

STATE OF MICHIGAN
STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES
FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of	)	
CONSUMERS ENERGY COMPANY	)	
for determination of net stranded	)	Case No. U-14526
costs for the year 2004.	)	
_____	)	

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on June 6, 2006.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before June 20, 2006, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before June 27, 2006. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing of exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for

Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before they are due.

STATE OFFICE OF ADMINISTRATIVE
HEARINGS AND RULES
For the Michigan Public Service Commission

**Sharon L.
Feldman**

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Sharon L. Feldman
Administrative Law Judge

June 6, 2006
Lansing, Michigan
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PROPOSAL FOR DECISION

I.

PROCEDURAL HISTORY

This case presents Consumers Energy Company's (Consumers) application for stranded cost recovery for the year 2004. The company filed its application on November 21, 2005. A prehearing conference was held on January 18, 2006, at which intervention was granted to ABATE, Energy Michigan, the Attorney General, National Energy Marketers Association and Midland Cogeneration Venture Limited Partnership, and a schedule was established. This schedule was subsequently adjusted by agreement of the parties. Consumers' filing seeks a determination that the company had approximately \$24.1 million in stranded costs for 2004, which it proposes to offset with an equivalent amount of revenues from third-party sales for a net stranded cost of zero. Consumers also presented an accounting of its excess securitization savings that was not disputed.

Consumers presented the testimony of two witnesses, Jean Kurzynowski and Charles Belknap. In addition to his direct testimony, Mr. Belknap filed supplemental and rebuttal testimony. Energy Michigan presented the direct and rebuttal testimony of Richard Polich, and the Attorney General presented the testimony of Charles King. At a hearing on April 11, 2006, I denied Energy Michigan's motion to strike supplemental and rebuttal testimony of Mr. Belknap. The testimony of each witness was bound in without cross-examination. Each party filed briefs and reply briefs in accordance with the established schedule. ABATE and Staff did not present testimony but did file briefs and reply briefs setting forth their positions. National Energy Marketers Association and Midland Cogeneration Venture Limited Partnership did not present testimony or briefs. The evidentiary record for this case is contained in 126 pages of transcribed testimony and 15 exhibits.

II.

POSITIONS OF THE PARTIES

As indicated above, Consumers' filing seeks a determination that it had stranded costs of approximately \$24.1 million in 2004, which it seeks to offset by an equivalent amount of revenue from third-party sales. Consumers asserts that these calculations followed the methodology for determining stranded costs established by the Commission in prior cases, Cases Nos. U-12639, U-13380, U-13720 and U-14098. Ms. Kurzynowski testified to the cost and purpose of longer-term seasonal capacity purchases of approximately \$14.1 million included in the company's stranded cost

calculation,¹ and to the company's allocation of revenues from third-party sales to offset stranded costs.² Ms. Kurzynowski explained that of a total net revenue from third-party sales of \$47.1 million, the company allocated \$17.4 million to PSCR customers to reflect the allocation embedded in the 1997 PSCR rates, prior to the suspension of the PSCR clause and the 2000 PA 141 rate freeze;³ then the company allocated revenues exactly sufficient to offset the stranded costs it calculates, \$24.1 million, with the remainder also to be credited to PSCR customers. Mr. Belknap presented the exhibits that principally contain the company's stranded cost calculations, Exhibits A-1 and A-2, generally following the "revenue requirements" calculations from prior cases.⁴ He also presented supplemental Exhibit A-8, which modified the treatment of revenues from third-party sales and the treatment of PSCR costs to attempt to reflect a Staff proposal put forth in the company's PSCR case, U-14274.⁵ Exhibit A-8 reflects a stranded cost of approximately \$23.8 million, to be offset by \$1.5 million in revenues from third-party sales for a net stranded cost of \$22.3 million.

Mr. King, on behalf of the Attorney General, testified that Consumers has failed to establish that it has any stranded costs because it has not shown it did not recover costs because of competition.⁶ Energy Michigan's witness Mr. Polich argued for an allocation of all incremental third-party revenues (approximately \$29.7 million) to reduce stranded costs to a negative value, asserting that none of the revenues should be

¹ See Tr. 49-50, Exhibit A-5.

² See Tr. 51-52, Exhibits A-6 and A-7.

³ And see Exhibit A-7, line 10, note 6.

⁴ See Tr. 55-64. Revenue requirements related to the Clean Air Act are presented in Exhibit A-3; excess securitization savings are presented in Exhibit A-4.

⁵ See Tr. 66-69. As discussed below, in the company's 2004 and 2005 plan cases, the Commission deferred consideration of the allocation of third-party revenues to the respective reconciliation cases, U-13917-R and U-14274-R.

⁶ Tr. 108-111.

allocated to PSCR customers beyond those reflected in the 1997 PSCR rates, and took issue with numerous elements of the stranded cost calculation, identifying what he perceived to be errors in the inclusion of PSCR costs, and proposing alternatives reflecting a series of adjustments to the stranded cost calculations in Exhibits A-1 and A-2. These adjustments are presented in Exhibits EM-1 and EM-2, columns c, d and e. Mr. Polich also presented testimony similar to Mr. King's, asserting that the current market forces preclude the utility from incurring stranded costs because customers are not leaving the utility⁷, and in addition claiming that because the utility needs additional capacity, it has benefited from those retail customers who did become ROA customers.⁸ Finally, Mr. Polich testified in support of Energy's Michigan's request that the Commission require Consumers to provide ROA customers with power in exchange for the securitization bond charges and nuclear decommissioning costs paid by those customers.⁹ Mr. Polich's rebuttal testimony focused on Mr. Belknap's supplemental testimony and the calculations presented in Exhibit A-8.

Mr. Belknap's rebuttal testimony addressed Mr. King's and Mr. Polich's testimony, asserting that the company adhered to the correct formula for determining stranded costs, and testifying that Mr. Polich's adjustments to the stranded cost calculation are based on a confusion of PSCR costs with PSCR revenues, and power supply costs with PSCR costs.¹⁰ Mr. Belknap also addressed Mr. Polich's proposal to eliminate PSCR costs from the stranded cost calculation as set forth in column e of Exhibits EM-1 and EM-2, expressing a preference for the approach reflected in Exhibit

⁷ Tr. 97-98.

⁸ Tr. 99-100.

⁹ Tr. 101.

¹⁰ Tr. 70-75.

A-8¹¹, and opposed Mr. Polich's proposal to require the utility to provide power to ROA customers in exchange for their payment of securitization and nuclear decommissioning costs.¹²

With a few noteworthy exceptions, the briefs and reply briefs of these parties adopt the positions taken by their respective witnesses. The Attorney General advocates the position testified to by Mr. King that Consumers does not have stranded costs within the definition established by the Commission. Energy Michigan focuses its brief largely on the question of the allocation of revenues from third-party sales. With respect to the calculation of stranded costs before the allocation of any third-party revenues, Energy Michigan acknowledges certain errors in Mr. Polich's analysis, and presents revised exhibits as attachments to its brief setting forth a revised analysis and calculation of stranded costs.

Consumers stands by its calculation of stranded costs as reflected in its Exhibits A-1 and A-2, but does not take a strong position on the allocation of revenue from third-party sales, pointing out the policy implications of alternative approaches as reflected in its initial exhibits compared to Exhibit A-8, but opposing Energy Michigan's claim for all third-party revenues above the previously-credited amount. Consumers opposes the other adjustments proposed by Energy Michigan, and its proposal that ROA customers receive power in exchange for the payment of securitization and nuclear decommissioning costs.

Staff did not present testimony, but its briefs endorse the allocation of third-party revenues reflected in Exhibit A-8. While Exhibit A-8 also modified the stranded cost

¹¹ Tr. 75.

¹² Tr. 76.

calculations by eliminating PSCR costs, Staff's briefs do not address this element of Exhibit A-8 directly. Instead, Staff requests that the Commission adopt the stranded cost calculations presented in Exhibit A-1 if Staff's allocation of third-party revenues is rejected.¹³

ABATE did not present testimony, but its briefs endorse the Attorney General's argument that Consumers does not have any stranded costs, without regard to the allocation of revenues from third-party sales. ABATE and the Attorney General also endorse the allocation of revenues from third-party sales reflected in Exhibit A-8 and adopted by Staff. ABATE supports in part Energy Michigan's request that ROA customers receive power in exchange for payment of certain charges.

III.

DISCUSSION

Whether the costs identified by Consumers as stranded meet the Commission's definition of stranded costs is discussed in section A below. The appropriate allocation of third-party revenues is discussed in section B. Other aspects of the stranded cost calculation disputed by the parties are discussed in sections C and D. Energy Michigan's request for power in exchange for payment of charges assessed on ROA customers is discussed in section E. In accordance with the Commission's December 20, 2001 order in Case No. U-12639, Consumers has the burden of proof to establish that it has stranded costs greater than zero.¹⁴

¹³ Staff initial brief, p. 6.

¹⁴ Order, p. 10.

A. Stranded Costs--Definition

The Attorney General seeks a determination that Consumers did not have stranded costs for 2004 because it failed to establish that any of its unrecovered production fixed costs are costs that would have been recovered under regulation but cannot be recovered under competition. In support of his recommendation that Consumers' application for stranded costs be denied, the Attorney General relies on language from the Commission's prior stranded cost decisions correspondingly defining stranded costs as costs that would have been recovered under regulation that cannot be recovered under competition. Mr. King explained that Consumers' application of the stranded cost formula captures any shortfall in the recovery of production fixed costs, regardless of the reason.¹⁵ Mr. King testified:

The alleged stranded costs do not result from the departure of retail customers to ROA service, which is the standard for determining stranded costs. Rather, the apparent revenue shortfall in the recovery of production fixed costs resulted from two causes. First, residential rates were capped during 2004 under the provisions of §10d(2) of 2000 Public Act 141. Second, although Consumers could lawfully have increased its commercial and industrial rates during 2004, it failed to file for such increases until December 17 of that year. As a consequence, Consumers' 2004 retail base rates were insufficient to recover all of Consumers' costs, including production fixed costs. Once rate relief was granted in late 2005, Consumers' production fixed costs were fully recovered from retail customers. The shortfall in production fixed cost recovery was therefore the result of the inadequacy of retail full service rates, not the departure of ROA customers to alternative generation suppliers. Tr. 110-111.

Consumers' rebuttal testimony on this issue was limited to Mr. Belknap's testimony that the company had adhered to the formula for determining stranded costs established in Case No. U-12639 and applied in subsequent stranded cost cases, and

¹⁵ Tr. 110.

his description of the revenue requirements calculation.¹⁶ He asserts that Mr. King is proposing an entirely different method of determining stranded costs.¹⁷ In its briefs, Consumers also asserts that the Attorney General's argument imposes a subjective requirement on the stranded cost calculation, and also seems to assert that Mr. King's analysis is speculative, although it devoted little briefing space to analyzing the issue or prior commission decisions. Staff seems to oppose the Attorney General's position, but it does not directly address the Attorney General's argument that competition did not cause Consumers' underrecovery of fixed production costs.

I conclude that the Attorney General's recommendation should be accepted and the Commission should find that Consumers has failed to establish that any of the costs it claims are stranded meet the threshold requirement for stranded costs, that they are costs that would have been recovered under regulation but cannot be recovered under competition.

The unrefuted evidence on this record establishes that the revenue requirements calculation produces "stranded costs" of approximately \$24.1 million (prior to any credit for revenues from third-party sales) for only two reasons: the company's residential rates were capped by 2000 PA 141 and the company did not recover costs that could have been recovered from commercial and industrial customers had the utility sought timely rate relief. Neither of these reasons justifies a determination that the costs are "stranded" under the Commission's stranded cost formula:

The formula is "costs that would have been recovered under regulation than cannot be recovered under competition, offset by mitigation (such as market sales of capacity and energy that are freed up when customers choose alternative suppliers) and stranded benefits (such as generation

¹⁶ Tr. 70-71.

¹⁷ Tr. 71.

assets with below-market costs).” December 20, 2001 order in Case No. U-12639, p. 10. [November 23, 2004 order, Case Nos. U-13720 and U-14098, p. 4 n2.]

Consumers disputes that there is any threshold determination required, arguing that the Commission’s orders establish a “formula” (the revenue requirements calculation) that is simply to be applied without further analysis. I conclude this is an incorrect reading of the Commission’s prior orders. The Commission stated the “formula” for determining stranded costs in its order in Case No. U-12639, and in its November 23, 2004 order in Case Nos. U-13720 and U-14098 as quoted above. Consumers does not address or even acknowledge this language in either of its briefs. Instead, it relies on the following two quotations from the Commission’s prior decisions.¹⁸ From the December 20, 2001 decision in Case No. U-12639, Consumers cites the following:

When the revenue requirement for a specific year exceeds the revenues available to cover those costs, the utility has stranded costs for the year.
[*Id.*, p. 4]

This passage, however, is taken from a general description of the Staff’s method, and does not modify the Commission’s finding at page 10 of that decision quoted above, recognizing net stranded costs as “costs that would have been recovered under regulation that cannot be recovered under competition, offset by mitigation . . . and stranded benefits.” Consumers also relies on the following language from the Commission’s January 10, 2006 decision in Cases Nos. U-13380, U-13720 and U-14098:

The stranded cost method adopted by the Commission compares the revenue requirement for the fixed generation costs of the utility with the recovery available through revenues actually collected. See, December

¹⁸ Tr. 71, brief p. 8, reply brief p. 8-9.

20, 2001 order in Case No. U-12639, p. 10. In general, the Commission must determine if the utility collected enough revenues to cover its fixed generation costs. If not, it has stranded costs for that year. [*Id.*, p. 11.]

Again, nothing in this language modifies the Commission's prior determinations. Note that in this decision, the Commission held that rehearing and reconsideration should be denied—it does not modify the Commission's earlier orders, including the language relied on by the Attorney General. Nothing in the language quoted by Consumers indicates that the utility was to be guaranteed recovery of all of its fixed production costs, regardless of the cause. Note that in that passage quoted by the utility, the Commission uses of the qualification: "in general." Also, the Commission's discussion in this January 2006 decision shows that the record before it contained at least some evidence showing that Consumers could not recover all of its production fixed costs due to competition:

Consumers avers that stranded benefits arise, if at all, from the ability to sell at market prices the generating capacity that is "freed-up" by ROA load, or, under some circumstances, to avoid the purchase of generating capacity. Consumers contends that it has provided evidence in the referenced cases showing that it could not re-sell the capacity "freed-up" by ROA for the prices implied by Energy Michigan, and certainly could not avoid costs of this magnitude due to ROA participation. [January 10, 2006 Order, p. 8]

In this case, as to 2004 costs, there is no record evidence that would establish that any of Consumers' unrecovered fixed production costs were unrecovered because of competition.

A review of other elements of the Commission's stranded cost decision(s) also shows that it did not intend rote application of the stranded cost formula. The Commission rejected the inclusion of "variable" costs within the formula, finding that such costs are avoidable and thus not stranded. See Case No. U-12639, December 20,

2001 order, p. 16-17. In reaching this decision, the Commission also stated: “Likewise contracts for the purchase of unneeded capacity and energy are avoidable, and thus not stranded.” *Id.*, p. 17. In its November 23, 2004 order in Cases Nos. U-13720 and 14098, p.11, the Commission adopted Staff recommendations to include “imputed” sales revenue from special contract discounts, and agreed that short-term purchase power costs are avoidable, within the control of Consumers, and are thus not stranded costs.

The Commission has thus made clear that costs that can be avoided are not “stranded” costs, and costs that were not reasonably and prudently incurred are not “stranded costs”. Clearly, the failure to seek rate relief at meaningful times does not establish that the costs that could have been recovered were reasonably “stranded” in the sense of “unrecovered”. Likewise, any underrecoveries due strictly to the legislatively imposed rate freeze are not “stranded” within the meaning of the Commission’s formula.

Also, I cannot find and no party has suggested that there is a presumption that stranded costs exist this year simply because they existed in past years. The Commission has determined that negative stranded costs do not carry forward to future years. The Commission’s determination that net stranded costs cannot be less than zero shows that the Commission intended the concept to have some inherent meaning beyond rote computation.

Consumers’ brief, p. 8, attempts to characterize the Attorney General’s analysis as calling for a “subjective” determination. Consumers does not elaborate, but determining whether the utility failed to recover its fixed production costs in 2004

because of competition is not inherently speculative. Nor does Mr. King's testimony purport to be anything other than the product of reasoned, expert analysis. Consumers had ample opportunity to rebut Mr. King's factual conclusions with concrete objective analysis of its own and it failed to do so. If Mr. King's analysis were "subjective", then presumably Consumers could have explained how differing conclusions could be reached from the same underlying data. Again, it did not. Consumers' reply brief, in the context of addressing ABATE's argument supporting the Attorney General's position, also characterizes as "speculative" the claim that failure to seek timely rate relief accounts for some of the utility's underrecovery.¹⁹ Again, this claim is supported by Mr. King's unrefuted testimony, and his conclusions are not inherently speculative.

Staff addresses the Attorney General's position only in its reply brief, focusing on the Attorney General's assertion that the unrecovered costs measured by Consumers' revenue requirements calculation are not caused by the departure of retail customers to the ROA program. Staff claims that the loss of customers to the ROA program is not the standard or definition for stranded costs, but Staff does agree that stranded costs should be defined as costs that would have been recovered under regulation but cannot be recovered under competition.²⁰ This is the same definition principally relied on by the Attorney General.²¹ Staff does not directly address whether the costs produced by the revenue requirements calculation meet this definition or not.²² Nor does Staff directly challenge Mr. King's testimony that there were only two reasons why

¹⁹ Reply brief, p. 9.

²⁰ See Staff reply brief, p. 3, and p. 10 at n8 and n10.

²¹ See King, Tr. 110, lines 8-10; Tr.111, lines 15-17 and lines 21-24.

²² Staff does assert in its reply brief, p. 2, that Consumers "concisely articulated the stranded cost methodology that the Commission adopted in Case No. U-12639," and that "[t]he definitions and standards employed by EM and the AG do not meet this concise definition." But Staff does not explain how Consumers' calculations reflect "costs that would have been recovered under regulation that cannot be recovered under competition."

Consumers failed to recover all its fixed production costs as shown by the revenue requirements calculation: the rate cap and Consumers' failure to seek rate relief.

Staff's argument that the Attorney General has applied the wrong definition of stranded costs is also difficult to understand in light of Staff's further analysis of the Commission's definition of stranded costs. Staff argues that to understand the Commission's stranded cost methodology, since the Commission approved the Staff's recommended approach, it is appropriate to review the testimony of Staff's witness from that case.²³ Staff attached Mr. Carlson's testimony to its reply brief. In that testimony, Mr. Carlson describes the methodology as follows:

Staff is using a revenue requirement approach to estimating stranded costs. Staff recognizes that companies have fixed costs in the form of investments in generating plants and purchased power agreements (as well as in the form of certain regulatory assets) which were expected to have been recovered over time through the sale of electricity to customers. If a company loses sales to retail open access, the full recovery of those fixed costs may be impaired. The Staff approach to stranded costs is to first calculate the annual level of these fixed power supply costs, and then to compare the amount of these annual fixed costs to the revenues from the sale of electricity which are applicable to meet these fixed costs. If the revenues received which are applicable to meet fixed costs are less than those costs, then the short-fall represents the maximum level of stranded costs. [Staff reply brief, Attachment 1, pp. 1-2]

He then explained why the calculated short-fall would be the maximum level of stranded costs:

If a company's sales should fall for reasons other than a loss of customers due to retail open access, a short-fall in the recovery of fixed costs may be observed, but this short-fall would not be referred to as a stranded cost, if that term is used to refer to short-falls caused by retail open access. [Staff reply brief, Attachment 1, p. 2]

²³ See Staff reply brief, pp. 3-4, 9-11.

Thus, Staff's presentation appears to support the Attorney General's analysis, that the revenue requirements calculations provided for in the stranded cost methodology are not sufficient to establish the existence of stranded costs.

I find that Mr. King applied the correct definition of stranded costs in his testimony, recognizing that stranded costs must be costs that would have been recovered under regulation that cannot be recovered under competition. The obvious reason for the company to be unable to recover costs under competition would be the departure of customers to the ROA program. Rather than creating a new standard, Mr. King's testimony simply reflected a natural understanding of the expected form of competition that would prevent the utility from recovering its costs, the ROA program. While there may be other forms or impacts of competition that would prevent the utility from recovering costs it would otherwise recover under regulation, and it may be appropriate to consider those costs as "stranded" costs, there is no evidence on this record that any of Consumers' unrecovered costs were unrecovered due to competition of any form. Instead, Mr. King's analysis identified two other causes of the underrecovery, as explained above.

For these reasons, I recommend the Commission find that Consumers failed to establish that it had any stranded costs in 2004. A threshold requirement that the utility establish that at least some of its failure to recover fixed production costs was attributable to competition is not an unreasonable burden. Costs that can be recovered under regulation should not be considered stranded. The alternative advocated by Consumers, rote application of a revenue requirements calculation that provides guaranteed recovery of all fixed production costs, essentially permits the utility to

choose the group of customers to pay those costs, and may have other unintended consequences. For example, if the utility can choose to defer a rate increase to recover costs from its sales customers, it can force its choice customers to pay costs that are in no meaningful sense stranded, leaving the utility with no risk and deterring competition. While stranded costs need not be determined with great precision, it is one thing to allow the utility annually to recover all fixed cost shortfalls within a calendar year if it actually has “stranded” costs for that year, but it is another thing to preclude the threshold question from being asked whether any of the utility’s unrecovered production costs are attributable to decisions that were made with the expectation the costs would be recovered through regulation but cannot be recovered because of competition. Consumers has made no such showing in this case.

B. Third-party Revenues

Even though it is my recommendation that the Commission find that Consumers has failed to meet its burden to prove that it has any stranded costs, for the reasons discussed above, nonetheless it is appropriate to attempt to resolve the disputes among the parties as to how stranded costs should be computed in the event that recommendation is rejected. The most contentious dispute among the parties in determining net stranded costs is the allocation of net revenues received from third-party sales.

Consumers’ filing reflects approximately \$49.1 million in net revenues from sales to third parties, “net” after variable costs such as the fuel used to produce the power that generated those revenues are subtracted. All parties seem to agree that the amount of net third-party revenues used to offset PSCR rates prior to the PSCR clause

suspension and the 2000 PA 141 rate freeze, approximately \$17.4 million, should continue to be allocated to PSCR rates, leaving “incremental” net third-party revenues of \$29.7 million to be allocated.

Consumers advocates assigning sufficient revenues to stranded costs to fully offset the stranded costs it calculates. In support of the company’s proposal, Ms. Kurzynowski explained that Consumers’ filing follows the approach used in prior stranded cost cases, when the PSCR factor was frozen: the incremental third-party revenues are used to offset calculated stranded costs.²⁴ Because the Commission does not recognize “negative” net stranded costs, Consumers first determined to fully offset stranded costs, accounting for approximately \$24.1 million, and would then credit the rest to PSCR customers.²⁵

Staff, ABATE²⁶ and the Attorney General advocate allocating the revenues in accordance with Staff’s proposal in the pending 2004 PSCR reconciliation case, U-13917-R, which would be most relevant for this case, and also Case No. U-14274 for 2005 PSCR costs. In supplemental testimony filed on March 7, 2006, Mr. Belknap presented a calculation Staff asked him to produce during its audit of the company.²⁷ In this calculation, Exhibit A-8, Mr. Belknap has modified the calculations otherwise reflected in his Exhibits A-1 and A-2 to reflect the proposed allocation of revenues from energy and capacity sales to third parties that Staff made in the PSCR cases.

²⁴ See Exhibits A-6 and A-7; Exhibit A-1, line 18.

²⁵ See also Belknap, Tr. 72, 76-77.

²⁶ See ABATE reply brief, pp. 4-5. Consumers appears to incorrectly characterize ABATE’s position as aligned with Energy Michigan’s request for full allocation of incremental third-party revenues to offset stranded costs. See Consumers’ reply brief, p. 9.

²⁷ Tr. 66. This testimony was filed after the scheduled date for Staff and Intervenor filings, and before the schedule date for rebuttal filings.

The utility does not support this calculation. Consumers' brief instead asserts that the allocation of third-party revenues is really a policy choice to be made by the Commission, and points out arguments in favor of each approach, but requests that the Commission adopt the allocation reflected in the company's filing.

Energy Michigan proposes allocating all "incremental" third-party revenues to the stranded cost calculation, even if it results in negative stranded costs, because it asserts that these revenues were obtained due to capacity made available by utility customers becoming retail open access customers. Energy Michigan argues there is no record support for Staff's recommendation, because only the calculation itself is in the record, but the "theory" underlying it is not supported by a witness.²⁸

Both Staff and the utility essentially make a consistency argument regarding the treatment of these revenues. Staff's brief asserts that consistency with whatever decision the Commission makes in Case No. U-13917-R is required.²⁹ Consumers witness Mr. Belknap supported this with express testimony at Tr. 60:

If the Commission determines that an allocation of third-party sales net revenues different from that shown on Exhibit A-1 (CFB-1) is appropriate for 2004, the resulting stranded cost must be recovered from ROA customers through a stranded cost recovery charge. . . . The allocation of third-party sales net revenues requires alignment between the 2004 PSCR reconciliation case (U-13917-R) and this stranded cost proceeding (U-14526) so that the total third-party sales net revenue allocate does not exceed the total amount available (i.e. avoid double counting).

Moreover, testimony is principally required to develop a factual record—no one has identified any missing facts to support Staff's contentions. Thus, I reject Energy Michigan's argument that the record is insufficient to support Staff's recommendation.

²⁸ Energy Michigan brief, pp. 4-5.

²⁹ See Staff brief, p. 5; Consumers reply brief, p.3.

Energy Michigan also argues that because Staff did not file testimony on this issue, it was deprived of a meaningful opportunity to conduct discovery, and present rebuttal, and could not conduct cross-examination because there was no Staff witness for it to cross-examine. These are arguments I previously rejected in denying Energy Michigan's motion to strike. Because Energy Michigan did have the opportunity to present rebuttal testimony on this issue, and indeed did present rebuttal testimony on this issue, I concluded Energy Michigan was not prejudiced. As indicated above, the primary purpose for testimony is to develop a factual record; Energy Michigan has not asserted that Staff had access to key facts that it was precluded from discovering. Any factual information Energy Michigan determined to be relevant to full consideration of this issue by the Commission on this record it had the opportunity to present.

I recommend that the Commission allocate revenues from third-party sales consistent with the allocation it adopts in the pending PSCR reconciliation case. This recommendation is supported by testimony in this proceeding, and is supported by compelling logic. There is no need for the Commission to consider the issue on policy grounds based on two different records. The Commission has already expressed a preference for the forum in which this determination is to be made. In its February 28, 2005 decision in Consumers' PSCR plan proceeding, Case No. U-13917, the Commission discussed the allocation of third-party revenues, acknowledged that the same revenues should not be allocated twice, and deferred it to the company's PSCR reconciliation:

The Commission finds that Consumers is correct in concluding that net revenues from third-party sales cannot be used to offset both PSCR costs and stranded costs. However, because the actual levels of Consumers' 2004 third-party sales are not yet known, the Commission defers this

issue of the application of those sales to the reconciliation proceeding.
[*Id.*, p. 6]³⁰

It clearly makes sense that the same revenues would not be allocated twice. The Commission also endorsed this logic in its decision in Case No. U-12639 when it addressed Detroit Edison's concerns with the potential double-counting of revenues from third-party sales:

[Detroit Edison] also argues that because its frozen rates include a frozen power supply cost recovery (PSCR) factor, and that frozen PSCR factor includes a credit for third-party sales, its rates already reflect a credit for third-party sales [I]t is not likely that the Staff has significantly double-counted revenues from third-party sales. Although the frozen PSCR factor includes some amount for those sales, the revenues from the third-party sales can be expected to increase as customers choose ROA service and the utility's sell the freed-up capacity and energy on the market. More important, Detroit Edison could have offered evidence on the record to support its position, but did not. [December 20, 2001 order, pp. 17-18]

Here, any double-counting can be avoided if the allocations are consistent, and it is my recommendation that the Commission allocate net revenues from third-party sales in this case in accordance with its decision in Case No. U-13917-R.

In addition to the compelling argument in its initial brief that the allocation of third-party revenues should be consistent with the Commission's decision in Case No. U-13917-R, Staff presents additional arguments in its reply brief, arguing that law and policy compel the result it advocates. Legally, Staff argues that MCL 460.10a(19) precludes an alternative allocation of third-party revenues. This section provides:

After the time period described in section 10d(2), the rates for retail customers that remain with or leave and later return to the incumbent electric utility shall be determined in the same manner as the rates were determined before the effective date of this section.

³⁰ See also June 30, 2005 order, Case No. U-14274, p. 14, deferring the issue in the 2005 PSCR cost case to that reconciliation.

Staff asserts that because PSCR customers historically were credited with third-party revenues, this section requires that PSCR customers must continue to be credited with third-party revenues. First and foremost, because I find the Commission is addressing this in the reconciliation case(s), I do not make any recommendation regarding Staff's legal argument. I note, however, that based on the analysis presented in this case, it is hard to conclude that the legislature intended to bind the Commission in perpetuity to any particular rate-making methodology employed prior to the enactment of 2000 PA 141, or to preclude the Commission from the ordinary exercise of discretion that is a hallmark of traditional ratemaking authority.

On a policy level, Staff delves into its rationale for the allocation of net third-party revenues it advocates in the PSCR reconciliation cases to challenge Energy Michigan's reliance on the approach taken in prior stranded cost cases. In presenting its policy argument, Staff cites to testimony from the 2005 PSCR case.³¹ Because I find Staff's consistency argument compelling, and because the record in this case does not comprehensively include evidentiary and legal presentations of parties to the PSCR cases, I decline to offer a policy recommendation as to the basis on which revenues should be allocated to PSCR customers in this proceeding. As explained above, I believe it is in any event properly a question to be resolved in the PSCR context.

Likewise, I reject Energy Michigan's and Consumers' invitations to make policy recommendations regarding the allocation of third-party revenues based on this record. Consumers argues that the allocation of third-party revenues is "for the most part, a policy decision for the ALJ and Commission to resolve", to include consideration of "the

³¹ See Staff reply brief, pp. 4-6.

impact on the ROA program of increasing the amount of stranded costs that are payable by ROA customers, and the impact on PSCR customers of diverting a portion of third party net revenues to pay for stranded costs.” Consumers brief, p. 9. Energy Michigan argues that all incremental third-party revenues should be used to offset the stranded cost calculation, relying on Mr. Polich’s testimony that the third-party sales would not have been possible without capacity “freed up” by ROA customers.³²

Mr. Polich explained the basis for his conclusion as follows:

The discovery responses provided by Consumers demonstrate that 2004 third party sales were approximately 2.24 million MWh and ROA sales were approximately 4 million MWh. . . . If Consumers had been serving the load on ROA under full service rates, the amount of third party sales would have disappeared. In addition, Consumers would have been placed in the position of increasing its power purchases since the ROA sales exceed third party sales by 1.6 million MWh. I therefore conclude that all third party sales resulted from MWh freed up by the ROA program. Tr. 90.

As a factual matter, Mr. Polich’s conclusion is not supported by his analysis. Historically, the company has had third-party sales revenue, and these revenues have been credited to PSCR customers as part of the PSCR process. As Consumers responds in its reply brief, p. 2:

Such a conclusion is plainly not supported by Mr. Polich’s simple comparison of the annual amount of ROA load to the annual amount of third party sales. Consumers Energy engaged in third party sales of electricity before there was a retail open access program, and these sales are at least somewhat independent of the ROA load. Further, Mr. Polich conducted no analysis of the hourly relationship of third party sales to ROA load to see whether third party sales always equaled or exceeded ROA load.³³

Consistent with Consumers’ argument, Ms. Kurzynowski explained that Consumers maintains a capacity reserve margin of 11% to meet the needs of its present customers.

³² See Tr. 90.

³³ See also ABATE reply brief, p. 4.

There is no evidence on this record that would indicate, for example, whether sales to third-parties reflect sales of capacity or energy available to the utility but not needed to meet planned for peak demand. While I note this limitation to Mr. Polich's analysis, it is not possible on this record to meaningfully evaluate relative cost responsibility or other equitable considerations to determine an appropriate disposition of third-party revenues, and I decline to do so, in deference to the records created in the PSCR reconciliation cases.

C. Energy Michigan's Revised Calculation

Energy Michigan's initial testimony focused on a perceived mismatch in the allocation of costs and revenues to the stranded cost calculation. Mr. Polich testified that 98% of the costs were allocated to the calculation, but only 89% of revenues.³⁴ Mr. Polich proposed alternatives to reflect this perceived discrepancy in columns c, d and e of his Exhibits EM-1 and EM-2. Consumers' rebuttal testimony denied any mismatch, asserting that it appropriately reflected power supply costs and revenues in the calculation of stranded costs.³⁵ Consumers brief did not address Mr. Polich's analysis in any detail, indicating it would wait to see how the analysis was reflected in Energy Michigan's brief.³⁶

³⁴ Tr. 87-88.

³⁵ Belknap, Tr. 71-74.

³⁶ Consumers' initial brief also asserts that consideration of the stranded cost calculation adjustments recommended by Mr. Polich was somehow foreclosed by the Commission's notice in this proceeding. Brief, p. 7. Consumers does not state what portion of the Commission's notice it is relying on. I have read the notice carefully, and the only context in which it discusses a methodology for determining stranded costs is in characterizing the company's filing. The notice clearly indicates the hearing is to consider the company's filing: this language does not preclude the Commission from considering arguments challenging that filing. While the Commission may find some or all of Energy Michigan's arguments addressed and adequately resolved by the Commission's prior decisions, nothing in the notice of hearing precludes Energy Michigan from advancing its position. The Commission also has made clear that the methodology for determining stranded costs is an evolving one, and also that it would revisit the

Energy's Michigan's initial brief candidly acknowledges the calculation of the 89%/98% difference was erroneous, but through attachments to its brief, seeks to substitute a new comparison resulting in a 93%/98% difference, and an alternative approach to addressing the perceived discrepancy in the calculation of stranded costs. Energy Michigan's revised calculations adjust the company's revenue requirements calculations, both to establish the fixed costs the company could recover in 2004 (compare Exhibit A-1, lines 1 through 11 with Energy Michigan's Attachment B) and the percent of revenues that should be allocated to recovery of those fixed costs (compare Exhibit A-2 with Energy Michigan's Attachment C), to reflect what Energy Michigan argues is a more equitable allocation of costs.

To determine costs that are eligible for stranded cost recovery, Consumers identifies "jurisdictional" fixed costs, including plant and longer-term purchased power agreements.³⁷ By "jurisdictional", Consumers means retail as opposed to wholesale.³⁸ Energy Michigan's argument starts with the premise that to be equitable, the allocation of the utility's fixed costs to the stranded cost calculation should be equivalent to the percent of total company sales that are considered "jurisdictional".³⁹ Relying in part on two exhibits that are not part of the record of this proceeding, Energy Michigan estimates that 93% of the company's sales were "retail" sales, while 7% were wholesale.⁴⁰ Energy Michigan's Attachments B and C readjust the allocation of the

appropriate approach when the rate caps expire. See Case No. U-12639, December 20, 2001 order, p. 14, p. 30.

³⁷ See Exhibit A-1, lines 1-11.

³⁸ Presumably, costs that are not attributable to the company's Michigan-regulated utility service do not meet the definition for stranded costs, because the utility could not have expected to recover those costs through state regulation.

³⁹ Energy Michigan brief, p. 12.

⁴⁰ See Energy Michigan's brief, pp. 10-11. Note Energy Michigan cites Exhibits A-13 and A-22 from Case No. U-13917-R, not part of this record.

company's fixed costs in that proportion—and make adjustments to the base revenue amount used to determine the portion of revenues that recover fixed costs as it determines appropriate to coordinate with this adjustment. The result is an estimate of stranded costs of approximately \$12.5 million, without consideration of third-party revenues.⁴¹

I recommend the Commission reject Energy Michigan's adjustment to the stranded cost calculation because I find the premise to be unsupported. It is not clear that fixed costs should be determined to be "jurisdictional", or correspondingly subject to recovery under the stranded cost formula, based simply on the percentage of sales volumes represented by retail sales. Instead, cost of service studies and accounting procedures used to produce a determination of jurisdictional costs are complex and consider other factors than simply kilowatt-hours sold. I also note that Energy Michigan's rhetorical argument, asserting that 98% of costs are allocated to Retail Open Access customers, is not accurate: instead, the revenue requirements calculations determine the fixed costs Consumers did not recover during a calendar year. Energy Michigan has not provided a basis to conclude that either the costs were overstated or that the offsetting revenues were understated. While Consumers asserts that Energy Michigan's analysis at the root is a dispute about third-party revenues, which are discussed above, Consumers also correctly points out that the point of the calculation is to use retail costs and revenues—the costs that the Commission could assign to customers in a regulatory proceeding—and that the allocation of costs between retail and wholesale are based on a jurisdictional study, and that the revenues used in the

⁴¹ See Energy Michigan's brief, pp. 12-13, and Attachments B and C.

calculation as available to cover these costs are recorded separately on the company's books.⁴²

Consumers objects to Energy Michigan's reliance on evidence outside the record and recommends that references to non-record exhibits and the Intervenor's revised calculations in Attachments B and C be stricken. Acknowledging that the exhibits cited are not part of the evidentiary record in this case, and therefore should not be relied on to establish disputed facts, I do not see any value in formally striking Energy Michigan's submission. The Commission is unlikely to be confused regarding what is record evidence in this proceeding, and I am recommending that Energy Michigan's alternative calculation of stranded costs be rejected because Energy Michigan has failed to establish that it is an analytically valid methodology.

D. PSCR Costs

In past stranded cost cases, PSCR costs have been included in the stranded cost calculations: longer-term fixed supply contracts were treated as a cost eligible for stranded cost recovery (see line 8 of Exhibit A-1); and PSCR costs and revenues were included in determining the percent of revenues that recover the company's fixed costs (see Exhibit A-2, lines 7, 17-18, 20-21). Certain fixed power supply costs were considered eligible for stranded cost recovery because they could not be avoided and because the PSCR freeze may have prevented the company from fully recovering these costs. The historical base costs and revenues used to determine the percentage of fixed costs recovered through revenue received by the company were correspondingly adjusted to reflect the most recent year (1997) PSCR costs had been reviewed. 2004

⁴² Consumers reply brief, p. 4.

marked the first year in which the PSCR process was reinstated. Ms. Kurzynowski testified that the company followed the same methodology as in prior stranded cost cases. Her testimony supported including certain longer-term seasonal capacity contracts, also PSCR costs, as a cost eligible for stranded cost recovery.⁴³

As Mr. Belknap explained in his supplemental testimony, Exhibit A-8 was intended to reflect the Staff's proposal in the company's pending PSCR cases, and in addition to containing an alternative allocation of third-party revenues, the exhibit eliminates the PSCR costs from the stranded cost calculation.⁴⁴ As Consumers' brief indicates, the difference in the calculation of stranded costs is relatively small using this approach compared to the company's approach. While the company calculated stranded costs of \$24.1 million without regard to third-party revenues, Exhibit A-8 shows a stranded cost calculation of \$23.8 million without regard to third-party revenues.⁴⁵

Although Mr. Belknap testified that this was Staff's approach, Staff does not address the treatment of PSCR costs in this stranded cost case either in its brief or in its reply brief.⁴⁶ Both Staff and Consumers appear to view the inclusion of PSCR costs in the revenue requirements calculation as a corollary of the allocation of third party revenues, each contending that the Exhibits A-1 and A-2 revenue requirements calculation should be used in conjunction with Consumers' allocation of third-party revenues, and the Exhibit A-8 calculation should be used in conjunction with Staff's

⁴³ Tr. 48-49.

⁴⁴ Mr. Polich initially identified errors in Exhibit A-8, but Energy Michigan in its brief, p.9, forthrightly acknowledges on further analysis that the double-counting it was concerned with did not occur.

⁴⁵ Exhibit A-8, line 20 + line 18 = \$13,775,000.

⁴⁶ Staff's reply brief, p. 5, does seem to acknowledge that PSCR costs should not be included, quoting Mr. Ancona's testimony in Case No. U-14274, but Staff does not seek any recommendation from the Commission on this issue, or challenge the inclusion of these costs in Mr. Belknap's Exhibits A-1 and A-2.

recommended allocation of third-party revenues.⁴⁷ But there is no obvious link between the treatment of PSCR costs in the revenue requirements calculation and the allocation of third-party revenues. While Energy Michigan does not support the specific alternative revenue requirements calculations presented by Mr. Polich, as discussed above, Mr. Polich testified that PSCR costs should be eliminated from the revenue requirements calculation.⁴⁸ I conclude that the logic underlying the inclusion of these costs in the calculation appears to have expired, and the reasonable presumption is that all reasonably and prudently incurred PSCR costs will be recovered through the PSCR process and could not be considered “stranded”. For these reasons, recognizing that Consumers does not appear to object, and recognizing that it presented no argument in favor of continuing to include PSCR costs in the revenue requirements calculation now that PSCR rates are no longer frozen, I recommend that the \$23.8 million reflected in Exhibit A-8 be used as the appropriate measure of the company’s unrecovered fixed costs, prior to the appropriate offset for revenues received from third-party sales.

E. Energy Michigan’s Power Supply Proposal

Energy Michigan also advances a proposal that in exchange for payment by ROA customers of securitization bond charges and nuclear decommissioning charges, the customers should have the option of obtaining an amount of power equivalent in cost to the ROA payments.⁴⁹ ABATE supports Energy Michigan’s position, at least in part, asserting that the requirement that ROA customers pay nuclear decommissioning

⁴⁷ Consumers brief, p. 6; Staff brief, p. 5.

⁴⁸ See Tr. 92-96, Exhibit EM-4.

⁴⁹ See Polich, Tr. 101; brief, p. 19.

charges is unjustified.⁵⁰ Consumers strongly opposes this proposal.⁵¹ Consumers' reply brief traces the history of the assessment of these charges, indicating that the Commission authorized the securitization charge to be collected from all customers in its October 24, 2000 order in Case No. U-12505, p. 41; and the Commission approved a contested settlement agreement in its September 20, 2005 order in Case No. U-14150 that required the nuclear decommissioning charges to be paid by all customers. Consumers quotes language from the Commission's recent decision in Consumers' rate case to establish that the Commission has found that assessment of these charges is not unfair.⁵² In its December 22, 2005 order in Case No. U-14347, the Commission rejected Energy Michigan and ABATE requests to change the allocation of securitization and nuclear decommissioning costs:

This argument has been previously addressed, and the Commission sees no reason to deviate from its previous rulings. Act 142 provides that securitization charges are nonbypassable, and, thus, must be imposed on all customers. . . . The Commission has likewise had a long-standing policy that nuclear decommissioning charges should be paid by all customers. [Order, p. 75, citations omitted.]

With only an oblique reference to the Court of Appeals decision in *Consumers Energy v MPSC*, 268 Mich App 171; 707 NW2d 633 (2005), Energy Michigan has failed to establish that a decision on such a matter is appropriately within the scope of this proceeding, which was triggered by and noticed to evaluate Consumers' stranded cost filing. Nonetheless, it is also clear to me that the Commission has recently reaffirmed the appropriateness of these charges in its decision in Case No. U-14347⁵³, for good and valid reasons, and that Energy Michigan's proposal is contrary to the basis on

⁵⁰ ABATE brief, p. 2.

⁵¹ See Belknap, Tr. 76; reply brief, pp. 7-8.

⁵² Consumers reply brief, p. 8.

⁵³ December 22, 2005 order, pp. 75, 88.

which the securitization and nuclear decommissioning charges have been assessed. For these reasons, I recommend that the proposal be rejected.

IV.

CONCLUSION

For the reasons explained above, I recommend that the Commission find that Consumers does not have stranded costs for 2004 because it has not shown it has any unrecovered costs due to competition. If this recommendation is rejected, I further recommend that the Commission offset Consumers' calculation of stranded costs of \$23.8 million in Exhibit A-8 with net revenues from sales to third parties in an amount consistent with the Commission's decision in Case No. U-13917-R. I further recommend that the Commission reject the other modifications to the stranded cost calculations proposed by Energy Michigan, and that the Commission reject the request that ROA customers receive power in exchange for payment of nuclear decommissioning and securitization bond charges previously assessed by the Commission.

STATE OFFICE OF ADMINISTRATIVE
HEARINGS AND RULES
For the Michigan Public Service Commission

**Sharon L.
Feldman**

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Feldman
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US
Date: 2006.06.06 10:08:05 -04'00'

Sharon L. Feldman
Administrative Law Judge

ISSUED AND SERVED: June 6, 2006

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

STATE OF MICHIGAN	)		
	)	SS.	Case No. U-14467
County of Ingham	)		
_____	)		

P R O O F O F S E R V I C E

Dawn M. Prawdzik deposes and says that on the 6th day of June 2006, she served a copy of the attached Proposal for Decision upon those persons shown on Attachment A, by enclosing same in a sealed envelope addressed as indicated above and delivering the envelope to the Commission's mail courier for (1) postage prepayment and deposit with the United States Postal Service, or (2) delivery through interdepartmental mail (I.D.M.).

**Dawn M.
Prawdzik**

Digitally signed by Dawn M.
Prawdzik
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C = US
Date: 2006.06.06 10:09:23 -
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Subscribed to before me this 6th
day of June, A.D. 2006.

Notary Public, Ingham County, Michigan

My Commission expires 8-16-2011.

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