring, and (iii) carrying costs associated with the first two categories. Mr. Kusiak does not assert that the costs are imprudent. Rather, Mr. Kusiak states that he does not believe that the labor costs are incremental. 3 Tr 137. He does not offer any explanation for removing the non-labor portion of employee impact-related costs.

The Commission should reject Staff's recommendation to reduce the implementation costs by \$4.996 million and should approve recovery of the full \$30.152 million of expenditures incurred by Consumers Energy in 1999 in implementing electric customer choice. Staff's assumption that the costs are not incremental is based upon unsupported speculation. In Section A the Company will discuss labor costs that are not associated with employee impact restructuring costs. In Section B the Company will discuss the labor and non-labor employee impact restructuring costs.

A. Labor Costs Are Properly Recoverable

1. The Company Has Presented Evidence Showing That 100% of Labor Hours Charged to Electric Restructuring in 1999 Were Incremental

The labor costs which were incurred in 1999 in connection with implementation of electric utility restructuring are comprised of \$3.369 million of labor costs not associated with employee impact costs plus \$1.150 million of labor costs associated with employee impact costs. 3 Tr 61. This section will focus on the \$3.369 million of labor costs. Labor costs associated with employee impact costs will be addressed in Section IV.B.

Labor costs related to implementation are properly recoverable as implementation costs. While in Case Nos. U-11955, U-11956 the Commission disallowed certain labor costs incurred in 1997 and 1998, it did so not because labor costs could never be recoverable, but rather because it concluded that the evidence in the earlier case did not establish the costs incurred in 1997-1998 were incremental. The Commission did not foreclose recovery of those types of costs in the future if certain evidentiary thresholds were established.

In its October 24, 2000 Order in Case Nos. U-11955, U-11956, the Commission discussed what it perceived to be the weakness in the evidence which had been presented with regard to labor costs incurred in 1997 and 1998 and gave guidance regarding the type of evidence that would be adequate to show costs were incremental in future proceedings. The Commission in its Order stated with regard to the evidence in that case:

“Neither Consumers not Detroit Edison provided an adequate showing that those costs were in addition to the employee-related costs typically incurred by a utility operation in providing electric service in a reasonable, efficient manner....Unless the cost would not have been incurred, and represents a task or activity that would not have been performed, but for restructuring, it is more properly classified as the type of expense assigned to base rates. The record [in Case Nos. U-11955, U-11956] does not establish that the labor costs subject to the proposed disallowances are incremental. In future true-up proceedings, Consumers and Detroit Edison should demonstrate the extent, if any, to which employee reassignments represent incremental costs. One approach would be to identify the vacated positions or responsibilities that the company was, or will be, required to fill by hiring additional employees or acquiring replacement services.” Order, pp 9-10 [Footnote omitted.]

In the present case, Consumers Energy has presented evidence which meets the criteria identified by the Commission.

The evidence presented by the Company in Case No. U-12358 establishes that the labor costs incurred in 1999 were incremental. Mr. Gilzow testified:

“The labor costs are (i) for costs that would not have been incurred but for restructuring and (ii) represent activities that would not have been performed but for restructuring. These costs are in addition to the costs that would typically be incurred in providing electric service in a reasonable, efficient manner.” 3 Tr 62.

Mr. Gilzow illustrated the incremental nature of the labor hours on his Exhibit A-2.

During 1999 there were 57 employees who charged all or part of their time to Electric Restructuring Implementation. 3 Tr 62. The \$3.369 million of labor costs are the result of 100,007 hours of labor spent on the project in 1999. 3 Tr 62. This total is comprised of 66,157 direct labor hours and 33,850 chargeback hours. 3 Tr 62. Through a detailed analysis of labor hours, Mr. Gilzow shows that 100% of these labor hours were incremental. 3 Tr 62-67, Exhibit A-2.

The Company has incrementally supported implementation of retail open access through a number of alternative approaches. On Exhibit A-2 Mr. Gilzow has classified labor hours among six categories. In his testimony he explains why each of these categories should be considered incremental. In 1999, labor hours were attributable to:

- (i) Adding new employees to fill new positions created by the restructuring project (10% of the total hours);
- (ii) Shifting existing employees from areas outside the electric strategic business unit into the electric strategic business unit (2.1% of total hours);
- (iii) Moving existing employees from their current job and backfilling that position through use of new employees (26.4% of total hours);
- (iv) Paying for overtime hours (0.5% of total hours);
- (v) Incurring chargeback labor from internal support organizations directly related to electric restructuring (33.8% of total hours); and

- (vi) Utilizing existing employees with other personnel picking up additional workload, work being deferred, or use of non-paid overtime for other work (27.2% of total hours).

Exhibit A-2, 3 Tr 63. Exhibit A-2 shows the breakdown both by total for each of the six categories and by area of activity. The six categories are addressed further below. The number of employees involved in each of the specific implementation activities listed is shown in column (A) of Exhibit A-2.

The evidence presented by Consumers Energy in the instant case establishes that, contrary to the Staff's conclusion, labor costs in 1999 were incremental and that disallowing all labor costs incurred in 1999 in connection with implementation of electric restructuring would not be appropriate. The evidence shows that each of the categories meets the criteria for recovery.

2. Labor Hours in All Six of the Labor Categories Are Incremental

a. New Employees Were Added to Fill New Positions Created As a Result of Electric Restructuring

In 1999 labor hours for eight employees were attributable to new employees that were added to fill new positions created by electric restructuring. 3 Tr 63. These employees were responsible for 10,000 of the labor hours charged to the electric restructuring in 1999, which represents approximately 10.0% of the total hours. 3 Tr 63, Exhibit A-2. These employees were assigned to positions in customer enrollment, retailer settlement, energy scheduling, and to activities related to the formation of a regional transmission organization. 3 Tr 63-64. These are employees who both filled new positions related to electric restructuring and were new to Consumers Energy. 3 Tr 64. The hours are all incremental and represent costs

that would not have been incurred but for restructuring and activities that would not have been performed but for restructuring. The hours are shown in column (B) of Exhibit A-2.

b. An Employee Formerly in the Gas Business Unit Was Transferred to Electric Restructuring to Fill a New Position

In 1999 there were 2080 hours charged to the project, representing approximately 2.1% of the total hours, which were attributable to an employee that shifted from an area outside of the electric strategic business unit into the strategic business unit. 3 T 64. That employee had previously held a position in the gas strategic business unit. 3 Tr 64. The employee filled a new position related to electric restructuring. 3 Tr 64. Labor costs for this employee's prior position, if included in rates, would have been included in gas rates, not electric rates. These hours, and the associated costs, were incremental with regard to electric operations. The expenses would not have been included in electric rates. The hours are shown in column (C) of Exhibit A-2.

c. Some Employees Were Moved to Electric Restructuring and Their Prior Positions Filled With New Employees

In 1999, labor hours for 16 employees were attributable to employees who had been moved from their prior job and had their prior job backfilled through use of new employees. 3 Tr 64. These employees were responsible for 26,421 of the labor hours charged to electric restructuring in 1999, which represents approximately 26.4% of the total hours. 3 Tr 64, Exhibit A-2. These 16 employees either filled a new position within electric restructuring or worked on electric restructuring and had their prior responsibilities backfilled through the use of new employees. 3 Tr 64. These employees performed electric restructuring work in such areas as customer billing, customer enrollment, energy scheduling, project management, and activities

related to RTO formation. 3 Tr 64. These employee assignments represent incremental costs, thus meeting the criteria for recovery. The hours are shown in column (D) of Exhibit A-2.

d. Some Employees Incurred Paid Overtime Hours as a Result of Electric Restructuring Activities Which Were Performed in Addition to Their Normal Jobs

In 1999, 16 employees received overtime pay for work on electric restructuring activities. 3 Tr 64. These employees were responsible for 452 of the labor hours charged to electric restructuring in 1999, which represents approximately 0.5% of the total hours. 3 Tr 64, Exhibit A-2. Overtime hours were in such areas as customer billing, customer enrollment, retailer settlement, energy scheduling, project management and bidding. 3 Tr 64. These hours represent overtime hours paid to employees who worked on electric restructuring in addition to working their normal jobs. 3 Tr 65. These expenses represent incremental costs which are directly the result of restructuring and meet the criteria for recovery. The hours are shown in column (E) on Exhibit A-2.

e. Chargeback Hours Are Essentially the Same as Outside Consulting Services

In 1999, the electric restructuring project was charged for 33,850 hours of work which was performed by Information Services and Technology ("IS&T") and by Meter Technology Centers and Meter Services ("Metering"). 3 Tr 65. This represents approximately 33.8% of the total hours. Exhibit A-2. The work performed by these personnel was critical to the successful implementation of electric restructuring. 3 Tr 65-66.

To support retail open access, Consumers Energy had to be able to enroll customers and to bill customers and retailers for services the Company provides. 3 Tr 65. This required significant modifications to existing systems and creation of a new Retailer Billing System. 3 Tr 65. IS&T along with Ersnt & Young performed necessary system design to

successfully complete this effort. 3 Tr 65-66. In 1999, there were 22,130 hours charged to the project by IS&T. Exhibit A-2.

Metering personnel tested, purchased and programmed interval data recording meters to serve load profiling customers and customers with load above 20 kW. 3 Tr 66. Metering also added 1,500 new accounts to the interval data retrieval system and introduced a new cellular data based retrieval package to support retail open access customers. 3 Tr 66. In 1999, there were 11,720 hours charged to the project by Metering personnel. Exhibit A-2.

Chargeback hours are hours which are charged by personnel outside of the Electric Strategic Business Unit. Mr. Gilzow testified that chargeback services are essentially the same as outside consulting services. 3 Tr 65. The Company utilizes a chargeback procedure for allocating such costs as labor costs to support the maintenance of existing systems and to design new metering and billing systems. 3 Tr 65. These costs are directly related to electric restructuring and are incremental to the costs which would otherwise have been incurred by electric operations. The chargeback hours are shown in column (F) of Exhibit A-2.

f. Additional Labor Hours Were Also Incremental

In 1999 there were 27,204 hours charged to electric restructuring that are attributable to utilizing existing employees with other personnel picking up additional work load, work being deferred, or use of non-paid overtime hours for other work. 3 Tr 66. This represents approximately 27.2% of total hours. Exhibit A-2. These hours were necessary to incrementally support implementation of retail open access. These hours represented work of 31 employees (the equivalent of approximately 14 full-time employees) and covered all aspects of electric restructuring work. 3 Tr 66. The hours are shown in column (G) of Exhibit A-2 by implementation activity and total.

3. The Company's Labor-Hour Specific Analysis of Whether Labor Was Incremental Requires Rejection of Staff's Proxy Analysis for Labor

Mr. Kusiak's review of whether labor costs were incremental was based on proxy comparisons of overall O&M dollars and employee levels rather than an analysis of the specific labor dollars or labor hours charged to electric restructuring in 1999. He qualified his conclusions with phrases such as "It would therefore appear," "one could conclude" and "Based on this review, I do not believe." 3 Tr 137.

In this proceeding the Company has presented in the rebuttal testimony of Mr. Gilzow an analysis of labor that is specific to the actual employees that charged time to electric restructuring. See 3 Tr 58-71, Exhibit A-2. At the time of his review, Mr. Kusiak did not have available to him this more detailed analysis. The Company's analysis provides additional data which compels rejection of the proposal of Staff's witness to exclude the labor costs.

The Company has shown through its analysis of the labor hours that the labor expenses were incremental. The evidence shows that the labor costs would not have been incurred and the activities involved would not have been performed but for restructuring. The evidence shows that the \$3.369 million of labor costs incurred in 1999 are recoverable costs.

B. Employee Impact-Related Restructuring Costs Are Properly Recoverable

In 1999 Consumers Energy incurred \$1,150,000 of labor-related employee impact costs and \$331,000 of non-labor employee impact costs in connection with electric restructuring, resulting in a total of \$1,481,000 of employee impact costs. 3 Tr 67. Mr. Kusiak recommends disallowing both the labor and non-labor portion of the employee impact costs. He groups the

labor portion in with his general discussion of labor costs. He does not discuss the non-labor portion at all. His recommendation should be rejected.

Staff previously concluded in the Staff Report on Electric Industry Restructuring that “costs incurred to facilitate the transition from regulated monopoly status to competitive market status” are properly recoverable from customers. Staff Report, p 12. Staff acknowledged that recoverable costs would include “employee related restructuring costs.” Staff Report, pp 13-14. Staff also stated that “costs incurred to transition the work force as a result of industry restructuring should be included.” Staff Report, p 15. The costs which Mr., Kusiak seeks to disallow meet these criteria.

The Commission in its October 24, 2000 Order in Case Nos. U-11955, U-11956 provided guidance regarding recovery of such costs in its discussion of costs that were at issue in that case which were related to reduction of generating plant workforce:

“The Commission finds that the Staff’s proposed disallowance of severance expense that Consumers incurred in reducing its generation workforce is appropriate.... Consumers does not explain any connection between its efforts to reduce its employee count and the Commission’s initiation of restructuring proceedings. Absent a showing that restructuring caused the costs to be incurred, a utility could use restructuring as an opportunity to recoup out-of-pocket costs for efficiency measures that it would have undertaken in any event.” Order, pp 10-11. (Emphasis added)

In the present proceeding, the Company explains the connection between the initiatives for which it seeks recovery and electric restructuring. The evidence in the present proceeding shows that restructuring caused the \$1.481 million of employee impact costs which were incurred in 1999.

The first and largest of the two employee impact initiatives which resulted in costs being incurred in 1999 involved the elimination of jobs of the Traveling Repair Crew.

3 Tr 68. This accounts for \$924,000 of the costs. The Traveling Repair Crew was responsible for performing maintenance tasks at generating units, primarily during scheduled outages.

3 Tr 68. The elimination of the Traveling Repair Crew is directly related to electric restructuring. Mr. Gilzow explained:

“Electric restructuring has resulted in changing the way outages are scheduled. In the past, outages were scheduled throughout the year enabling the utility to employ a constant workforce that traveled from site to site to support the outages. Because of electric restructuring, outages will be concentrated in the off-peak periods of the spring and fall requiring large numbers of craft during those periods and few if any in the summer and winter peak periods. Maintaining a workforce year around under those conditions cannot be justified. Therefore the Company decided to eliminate the Traveling Repair Crew and have the work performed by outside contractors.” 3 Tr 68-69.

This impacted 49 employees. 3 Tr 69.

Section 10p(1) of 2000 PA 141 states:

“(1) Each electric utility operating in this state shall establish an industry worker transition program that shall...provide skills upgrades, apprenticeship and training programs, voluntary separation packages...and job banks to coordinate and assist placement of employees...

Section 10p(2) states that employee-related restructuring costs, including employee retraining programs, are recoverable costs.

Forty three of the affected employees transferred to substation construction jobs in the transmission and distribution area of the Company. 3 Tr 69. This work had been previously performed by contractors. 3 Tr 69. In order to make the transition, these employees had to be retrained for the new work and new work management systems and processes. 3 Tr 69. Six additional employees transferred to meter reading, which again required retraining. 3 Tr 69. The employee impact costs are comprised of \$899,000 for labor, materials and related expenses

associated with retraining these employees and \$25,000 for relocation and other related employee expenses. 3 Tr 69. These are exactly the types of costs envisioned in Section 10p(1) of 2000 PA 141.

The second employee impact initiative relates to retention of employees critical to the transmission function. On December 31, 1996, Detroit Edison gave notice to Consumers Energy of its intent to terminate the Electric Coordination Agreement between the two companies. 3 Tr 69. Exhibit A-3 is a copy of the notice. This notice, along with the increasing number of states in different stages of restructuring necessitated the Company to take action to retain critical Consumers Energy staff at the Michigan Electric Power Coordination Center. 3 Tr 69.

The costs associated with the second initiative are directly related to electric restructuring. Mr. Gilzow stated:

“As a result of electric restructuring, people with skills related to scheduling and controlling power flows through the bulk power transmission system are in high demand. With the advent of competition, the number of power suppliers and different energy transactions have significantly increased. This has made the jobs of energy controllers and schedulers much more complex and more in demand. Consumers’s is very fortunate to have a highly skilled, competent workforce with many years of experience. These employees, who would be very difficult to replace...have highly specialized skill sets for which there is increased competition within the industry.” 3 Tr 69-70.

The Company identified 28 employees whose jobs and skills were deemed critical to the function of the Michigan Electric Power Coordination Center. 3 Tr 70.

The costs incurred for this initiative are non-recurring costs directly related to electric restructuring. In order to retain, provide an incentive and equitably compensate these transmission employees, they were offered a comprehensive retention package consisting of a

retention bonus, signing bonus and an adjustment in their compensation if appropriate. In exchange the Company was assured of their continued employment through 2001. 3 Tr 70. The payout in 1999 for these employees was \$344,000. 3 Tr 70. This is properly recoverable as part of implementation costs.

The remaining employee-related costs for 1999 are attributable to materials and expenses related to the two initiatives described above. 3 Tr 71. These expenses would also be properly recoverable as implementation costs.

V. IMPLEMENTATION COSTS SHOULD BE RECOVERED FROM ALL CUSTOMERS USING THE METHODOLOGY PROPOSED BY THE COMPANY

The methodology being proposed by the Company for recovery of costs associated with implementation of retail open access was presented by Mr. Ernst. As Executive Director of Rates and Electric SBU Planning Mr. Ernst is responsible for all of the Company's rates, both at the state and federal level. 3 Tr 87. His responsibilities include being responsible for, among other things, the Company's electric rate design as well as rate administration. 3 Tr 87.

Mr. Ernst proposes a methodology that is consistent with 2000 PA 141 and 2000 PA 142. Mr. Ernst testified:

"The implementation costs are already being deferred in accordance with prior Michigan Public Service Commission ("MPSC") orders. The Company plans to continue to account for these implementation costs as regulatory assets. Recovery of implementation costs, along with carrying costs, are probable in future periods as identified in prior orders. Implementation costs will be amortized to the extent (i) the securitization proceeding approves the use of amounts in excess of the residential rate reduction implemented by the Company for offsetting Other Qualified Costs which are not securitized and (ii) such amounts are applied to implementation costs." 3 Tr 92.

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

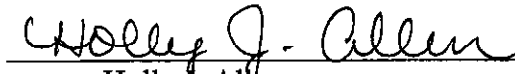
In the matter of the application of)
CONSUMERS ENERGY COMPANY)
to recover implementation costs for)
the period ended December 31, 1999)
_____)

Case No. U-12358

PROOF OF SERVICE

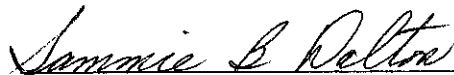
STATE OF MICHIGAN)
) SS
COUNTY OF JACKSON)

Holly J. Allen, being first duly sworn, deposes and says that she is employed in the Legal Department of Consumers Energy Company; that she served an electronic copy of the **"Consumers Energy Company's Reply to Exceptions"** upon the persons listed in Attachment 1 hereto, at the e-mail addresses listed therein. She further states that she served a copy of the above-referenced document upon the same parties, at the addresses listed therein by depositing the same on April 30, 2001, in the United States mail in the City of Jackson, Michigan with first-class postage thereon fully paid.



Holly J. Allen

Subscribed and sworn to before me this 30th day of April, 2001.



Sammie B. Dalton
Notary Public, Jackson County, Michigan
My Commission Expires: 01/04/04

ATTACHMENT 1 -- to Case No. U-12358

Administrative Law Judge

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