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) 788-1462
Writer's 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
Roger K Krakusin
Eric V Luoma
Wendy A McIntyre
Raymond E McQuillan
Deborah A Moss*
Mir□e Michael Nestor
Robert M Neustifter
David A Pell
Vincent P Provenzano
Susan L Rasmussen
Catherine M Reynolds
John C Shea
P Leni Staley
Charlotte A Walls
Kimberly C Wilson
Michael G Wilson
Attorney

February 5, 2002

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

Re: Case No. U-12891

Dear Mrs. Wideman:

Enclosed for filing in the above referenced case are an original and four copies of the **"Exceptions of Consumers Energy Company"**. This document is also being filed electronically as part of the Commission's electronic filings programs. A Proof of Service is enclosed.

Sincerely,

Richard Chambers

H. Richard Chambers

CC: Hon. James N. Rigas, ALJ
Parties 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 electric restructuring implementation costs for the period ended December 31, 2000	))))))	Case No. U-12891

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EXCEPTIONS OF CONSUMERS ENERGY COMPANY

Pursuant to the schedule established by Administrative Law Judge James N. Rigas ("ALJ"), Consumers Energy Company ("Consumers Energy" or the "Company") submits the following Exceptions to the January 22, 2002 Proposal for Decision ("PFD") in this case.

In his PFD, the ALJ recommended recovery of $19.587 million of electric restructuring implementation costs incurred by Consumers Energy for the period ended December 31, 2000. This recommendation is fully supported by the record evidence. However, certain other recommendations are not.

Consumers Energy submits the following exceptions:

(i) The ALJ erred in recommending that recovery of prudently incurred implementation costs should be made conditional.

(ii) The ALJ erred in recommending the disallowance of $5.562 million of labor costs associated with implementation, retraining, and associated carrying costs.

(iii) The ALJ erred in failing to address and recommend the recovery methodology proposed by the Company.

The recommendations to which the Company is filing exceptions are contrary to the letter and spirit of Public Act 141 of 2000 ("PA 141") and to orders of this Commission establishing the framework for electric restructuring.

I. **THE ALJ ERRED IN RECOMMENDING THAT RECOVERY OF PRUDENTLY INCURRED IMPLEMENTATION COSTS SHOULD BE MADE CONDITIONAL**

The PFD contains the following findings regarding whether recovery of implementation costs should be made conditional in this case:

> "In prior implementation cost cases, the Commission has made recovery of implementation costs conditional. In this case the Administrative Law Judge finds Consumers has not demonstrated why its expenditures were necessary to facilitate transition to competitive markets or how its expenditures will facilitate such a transition. The Administrative Law Judge therefore concludes the conditional deferral and recovery of 2000 implementation costs in this case is appropriate." PFD, p 10.

These findings are not supported by the record evidence in Case No. U-12891 and, indeed, are contrary to the record evidence on this issue. Further, the standard applied is not the appropriate standard.

No witness challenged the prudence of any expenditures that are the subject of this case. Making recovery of the implementation costs that were subject to review in this case conditional would be unlawful and unreasonable. To make recovery of such costs conditional upon a subsequent review would be contrary to Commission orders establishing the framework for electric restructuring, PA 141, and the prudent investment test.

The Commission's stated rationale in prior cases for making such costs conditional was that at the time of the earlier orders it was difficult to judge the effectiveness of implementation programs. The Commission indicated that the Company should file information in its 2000 and 2001 cases regarding the effectiveness of implementation costs that the Company sought to recover. The Company did so in the current case, Case No. U-12891. Even if consideration of the effectiveness of the implementation costs is assumed pertinent to the review, the uncontested evidence in the record shows that the implementation costs that are the subject of this proceeding have been effective.

Consumers Energy should be able to rely upon Commission commitments that prudently incurred implementation costs will be recovered. Prudence, by definition, does not allow hindsight reviews. The evidence and the law require full, unconditional recovery of the implementation costs that are the subject of this case.[1]

A. The ALJ's Recommendation that Recovery of Costs that Were Reviewed in this Case Be Made Conditional is Contrary to Commission Orders Establishing Electric Restructuring, PA 141, and the Prudent Investment Test

1. Commission Orders Establishing Electric Restructuring Provide for Full Recovery of Prudently Incurred Implementation Costs

In its June 5, 1997 Opinion and Order in Case No. U-11290, the Commission held with respect to implementation costs:

> "These are costs that would not be incurred absent a direct access program.... If the costs are prudently incurred, it would...be inappropriate to disallow recovery by the utility. Thus, the only remaining option is to include these costs in the transition charge if they are prudently incurred." June 5 Order, pp 12-13.

No conditions were set forth for second reviews.

2. PA 141 Provides for Full Recovery of Implementation Costs

Section 10a(1) of PA 141 states:

[1] For the year 2000 the Company incurred $24.999 million of implementation costs. The balance of $150,000 was incurred in 1999 to begin to redefine the Company's relationship with Detroit Edison due to electric restructuring. In Case No. U-12358 the Company indicated it would seek recovery of these costs in a subsequent implementation costs filing. 2 Tr 60. For ease of reference the combined costs are sometimes referred to as year 2000 costs.

> "No later than January 1, 2002, the commission shall issue orders establishing the rates, terms and conditions of service that allow all retail customers of an electric utility or provider to choose an alternative electric supplier. <u>The orders shall provide for full recovery of a utility's</u> net stranded costs and <u>implementation costs</u> as determined by the commission." (Emphasis added)

As set forth above, the Commission has previously determined that prudently incurred implementation costs are recoverable. The Commission also has previously determined that implementation costs include those types of costs that are the subject of this case.

Section 10a(5) includes the following language:

> "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 net stranded costs and implementation costs and that confirm any voluntary commitments of electric utilities, are in compliance with this act and enforceable by the commission."

The implementation costs incurred in 2000 were voluntarily incurred in a good faith reliance on Commission orders providing for full recovery of implementation costs.

Both the letter and the spirit of PA 141 provide for recovery of costs incurred by an electric utility to implement electric restructuring. Requiring prudent expenditures to be evaluated based on events which occur after the expenditures are made would be confiscatory and unlawful retroactive ratemaking, in violation of statutory and constitutional protections. This is not the standard that the Legislature approved in PA 141.

3. <u>Making Recovery of the Implementation Costs Conditional Would Violate the Prudent Investment Test as Defined by the Courts of this State</u>

The prudent investment test requires that decisions be evaluated based on what was known at the time decisions were made. Making recovery of implementation costs conditional would be inconsistent with the prudent investment test that the Commission stated would be used in reviewing implementation costs.

Implementation of electric deregulation in Michigan is unprecedented. Efforts throughout the United States demonstrate varied approaches being used.

The Michigan Court of Appeals in ABATE v Public Service Commission, 208 Mich App 248; 527 NW 2d 533 (1994), lv den 450 Mich 890; 539 NW2d 507 (1995) explicitly held 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. (Emphasis added)

Accord, Duquesne Light Co. v Barasch, 488 US 299; 102 LEd 2d 646; 109 SCt 609 (1989). In ABATE, the Michigan Court of Appeals explicitly recognized that prudent costs may include unsuccessful investments. 208 Mich at 262.

Later in its decision, the Court of Appeals again emphasized this legal principle:

> "The PSC merely permitted Consumers to recover its prudent investment, and that investment was not made imprudent by Consumers' subsequent decisions. Under the prudent investment test, the end result does not dictate what can be recovered. The utility is compensated for prudent investments when made, irrespective of whether the investments are deemed necessary or beneficial in hindsight. [citation omitted]." 208 Mich App at 267. (Emphasis added)

A prudent investment is not made imprudent by subsequent events; the end result does not dictate what can be recovered. 208 Mich App at 267.

4. No Witness Challenged the Prudence of Any Expenditures that Consumers Energy Seeks to Recover in This Proceeding

Carl A. Gilzow, the Company's Electric Restructuring Implementation Project Manager, testified that the costs which are the subject of this case were prudently incurred. 2 Tr 59, 68-69, 76, 109. Charles V. Waits, Consumers Energy's Director of Transmission Transactions, and John J. Dellas, Consumers Energy's Executive Director, Electric Restructuring, also testified that implementation costs that are the subject of this proceeding were prudently incurred. 2 Tr 31, 45.

Mr. Gilzow testified, among other things, that Consumers Energy's plan for addressing implementation issues has been prudently designed, developed and implemented. 2 Tr 59. The Company has used existing systems where possible and has used a phased-in approach where possible during the transition period. 2 Tr 59. This plan provides for flexible business processes, allows customers to easily participate, and minimizes costs. 2 Tr 59. The Company has attempted to identify the least expensive means of developing the business processes necessary to implement the retail open access program consistent with the overall goals of retail open access. 2 Tr 58.

The only party other than Consumers Energy to present evidence in the instant case was the Staff, who presented one witness. Staff's witness did not challenge the prudence of any implementation costs for which Consumers Energy is seeking recovery in this proceeding. He testified that he did not identify any imprudent costs. 2 Tr 109. There is absolutely no evidence in the record that the costs which are the subject of this case were imprudent. The record evidence shows the costs that are the subject of this case were prudently incurred.

B. <u>The Record Evidence Establishes that the Implementation Costs that are the Subject of this Case Have Been Effective and Have Produced Results</u>

1. <u>Consumers Energy Has Enrolled Customers and Is Serving Customers Under Retail Open Access; Virtually Every System, Process and Procedure Included in the Implementation Plan Was Utilized</u>

While the end-result is not the criterion that is to be used under the prudence test, the unchallenged record evidence in this proceeding shows that the implementation expenditures have been effective and have produced results. Mr. Gilzow testified:

> "Consumers Energy was prepared to implement Electric Customer Choice and accept customer enrollments beginning on October 1, 1999, immediately after the first bids were awarded. Since that time, we have not only enrolled customers, but as of March 1, 2001, the Company was serving 30 customers and approximately 67 MW of ROA load. <u>In order to provide service, virtually every system, process and procedure included in the Electric Customer Choice implementation plan was utilized</u>." 2 Tr 74 (Emphasis added)

Mr. Waits testified with regard the Alliance Regional Transmission Organization ("Alliance RTO") that activities had progressed to the point where virtually all aspects of the Alliance RTO had been approved by the Federal Energy Regulatory Commission ("FERC"). 2 Tr 32. Mr. Dellas testified that the merchant operation and transmission operation changes required by restructuring were put into service on April 1, 2001. 2 Tr 45.

Thus, while evidence establishing the success of the end result is not required for prudence, such evidence has been presented by the Company in this proceeding. The implementation costs which are the subject of Case No. U-12891 are fully recoverable.

2. <u>Overview of Expenditures Incurred</u>

The $25.149 million of year 2000 implementation costs are summarized on Exhibit A-5. These costs directly relate to preparing for retail open access. 2 Tr 54, 74.

a. Customer Education/Information Programs

The first category of expenditures listed on Exhibit A-5 involves customer education and information. During 2000, Consumers Energy incurred $336,000 associated with the development of various communication tools targeted at informing and educating customers, retailers, and employees about electric customer choice. 2 Tr 61.

During 2000 call center operators handled thousands of calls from customers about Electric Customer Choice. 2 Tr 61. Additional personnel had to be added and trained to handle calls related to Electric Customer Choice. 2 Tr 61. The Retailer Handbook, which was first issued in August 1999, was revised in 2000 for program changes and updated on the Company's web site in early 2001. 2 Tr 61.

b. Customer and Retailer Billing Systems

The largest category of expenditures during 2000 related to customer and retailer billing systems. These costs represent $13.218 million, over 50% of the total costs incurred in 2000 to implement electric restructuring. Exhibit A-5, 2 Tr 62. Exhibit A-5 divides the costs into five major systems and support functions.

(i) Retailer Billing System

Costs in 2000 associated with developing the retailer billing system account for $2.218 million of the total. 2 Tr 62, Exhibit A-5. Some of the critical functions that the retailer billing system performs are to (i) track and validate contracts between Consumers Energy and retailers, (ii) maintain accurate portfolios of customers by retailer, (iii) verify a retailer has completed whatever licensing process is required, (iv) maintain the billing data necessary to bill the retailer in accordance with the FERC Open Access Transmission Tariff, (v) reconcile energy delivered to the Company's transmission system to actual energy used by the retailers' customers, and (vi) compute energy imbalances, if applicable. 2 Tr 62-63. Since these are functions that were not previously performed, the system had to be designed from scratch. 2 Tr 63.

The Retailer Billing System became operational in 1999 and the Company began enrolling customers in the fall of that year. 2 Tr 63. Major accomplishments for 2000 included Electronic Data Interchange ("EDI") enhancements, developing the capability to track and report average cycle time for all enrollments, adding "status dates" so that the Company can readily determine where every customer is in the enrollment process, automating the process for sending confirmation letters to customers when they are enrolled and issuing the first retailer bills. 2 Tr 63.

(ii) Load Profiling System

Load profiling is an alternative to requiring a time-of-use meter to provide interval data. 2 Tr 58, 59. Like retailer billing, load profiling is a function which was not previously performed by Consumers Energy and which was made necessary only because of retail open access. 2 Tr 63. In 2000 the Company incurred $201,000 in this category. The costs incurred in 2000 included the investment in a backup system for the MV-90 system, the annual license fee for LODESTAR, system maintenance and processing costs. 2 Tr 63. The load profiling system has been active since October 1999. 2 Tr 63. Since that time it has been providing valuable customer load data. 2 Tr 63.

(iii) Customer Billing Systems

During 2000 the Company incurred $4.943 million to modify and enhance the Company's billing systems to accommodate electric customer choice customers through the transition phase. 2 Tr 63. During 2000, the Company began using a revised, more detailed bill format for electric customers in preparation for full open access. 2 Tr 64. The new bill format clearly and concisely identifies every charge for which a customer is responsible, separately identifies any charges that Consumers Energy is billing on behalf of a retailer along with the retailer name, and shows the past 12 months of usage. 2 Tr 63-64. Additional accomplishments in 2000 include moving all large commercial and industrial accounts to the new large customer billing system in preparation for full retail open access, development of an optional credit service for retailers, and billing the first electric customer choice customers. 2 Tr 64.

(iv) <u>IT Project Management and System Integration</u>

The information technology ("IT") project management and systems integration category consists primarily of contract and incremental internal labor costs necessary to manage and support the information technology work and to support the definition and integration of new business processes required to support electric customer choice. 2 Tr 64-65. These costs include management costs for Consumers Energy and for Cap Gemini Ernst and Young, LLP. 2 Tr 64. The majority of the costs were incurred to assure that systems operated and correctly performed functions for which they were designed. 2 Tr 64. In addition to labor costs, this category includes costs for necessary software required to implement the new technology. 2 Tr 64. The total for this category is $2.598 million. 2 Tr 65, Exhibit A-5.

(v) <u>Business Subject Matter Experts</u>

Mr. Gilzow testified that the majority of the costs of $3.258 million for the business subject matter experts category are costs for incremental internal labor and related expenses. 2 Tr 65. Internal Company employees were needed as business subject matter experts to provide business logic and process flows for systems. 2 Tr 65. Their expertise was essential to assure that new and modified systems were compatible with existing systems and that customers could move easily from a bundled tariff to a retail open access tariff. 2 Tr 65. Also included in this cost is $350,000 that was used to develop eighty-six different job aids and train sixty-one different employees whose jobs were directly impacted by retail open access. 2 Tr 65.

c. <u>Metering Information</u>

Metering information is necessary to support load profiling and the transfer of time-of-use metering information to the customer and retailer billing systems. 2 Tr 65. In 2000 the Company completed the installation of the 1,500 sample meters and began accumulating valuable sample meter data. 2 Tr 65. In addition, telephone lines were connected to interval meters for enrolled customers greater than 20 kW. 2 Tr 65. The total for this category is $435,000. Exhibit A-5.

d. <u>Energy Scheduling</u>

Energy scheduling is fundamental to a retailer being able to provide customers the energy they need when they need it. 2 Tr 66. The enhanced energy scheduling system is required to support the energy schedules necessary to supply energy into the transmission system. 2 Tr 66. The total for this category in 2000 was $216,000, which represents primarily incremental labor and expenses required by the additional workload associated with energy scheduling. 2 Tr 66.

e. <u>Employee Impact Costs</u>

The Staff Report on Electric Utility Restructuring states that costs incurred to transition the work as a result of industry restructuring should be recoverable as part of the overall transition costs. Staff Report, pp 14, 15; 2 Tr 66. Mr. Gilzow testified:

> “The mitigation of adverse impacts of retail open access on employees who, in many cases, have devoted their entire working careers to serving bundles customers must be a priority in any restructuring program.” 2 Tr 66

The employee impact costs shown on line 11 of Exhibit A-5 represent actions which the Company has taken in 2000 with respect to certain segments of its workforce to prepare for retail open access. 2 Tr 66. Mr. Gilzow explained that these costs were a direct result of electric restructuring. 2 Tr 67.

Costs for this category in 2000 were $349,000. 2 Tr 66, Exhibit A-5. These costs were for expenses associated with retraining of employees whose jobs were eliminated as a result of electric restructuring. 2 Tr 68. The appropriateness of recovery of the retraining costs is discussed in more detail in Section II of these Exceptions.

f. Implementation Costs Incurred In Connection with Developing a Regional Transmission Organization

Traditionally utilities both owned and operated the electric transmission facilities that are used to serve retail customers. The need to develop an independent transmission system operator is a direct result of electric industry restructuring. 2 Tr 32. In 2000 Consumers Energy incurred $832,000 in connection with the development of an independent transmission system operator. 2 Tr 28, Exhibit A-1, Exhibit A-5.

These costs were incurred in addition to normal operational costs and were necessary in order to proceed with the development of an independent transmission system operator. 2 Tr 32. The costs would not have been incurred in the absence of electric restructuring and relate to activities that would not have been performed if not for restructuring. 2 Tr 32. The Commission approved expenditures that were made in 1997, 1998 and 1999 in connection with the development of an independent system operator in Case Nos. U-11955, U-11956 and Case No. U-12358.

Costs associated with development of an independent transmission system operator are divided among three categories. 2 Tr 28. The first category is labor costs associated with participation in activities related to the development of the Alliance RTO. 2 Tr 30. The second category is comprised of business expenses. Mr. Waits explained:

> "Development of a regional transmission system operator structure is a very complex and comprehensive undertaking. The Alliance RTO development process has been very intense in nature and has involved numerous meetings and working group sessions." 2 Tr 31.

The third category is for outside services. These expenditures include Alliance RTO charges for meeting costs and consulting services necessary to develop independent transmission system concepts and structures and in connection with the development of submittals for the FERC. 2 Tr 31.

Mr. Waits testified that all of the labor costs are incremental, and include costs for an employee who has spent 100% of his time on this effort from when he was hired. 2 Tr 30. Labor costs for individuals whose involvement was incidental to their regular work assignments were not included. 3 Tr 31.

The costs shown on Exhibit A-1 relate to efforts by Consumers Energy to pursue the development and establishment of a regional independent transmission system operator. 2 Tr 31. These costs were reasonably and prudently incurred and are fully recoverable from customers.

g. <u>Implementation Costs Incurred In Connection with MECS Electric Restructuring</u>

Prior to the advent of electric restructuring, Consumers Energy and Detroit Edison coordinated operations and exchanged electrical energy under various power pooling arrangements. 2 Tr 41. In the 1970s the two utilities began operating what is referred to as a "tight power pool" known as the Michigan Electric Coordinated Systems ("MECS"). 2 Tr 41.

In 1996 Detroit Edison initiated actions to terminate the Electric Coordination Agreement which governed the power pool, claiming that retail competition is incompatible with the Agreement. 2 Tr 41; Exhibits A-3, A-4. Under contractual provisions, the termination would have become effective four years from the notice of termination, approximately January 1, 2001. 2 Tr 42. By mutual agreement the termination was delayed until April 1, 2001.

The impending termination of the Electric Coordination Agreement required Consumers Energy to restructure its merchant and transmission systems to accommodate Consumers Energy merchant operation and transmission operation that were separate and apart from Detroit Edison. Consumer Energy incurred $8.979 million through December 31, 2000 as a result of changes to the merchant and transmission systems necessitated by electric restructuring.[2] 2 Tr 42, Exhibits A-2, A-5.

Exhibit A-2 divides implementation costs incurred as a result of changes to the merchant and transmission systems necessitated by electric restructuring into six categories. Costs shown in the Merchant Applications category are contractual costs paid to a vendor for the development of software, documentation, software licenses, databases and hardware necessary to perform planning and operation applications required to ensure an economic and reliable supply of electricity to Consumers Energy's customers. 2 Tr 43. Transaction Management System costs were paid to a vendor for the development of software, documentation, and software licenses necessary to enter all the power transaction information into the Energy Management

[2] $8.829 million was incurred in 2000. The remainder of $150,000 was incurred in 1999. The Company indicated in its 1999 implementation filing that since the 1999 costs in this category were modest, the Company would be seeking recovery in a subsequent filing. 2 Tr 43, 60.

System. 2 Tr 43. This is required to operate the electric system reliably and economically. 2 Tr 43. It is used for dispatch and billing of transactions. 2 Tr 44. Load Forecasting costs are costs paid to a vendor to develop and provide software to allow Consumers Energy to forecast load requirements. 2 Tr 44. The results provide accurate load forecasts to the merchant applications programs that enable those programs to produce efficient, accurate results. 2 Tr 44.

The Economic Dispatch/AGC system is critical to the real-time Energy Management System and is designed to handle economic dispatch of Consumers Energy's electric resources and second-to-second balancing between energy supply and system load. 2 Tr 44. This is crucial to the operation of Consumers Energy's system. 2 Tr 44. Costs were paid to a vendor for development of software, software licenses, documentation and hardware for the system. 2 Tr 44.

The vast majority of the costs in the category Other Equipment, Licenses and Expenses were incurred in for equipment, licenses and contracted services which were necessary to put in place and operate the systems previously described. 2 Tr 44. Electric Restructuring Department costs are costs for direct labor and business expenses of the Electric Restructuring Department to manage the MECS electric restructuring. 2 Tr 45.

The costs for MECS electric restructuring were incurred in addition to normal operational costs. 2 Tr 45. These costs are a direct result of electric restructuring. 2 Tr 41, 45. Only costs that were incremental were included on Exhibit A-2. 2 Tr 45. The systems are <u>operable and effective</u>. 2 Tr 45. All of the systems were put into service on April 1, 2001. 2 Tr 45. These costs are fully recoverable from customers.

3. **Summary of Results**

As discussed previously, Consumers Energy has enrolled customers and is serving ROA load. 2 Tr 74. Virtually every system, process and procedure included in the implementation plan was utilized. 2 Tr 74. Mr. Gilzow included the following summary of results, organized by process, in testimony dated March 30, 2001:

"I. Bidding

- Completed five separate bids where 671 MW of capacity were successfully awarded
- Bids were awarded to over 60 different winning bidders
- On October 20, 1999, the MPSC Staff issued their report on bid cycle one. Below are quotes from that report:
  - 'The bid procedure was completed on schedule and in accordance with the prescribed plans' (Page 1)
  - 'The entire procedure was conducted in a most professional manner and in strict conformance with published procedures.' (Page 1)
  - 'No major changes to the bid process are recommended at this time. The initial bid cycle, based on empirical results tabulated in this review appears to have successfully encouraged adequate bid participation…' (Page 2)
  - 'Of particular significance in this regard, no complaints were registered with Staff concerning conduct of the bid procedure.' (Page 2)

II. Customer Education/Information

- Published "Customer Guide to Electric Customer Choice"
- Published "Employee Guide to Electric Customer Choice"
- Developed "Retailer Handbook" and installed it on Company website
- Provided bid results on Company website

III. Customer and Retailer Billing

- Negotiated Transmission Service Enabling Agreements, Transmission Service Agreements and Distribution Agreements with three different retailers (Nordic Electric, Quest Energy and DTE Energy Marketing)
- Issued six FERC OATT bills to two different retailers accurately and on time
- Collected six payments from retailers and posted the payments to their accounts
- Completed over 1000 enrollments for three different retailers

- Issued approximately 130 ROA bills accurately and on time

IV. Metering Information

- Completed installation of 1500 sample meters and began gathering sample meter data for all meters
- Gathered and processed monthly metering information for input into approximately 130 ECC monthly bills

V. Energy Scheduling

- Received and scheduled over 350 different hourly energy schedules for use of the transmission system."

2 Tr 74-76

The expenditures incurred for implementation of retail open access allowed implementation of retail open access to proceed to the point at which retail open access customers are now being served. Expenditures have been effective. There was no evidence presented to the contrary.

C. Consumers Energy Should be Able to Rely on Commission Commitments that Prudently Incurred Implementation Costs Will Be Recovered

In its March 8, 1999 Opinion and Order in Case Nos. U-11290 et al., the Commission approved Consumers Energy's implementation plan. Mr. Gilzow testified that the expenditures that the Company has incurred were incurred in support of the implementation plan approved by the Commission. 2 Tr 55-56.

Mr. Gilzow testified with regard to the 2000 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." 2 Tr 69.

Consumers Energy has incurred substantial costs in reliance on prior Commission determinations that such costs would be recovered if prudently incurred. 2 Tr 56.

Consumers Energy has acted in reliance on the Commission's prior orders. 2 Tr 56, 59, 79, 88. It would be unlawful and unreasonable to change the rules after implementation costs have been incurred and deny recovery of such costs.

Mr. Gilzow stated:

> "These costs can and should be evaluated based on what was known at the time they were incurred. To evaluate expenditures on a retroactive basis using standards which have yet to be defined is totally unfair and unreasonable. The Company has met the prudence test for these expenditures and that should be sufficient. It would be inappropriate to disallow recovery of prudently incurred implementation costs. <u>It is important that there be finality that the implementation expenditures will be recovered. Consumers Energy should be able to trust Commission orders which provide that Consumers Energy will be allowed full recovery of prudently incurred implementation costs</u>." 2 Tr 88. (Emphasis added)

Unconditional recovery of year 2000 implementation costs should be approved in this proceeding. Making recovery conditional would be unlawful and unreasonable.

D. <u>Making Recovery of Implementation Costs that Are the Subject of this Case Conditional Would Violate Consumers Energy's Constitutionally Protected Rights</u>

Consumers Energy has constitutional rights to just and reasonable rates. U.S. Const, Am V, XIV; Const 1963, art 1, section 17, art 10, section 2; <u>Missouri ex rel Southwestern Bell Telephone Co</u>. v <u>Public Service Comm of Missouri</u>, 262 US 276; 43 S Ct 544; 67 L Ed 981 (1923), <u>Federal Power Comm</u> v <u>Natural Gas Pipeline</u>, 315 US 575; 62 S Ct 736; 86 L Ed 1037 (1942), <u>Federal Power Comm</u> v <u>Hope Natural Gas Co</u>, 320 US 591; 64 S Ct 281; 88 L Ed 333 (1944), <u>Permian Basin Area Rate Cases</u>, 390 US 747; 88 S Ct 1344; 20 L Ed 2d 312 (1968), <u>Duquesne Light Co</u> v <u>Barasch</u>, 488 US 299; 102 L Ed 2d 646; 109 S Ct 609 (1989).

Michigan Constitution 1963, article 1, section 17 provides procedural and substantive protection against confiscatory rates by its due process clause and also by stating:

> "...the right of all individuals, firms, corporations and voluntary associations to fair and just treatment in the course of legislative and executive investigations and hearings shall not be infringed."

The Fourteenth Amendment to the United States Constitution provides procedural and substantive protection against confiscatory rates by its due process clause and by the "takings clause" of the Fifth Amendment to the United States Constitution, which is applicable to states under the Fourteenth Amendment. Accord, Northern Michigan Water Co v Public Service Comm, 381 Mich 340, 351; 161 NW 2d 584 (1968), ABATE v Public Service Comm, 430 Mich 33, 39; 420 NW 2d 81 (1988). See also Consumers Power Co v Public Service Comm, 415 Mich 134, 145; 327 NW2d 875 (1982); Michigan Consolidated Gas Co v Public Service Comm, 389 Mich 624, 638; 209 NW2d 210 (1973).

A regulator cannot arbitrarily switch ratemaking methodologies in a way that imposes risks on investors that they did not assume and for which they were not compensated. Duquesne, supra, 488 US at 315. Yet, that is precisely what would occur if the Commission makes recovery of the implementation costs addressed in this case conditional upon an additional review.

Essentially the Commission would be stating that the implementation cost hearing which was undertaken in Case No. U-12891 does not establish that any costs are recoverable, despite legislative pronouncements and prior Commission commitments that such costs would be recoverable. It is the position of Consumers Energy that the Commission cannot lawfully make the recovery of the implementation costs incurred in 2000 conditional.

II. THE ALJ ERRED IN RECOMMENDING THAT LABOR COSTS ASSOCIATED WITH IMPLEMENTATION AND RETRAINING SHOULD BE DISALLOWED

The January 22 PFD contains the following explanation of the recommendation that recovery of $5.048 million of labor costs incurred in 2000 in connection with implementation of retail open access, $341,000 of labor costs for employee retraining, and $173,000 of associated carrying costs be disallowed:

> "The Commission has determined that costs must be incremental, as well as reasonably and prudently incurred, to be recoverable. The Staff has shown that the $5.562 million of implementation costs were not in addition to O & M costs being recovered through current base rates.... The writer finds that Consumers has not demonstrated the labor and related overheads identified were in addition to O & M costs already being recovered.
>
> "With regard to the Staff proposed $341,000 disallowance of retraining costs, Consumers argues that they are recoverable under Section 10p(2) of Act 141. The writer is persuaded Section 10p(2) defines what types of costs may be considered stranded costs. Recovery under this section is not guaranteed. Consumers still must demonstrate that the costs are in addition to costs already being recovered." PFD pp 9-10.

The ALJ's findings that the labor costs should not be recovered are not supported by the record evidence in Case No U-12891.

A. The ALJ's Recommendation Would Result in an Unlawful Reduction in Base Rates During a Statutory Base Rate Freeze

Pursuant to prior orders of the Commission and 2000 PA 141, implementation costs are recoverable costs. Pursuant to 2000 PA 141 electric rates are currently frozen. Labor costs which were prudently incurred in 2000 for purposes of implementation are recoverable <u>as implementation costs</u>. The effect of diverting base rate dollars to pay for implementation costs would be to reduce base rates below levels that would have been in effect absent electric restructuring. 2 Tr 81. Diverting base rate revenues to pay for implementation costs would result in an unlawful rate reduction during a statutory base rate freeze and would unlawfully reduce base rates retroactively from levels previously approved by the Commission. 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), 2000 PA 141; MCL 460.10d.

Denying recovery of labor-related implementation costs under a theory that such costs should be considered as being recovered through base rates would be an unlawful and unreasonable disallowance of prudently incurred implementation costs.

B. Staff's Disallowance of Labor Costs Is Not Supported by the Record Evidence

The testimony of Mr. Kusiak on cross examination clearly establishes the disallowance proposed by Staff was not based on imprudence. 2 Tr 105-106, 109. Rather, the only reason for the disallowance was Mr. Kusiak's view that the labor costs were not incremental. 2 Tr 106, 109. The evidence does not support such a conclusion. Staff's position that the costs are not incremental is based upon unsupported speculation.

In its July 11, 2001 Order in Case No. U-12358, the Commission accepted Staff's recommendation to disallow labor costs incurred in 1999 on the theory that such costs were not incremental. Consumers Energy subsequently filed a Petition for Rehearing on that issue. Consumers Energy believes that the Commission's disallowance of 1999 labor costs was in error and should be reversed on rehearing. However, even if the Commission does not reverse its decision in that case, this would not preclude recovery of year 2000 labor costs in Case No. U-12891. In the present case, Consumers Energy's evidentiary presentation includes further and additional evidence not present in the prior case which supports full recovery of labor costs.

The record evidence in Case No. U-12891 shows that labor costs meet the two-prong test set forth by the Commission in its Case Nos. U-11955, U-11956 Order. Implementation costs incurred by Consumers Energy in 2000 were incurred in reliance on the Commission's commitment that all such prudently incurred costs would be recoverable from customers. 2 Tr 55-56, 69, 79.

Mr. Gilzow testified:

> "Consumers Energy incurred labor and other implementation costs during 2000 in reliance upon the Commission's pronouncements before and during 2000 that such costs would be recoverable. Consumers Energy should be able to trust and rely upon Commission orders indicating that it will be allowed full recovery of prudently incurred implementation costs and upon legislative enactments stating that the Commission's orders shall provide for full recovery of implementation costs. The Staff's proposed disallowance of labor costs is inconsistent with these pronouncements." 2 Tr 79.

Disallowance of the labor costs incurred in implementing electric restructuring for the period ended December 31, 2000 would be unreasonable and unlawful. Consequently, the carrying costs associated with these costs are also recoverable.

The evidence supporting recovery of the labor costs in this case is discussed further in the following sections. The record evidence does not support Staff's disallowance. To the contrary, the record evidence supports full recovery of year 2000 labor costs that are associated with implementation of electric restructuring and retraining.

C. <u>All Witnesses Agreed Labor Costs Were Directly Related to Electric Restructuring; There is No Evidence to the Contrary</u>

The record evidence in Case No. U-12891 establishes that labor costs were directly related to electric restructuring. All witnesses agreed. There is no evidence to the contrary.

1. **<u>Company Witnesses Testified That Labor Costs Were Related to Electric Restructuring</u>**

Mr. Gilzow testified:

> "Consumers Energy undertook implementation of the ROA program with the understanding that the costs it incurred in doing so would be recoverable from customers. <u>The labor costs which were incurred in 2000 were directly related to electric restructuring. These are costs that (i) would not have been incurred but for restructuring and (ii) represent activities that would not have been performed but for restructuring.</u> These costs are in addition to costs that would typically be incurred in providing electric service in a reasonable, efficient manner. These are costs that were prudently incurred and are properly recoverable. The would also be true for the labor costs incurred in 1999 associated with the restructuring of the MECS which are addressed by Mr. Dellas." 2 Tr 69 (Emphasis added)

Mr. Waits and Mr. Dellas reiterated with respect to costs they discussed that implementation costs were directly related to electric restructuring. 2 Tr 30, 32, 41, 45.

2. **<u>Staff's Witness Mr. Kusiak Testified that the Labor Costs Were Related to Electric Restructuring</u>**

Mr. Kusiak testified during cross examination:

> "Q For purposes of your testimony in this case, are you disputing that the labor costs were incurred in furtherance of the company's electric implementation program?
>
> A The electric employee costs were charged to the implementation program....
>
> Q ...Do you accept, for purposes of this case, that those costs were properly charged to the electric implementation program?
>
> A Yes." 2 Tr 109

Mr. Kusiak's proposed disallowance was not based on those costs not being implementation costs.

D. <u>All Witnesses Agreed Labor Costs Were Prudently Incurred; There is No Evidence to the Contrary</u>

All witnesses agreed that labor costs included in the Company's request in case were prudently incurred. There is no evidence to the contrary.

1. <u>Company Witnesses Testified that Labor Costs Were Prudently Incurred</u>

Mr. Gilzow testified that all the implementation costs being addressed in Case No. U-12891 were prudently incurred. 2 Tr 68-69. In addition to testifying generally to prudence, he testified specifically with regard to labor costs:

> "These are costs that were prudently incurred and are properly recoverable." 2 Tr 69

Mr. Dellas and Mr. Waits reiterated, with respect to the costs they described, that such costs were prudently incurred. 2 Tr 31, 45.

2. <u>Staff's Witness Mr. Kusiak Acknowledged that the Labor Costs Were Prudently Incurred</u>

Mr. Kusiak did not dispute that labor costs were prudently incurred. Moreover, he specifically testified that such costs were prudent:

> "Q Mr. Kusiak, is your disallowance of labor costs in this case based on a conclusion that any of the labor costs you disallow were not prudently incurred?
>
> A No. They were based on incremental.
>
> . . .
>
> Q With regard to employee costs, if you had concluded any of those costs were imprudent, would you have recommended disallowing them for that reason?
>
> A Yes. I would." 2 Tr 105-106

When asked if he identified any expenditures during his review that he would consider imprudent, Mr. Kusiak replied:

> "A No. None of the costs I looked at were imprudent." 2 Tr 109.

His disallowance was not based on any finding of imprudence.

E. <u>The Sole Reason for Mr. Kusiak's Disallowance of Labor Costs Was His Opinion that Such Costs Were Not Incremental; The Evidence Does Not Support Such a Conclusion</u>

1. <u>Mr. Kusiak's Analysis Does Not Support His Conclusion That Labor Costs Were Not Incremental</u>

Mr. Kusiak testified that he disallowed labor costs because such costs were, in his opinion, not incremental. 2 Tr 105. He stated that if he had thought the labor costs were incremental, he would have supported their recovery in this case. 2 Tr 109. Thus, the sole issue with regard to the recovery of labor costs is whether those costs were incremental.

Mr. Kusiak first sought to support his conclusion that labor costs were not incremental by comparing Operation and Maintenance Expense for 2000 with levels allowed by the Commission in Consumers Energy's last electric rate case. 2 Tr 103-104. He stated that since the year 2000 level of Other O&M expense was lower than the level used in setting base rates, "It would therefore appear" labor costs were not incremental. 2 Tr 104. However, the comparison made does not support such a conclusion.

Consumers Energy's witness Mr. Gilzow testified:

> "Other O&M expense is comprised of a great many components that are affected by many factors. The level of Other O&M does not provide a meaningful yardstick to measure whether the labor costs charged to electric restructuring were incremental." 2 Tr 80.

Use of Other O&M expense is an inappropriate criterion. 2 Tr 80.

During cross examination Mr. Kusiak clarified his position:

> "Q Is it your position that labor costs can never be incremental unless the overall level of O&M in the year of expenditures is higher than at the time rates were last set?

> A No, I'm talking about just labor and related expenses." 2 Tr 110.

This, however, is not the comparison that Staff made. Mr. Kusiak testified:

> "Q Would it be correct, then, Mr. Kusiak, that there are dollars in your [O&M] totals that remain that would be for things other than labor?
>
> A Yeah, in that total O&M there has to be additional costs that are not directly labor.
>
> Q So then would it be correct to conclude that the totals that you have at the top of page 3 [2 Tr 104] would include some costs that are non-labor costs?
>
> A Yes." 2 Tr 112

Mr. Kusiak stated that he had not undertaken an investigation of reasons why year 2000 O&M costs were lower than at the time of the last rate case. 2 Tr 113. His comparison cannot properly be relied upon as supporting a conclusion that labor costs are not incremental.

Mr. Kusiak next sought to support his conclusion that labor costs were not incremental by comparing the Consumers Energy employee count at December 31, 2000 with the employee count in 1996. He stated that since the number of employees at December 31, 2000 was lower "one could conclude the current rates of the company provide ample coverage of any implementation related labor costs." 2 Tr 103-104. However, this comparison does not support such a conclusion.

Even if a comparison of the number of employees was otherwise appropriate, Staff's comparison could not properly be relied upon. It uses both inappropriate time periods for the comparison and compares inappropriate groups of employees. Mr. Gilzow explained:

> "How the employee count at the end of 2000 compares to the number of employees at the time of the last rate case does not address the question of whether employee labor expense

> attributable to electric restructuring is incremental to levels that would have been incurred in the absence of electric restructuring." 2 Tr 82.

Furthermore, Staff is not comparing the number of electric employees. 2 Tr 82. Mr. Kusiak's comparison is based on a comparison of the level of overall Company employees, including both gas and electric employees. 2 Tr 82.

The fallacy of Staff's conclusion is reflected by looking at the number of electric employees between 1998 and 2000. Mr. Gilzow testified:

> "The number of electric employees at the end of 1998 was 5,692. This increased to 5,799 at the end of 1999 and 5,837 at the end of 2000. The increase from 1998 to 1999 was 107 employees and from 1998 to 2000 was 145 employees. While I do not believe that using employee count as a proxy is appropriate, this shows that the increase in the number of electric employees from 1998 to 2000 exceeds the number of employees charging time to electric restructuring." 2 Tr 82.

The number of employees charging time to electric restructuring in 2000 was 70. 2 Tr 82.

Mr. Kusiak states in his testimony that (i) most employees charging time to electric restructuring had been with Consumers Energy for 10 years and had worked in various work units and other parts of the Company and (ii) ten employees charging time to electric restructuring had three years or less experience with Consumers Energy. 2 Tr 104. This does not provide any support for his total disallowance of labor costs. In any event, during cross examination Mr. Kusiak testified that he would have disallowed the labor costs even if all 70 employees had been new employees hired specifically for purposes of electric restructuring:

> "Q To explore this further, let's just assume hypothetically that all of the 70 employees who charged time to electric restructuring in the year 2000 were new employees who had been hired specifically for this purpose, and that the number of electric employees in the year 2000 was at least 70 employees higher than at the end of 1998. Would this change your conclusion?

A No, I don't think it would." 2 Tr 113.

This highlights the inappropriateness of the criteria used by Staff. Creating such an absolute bar to recovery of labor costs is both unlawful and unreasonable.

The screening criteria used by Mr. Kusiak are not appropriate criteria for measuring whether or not labor costs related to electric restructuring are incremental. As will be discussed below, the Company has presented evidence that meets the criteria set forth by the Commission and recovery should be allowed.

Mr. Kusiak's statement that recovery of labor costs would result in double recovery is incorrect. Mr. Gilzow explained:

> "Mr. Kusiak's statement is based upon the assumption that such costs should be recovered as part of base rates. However, these labor-related implementation costs are in addition to costs included in base rates. There is no double recovery as a result of allowing recovery of these labor costs incurred for electric restructuring implementation. The labor costs are incremental costs." 2 Tr 87.

Recovery of labor costs would not result in double recovery.

2. <u>The Company Has Presented Evidence Showing That 100% of Labor Hours Charged to Electric Restructuring in 2000 Were Incremental</u>

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 October 24, 2000 Order stated with regard to the evidence in that case:

> "Neither Consumers nor 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 Case No. U-12891, Consumers Energy has presented evidence which meets the criteria identified by the Commission.

The evidence presented by the Company in Case No. U-12891 establishes that the labor costs incurred in 2000 were incremental. Mr. Gilzow testified:

> "These costs are in addition to the costs that would typically be incurred in providing electric service in a reasonable, efficient manner." 2 Tr 69. (Emphasis added)

Mr. Gilzow further testified:

> "The labor costs incurred by the Company in 2000 for electric restructuring (i) were incurred for implementation of electric restructuring, (ii) would not have been incurred but for electric restructuring, and (iii) <u>were in addition to electric labor costs that would otherwise have been incurred</u>. The costs represent tasks and activities that would not have been performed but for restructuring." 2 Tr 80-81 (Emphasis added)

Mr. Gilzow illustrated the incremental nature of the labor hours on his Exhibit A-6.

During 2000 there were 70 employees who charged all or part of their time to Electric Restructuring Implementation. 2 Tr 69. The labor costs are the result of 116,608 hours of labor spent on the project. 2 Tr 69. This total is comprised of 84,017 direct labor hours and 32,591 chargeback hours. 2 Tr 69. Through a detailed fact-specific analysis of labor hours, Mr. Gilzow shows that 100% of these labor hours were incremental.[3] 2 Tr 69-74, Exhibit A-6. In his rebuttal testimony Mr. Gilzow presents additional testimony and additional analysis further supporting the incremental nature of the labor. 2 Tr 78-88, Exhibit A-7, Exhibit A-8. This additional testimony and additional analysis has never been presented before by Consumers Energy in prior cases.

The Company has incrementally supported implementation of retail open access through a number of alternative approaches. On Exhibit A-6 Mr. Gilzow has classified labor hours among six categories. In his testimony he explains why each of these categories should be considered incremental. In 2000, labor hours were attributable to:

(i) Adding new employees to fill new positions created by the restructuring project (14.9% of the total hours);

(ii) Shifting existing employees from areas outside the electric strategic business unit into the electric strategic business unit (1.8% of total hours);

(iii) Moving existing employees from their current job and backfilling that position through use of new employees (30.0% of total hours);

(iv) Paying for overtime hours (0.4% of total hours);

(v) Incurring chargeback labor from internal support organizations directly related to electric restructuring (27.9% 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 (25.0% of total hours).

Exhibit A-5, 2 Tr 70. Exhibit A-6 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-6.

[3] This evidence was not presented by the Company in Case Nos. U-11955, U-11956.

The evidence presented by Consumers Energy in the instant case establishes that, contrary to the Staff's conclusion, labor costs in 2000 were incremental. The evidence shows that each of the categories meets the criteria for recovery.

3. 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 2000 labor hours for ten employees were attributable to new employees that were added to fill new positions created by electric restructuring. 2 Tr 70-71. These employees were responsible for 17,356 of the labor hours charged to the electric restructuring in 2000, which represents approximately 14.9% of the total hours. 2 Tr 71, Exhibit A-6. These employees were assigned to positions in customer enrollment, retailer settlement, energy scheduling, MECS restructuring, and to activities related to the formation of a regional transmission organization. 2 Tr 71. These are employees who both filled new positions related to electric restructuring and were new to Consumers Energy. 2 Tr 71. 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-6.

Since these are new employees who filled new positions, there are no prior positions to be backfilled. 2 Tr 85. There is no valid basis to conclude that the labor costs associated with these hours are not incremental. 2 Tr 85.

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

In 2000 there were 2080 hours charged to the project, representing approximately 1.8% 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. 2 Tr 71. That employee had previously held a position in the gas strategic business unit. 2 Tr 71. The employee filled a new position related to electric restructuring. 2 Tr 71. 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-6.

As with the prior category, there was no prior electric position to be backfilled. 2 Tr 85. There is no valid basis to conclude the associated costs are not incremental. 2 Tr 85.

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

In 2000, labor hours for 20 employees were attributable to employees who had been moved from their prior job and had their prior job backfilled through use of new employees. 2 Tr 71. These employees were responsible for 34,961 of the labor hours charged to electric restructuring in 2000, which represents approximately 30.0% of the total hours. 2 Tr 71, Exhibit A-6. These 20 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. 2 Tr 71. These employees performed electric restructuring work in such areas as customer billing, customer enrollment, energy scheduling, project management, and activities related to RTO formation. 2 Tr 71. These employee assignments represent incremental costs, thus meeting the criteria for recovery. The hours are shown in column (D) of Exhibit A-6.

On Exhibit A-7, Mr. Gilzow has shown for each employee whose job was backfilled what their responsibilities were with respect to restructuring and the responsibilities of the job that they left that was backfilled. 2 Tr 83. In every instance the employees charging time to electric restructuring left a position that was necessary to support the Company's ongoing responsibility as a utility. 2 Tr 83. All of the positions were backfilled. 2 Tr 83. This provides confirmation, through new and additional evidence not presented in any prior case, that this work performed on electric restructuring is incremental and the costs should be recoverable. 2 Tr 83.

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

In 2000, 13 employees received overtime pay for work on electric restructuring activities. 2 Tr 72. These employees were responsible for 495 of the labor hours charged to electric restructuring in 2000, which represents approximately 0.4% of the total hours. 2 Tr 72, Exhibit A-6. Overtime hours were in such areas as customer billing, customer enrollment, energy scheduling, project management and bidding. 2 Tr 72. These hours represent overtime hours paid to employees who worked on electric restructuring in addition to working their normal jobs. 2 Tr 72. 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-6.

The overtime was in addition to the time spent on normal duties. 2 Tr 85. Since it was overtime, there was no prior position to be backfilled. 2 Tr 85. There is no valid basis to conclude the associated labor costs are not incremental. 2 Tr 85.

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

In 2000, the electric restructuring project was charged for 32,591 hours of work which was performed by Information Services and Technology ("IS&T") and by Meter Technology Center and Meter Services ("Metering"). 2 Tr 72. This represents approximately 27.9% of the total hours. Exhibit A-6. The work performed by these personnel was necessary for the successful implementation of electric restructuring. 2 Tr 72-73.

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. 2 Tr 73. This required significant modifications to the existing special ledger system and creation of a new Retailer Billing System. 2 Tr 73. IS&T along with Cap Gemini Ernst & Young performed necessary system design to successfully complete this effort. 2 Tr 73. In 2000, 19,618 hours were charged to the project by IS&T. Exhibit A-6.

Metering personnel tested, purchased and programmed interval data recording meters to serve load profiling customers and customers with load above 20 kW. 2 Tr 73. Metering was responsible for installing the 1,500 sample meters and gathering the meter information. 2 Tr 73. In 2000, there were 11,406 hours charged to the project by Metering personnel. Exhibit A-9. An additional 1,567 hours were charged by the call center. Exhibit A-9. As noted previously, during 2000 call center operators handled thousands of calls and additional personnel had to be added. 2 Tr 61.

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. 2 Tr 72. The Company utilizes a chargeback procedure for allocating such costs as labor costs to support designing new metering and billing systems.

2 Tr 72-73. 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-6.

In this case, Consumers Energy provided further support, not previously presented that the chargeback labor costs are incremental to costs that would have been incurred in the absence of electric restructuring. 2 Tr 84. Mr. Gilzow testified:

> "These 32,591 hours and associated costs are in addition to the chargeback costs that the Company typically incurs to support call centers, to support other operating systems, to schedule and operated the business, and to install new and replacement meters. For the last three years (1998-2000) the chargeback costs to the Electric Strategic Business Unit ('SBU') for this work have averaged $12.3 million per year. For these same three years the average chargeback for implementation of electric restructuring has been an additional $12.2 million per year, thus doubling the costs from levels that would normally be charged to the Electric SBU. For the year 2000, the ERIP chargeback costs for IS&T, Metering and Call Centers was $8.6 million out of a total chargeback to the Electric SBU for these services of $20.8 million." 2 Tr 84

Mr. Gilzow continued:

> "Clearly these numbers demonstrate that the chargebacks incurred by the Electric SBU to support electric restructuring were considerably higher than would normally be incurred and were incremental. The incremental chargeback costs would not have been incurred by the Electric SBU in the absence of electric restructuring implementation." 2 Tr 84

This provides confirmation, through new and additional evidence not presented in any prior case, that the chargeback labor is incremental and the costs should be recoverable.

f. <u>The Other Labor Hours Were Also Incremental</u>

In 2000 there were 29,125 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. 2 Tr 72. This represents approximately 25.0% of total hours. Exhibit A-6. These hours were necessary to incrementally support implementation of retail open access. These hours represented work of 37 employees (the equivalent of approximately 14 full-time employees) and covered all aspects of electric restructuring work. 2 Tr 72. The hours are shown in column (G) of Exhibit A-6 by implementation activity and total.

On Exhibit A-8, Mr. Gilzow has shown the electric restructuring responsibilities and prior responsibilities for the employees who are included in this category. 2 Tr 86. The information is shown separately for each employee who worked over 1,000 hours on electric restructuring in 2000. 2 Tr 86. Information is summarized for the employees who worked less than 1,000 on electric restructuring. 2 Tr 86. Mr. Gilzow testified:

> "Clearly the work performed by these individuals on electric restructuring was both critical to the success of implementing this complex program and incremental. In every case, the work that they were performing prior to working on electric restructuring was important to Consumers Energy providing utility service, which is demonstrated by the fact that the work was not eliminated." 2 Tr 85-86.

The Company has provided confirmation, through new and additional evidence not presented in any prior case, that the this work performed on electric restructuring is incremental.

4. The Evidence Requires Rejection of Staff's Labor Disallowance

Consumers Energy has presented evidence establishing that the hours and associated labor costs charged to electric restructuring are incremental and should be recovered. The Company has presented evidence for each of the categories of labor costs showing that labor costs incurred by Consumers Energy for electric restructuring (i) were incurred for implementation of electric restructuring, (ii) would not have been incurred but for electric restructuring, and (iii) were in addition to electric labor costs that would otherwise have been incurred. The evidence indicates that the costs represent tasks and activities that would not have been performed but for restructuring. The Company's analysis and evidence provides data which compels rejection of the proposal of Staff to exclude the labor costs. The evidence shows that the labor costs incurred in 2000 associated with implementation are recoverable costs.

F. Employee Retraining Costs Are Properly Recoverable

The ALJ also recommended acceptance of Mr. Kusiak's disallowance of $341,000 of labor costs incurred in 2000 in connection with retraining of employees impacted by electric restructuring. 2 Tr 103, Exhibit S-10, line 19. His recommendation should be rejected.

Mr. Gilzow testified that these labor costs are employee-related restructuring costs for employee retraining. 2 Tr 87. These costs were incurred as a result of electric restructuring, are directly related to industry restructuring, and are incremental. 2 Tr 66, 87.

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 recoverable costs shall include audited and verified employee-related restructuring costs. Employee retraining programs are explicitly listed as being recoverable restructuring costs. The costs which Mr. Kusiak seeks to disallow meet the criteria for recovery set forth in Section 10p and are recoverable costs.

The employee impact labor costs that Staff seeks to disallow were incurred were for retraining employees whose jobs were eliminated as a result of electric restructuring. 2 Tr 67. Mr. Gilzow testified:

> "Electric restructuring has resulted in changing the way outages are scheduled. ... Because of electric restructuring, outages will be concentrated in the off-peak periods of the spring and fall requiring large numbers of repair personnel during those periods and few, if any, in the summer and winter peak periods. Maintaining a constant workforce under those conditions cannot be justified. Therefore the Company decided in 1999 to eliminate the Traveling Repair Crew and have the work performed by outside contractors." 2 Tr 67. (Emphasis added)

Mr. Gilzow noted:

> "In summary, these are exactly the types of costs the legislature envisioned in Section 10p. (1) of PA 141 when they referred to a 'worker transition program' which would provide skills upgrades." 2 Tr 68.

These are costs that are properly recoverable from customers.

Consumers Energy presented evidence showing that the $341,000 of employee labor costs that Staff seeks to disallow are labor costs for employee retraining incurred as a direct result of electric restructuring. There is absolutely no record evidence in this case to the contrary.

III. THE ALJ ERRED IN NOT RECOMMENDING THAT IMPLEMENTATION COSTS BE RECOVERED FROM ALL CUSTOMERS USING THE METHODOLOGY PROPOSED BY THE COMPANY

Implementation costs are currently being deferred for future recovery, consistent with prior Commission orders. Consumers Energy's witness Mr. Torrey proposed that implementation costs be recovered, along with a 7% carrying charge, through a surcharge applied to all full-service and Retail Open Access customers' bills for a period of not more than five years. 2 Tr 94-95. The mechanism proposed could also be used to recover prior year and future year implementation costs. 2 Tr 96. Exhibit A-9 is a one-page exhibit that illustrates the mechanism proposed by the Company. 2 Tr 96. The Company proposed the surcharge go into effect at the expiration of the rate freeze/rate cap period established by PA 141. 2 Tr 95.

Mr. Torrey testified:

> "The proposed implementation cost recovery mechanism is simple. By applying the surcharge to full-service and Retail Open Access customers for a period of up to five years, it reduces the impact on any single customer, and recognizes that the costs were incurred to implement systems that provide the benefit of choice to all of these customers. In addition, it avoids the possibility that imposing this charge only on ROA customers would inhibit the ability of customers to economically participate in the ROA program." 2 Tr 97.

The proposed methodology addresses implementation costs. It does not address net stranded cost issues.

In its October 24, 2000 Order in Case Nos. U-11955, U-11956 the Commission stated:

> "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. ... Instead of deciding how to effect the recovery of the 1998 implementation costs in this order, the Commission will defer the means of recovery until pending questions regarding the stranded cost recovery mechanism are resolved." Order, p 12.

In its July 11, 2001 Order in Case No. U-12358 again said it would defer consideration of the recovery mechanism.

Issues related to a determination of net stranded costs were litigated in Case No. U-12639. The Commission issued a decision in that case on December 20, 2001. Several petitions for clarification and rehearing are pending.

As noted previously, the Commission in its Order in Case Nos. U-11955 and U-11956 noted that implementation costs have been distinguished from other recoverable electric restructuring-related costs. There is no reason the implementation cost recovery mechanism cannot be addressed in this case.

Consumers Energy was the only party to present a recovery mechanism in this case. The Company requests that the Commission approve the methodology shown on Exhibit A-9 for purposes of calculating the implementation cost recovery surcharge.

IV. CONCLUSION

The evidence in this proceeding shows that the full of $25.149 million of implementation costs incurred by Consumers Energy for the period ended December 31, 2000 are recoverable. The Company requests that the Commission approve recovery of these costs, along with appropriate carrying costs, using the methodology proposed by the Company's witness Mr. Torrey.

Respectfully submitted,

CONSUMERS ENERGY COMPANY

Dated: February 5, 2001

By: Richard Chambers

H. Richard Chambers
212 West Michigan Avenue
Jackson, Michigan 49201
Attorney for Consumers Energy Company
(517) 788-1482

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of CONSUMERS ENERGY COMPANY to recover electric restructuring implementation costs for the period ended December 31, 2000	))))))	Case No. U-12891

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 "**Exceptions of Consumers Energy Company**" 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 February 5, 2002, in the United States mail in the City of Jackson, Michigan with first-class postage thereon fully paid.

Holly J. Allen

Holly J. Allen

Subscribed and sworn to before me this 5th day of February, 2002.

Sammie B Dalton

Sammie B. Dalton
Notary Public, Jackson County, Michigan
My Commission Expires: 01/04/2004

ATTACHMENT 1 -- to Case No. U-12891

Administrative Law Judge

Honorable James N. Rigas
6545 Mercantile Way, Suite 14
P.O. Box 30221
Lansing, MI 48909-8195
Facsimile: 517-335-6696
E-Mail: jnrigas@michigan.gov

Counsel for the Michigan Public Service Commission Staff

Patricia S. Barone, Esq.
Assistant Attorney General
Public Service Division
6545 Mercantile Way, Suite 15
Lansing, MI 48911
E-Mail: baronep@michigan.gov

Counsel for Energy Michigan, Inc.

Eric J. Schneidewind, Esq.
Angela M. Brown, Esq.
Varnum, Riddering, Schmidt & Howlett
The Victor Center, Suite 810
201 N. Washington Square
Lansing, MI 48933
E-Mail: ejschneidewind@vrsh.com
ambrown@vrsh.com

Counsel for the Attorney General, Jennifer M. Granholm

Donald E. Erickson, Esq.
Assistant Attorney General
6520 Mercantile Way, Suite 2
P. O. Box 30736
Lansing, MI 48909
E-Mail: ericksond@ag.state.mi.us

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

Thomas E. Maier, Esq.
Robert A.W. Strong, Esq.
Robert A. LeFevre, Esq.
Clark Hill PLC
2455 Woodlake Circle
Okemos, MI 48864-5941
E-Mail: tmaier@clarkhill.com
rstrong@clarkhill.com
rlefevre@clarkhill.com