

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	)	
approval of a power supply cost recovery	)	Case No. U-14701
plan and authorization of power supply	)	
cost recovery factors for calendar year 2006.	)	
_____	)	

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 May 25, 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 8, 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 19, 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

**Mark E.
Cummins**

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Mark E. Cummins
Administrative Law Judge

May 25, 2006
Lansing, Michigan
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PROPOSAL FOR DECISION

I.

HISTORY OF PROCEEDINGS

On September 30, 2005, Consumers Energy Company (Consumers) filed an application--with supporting testimony and exhibits--seeking approval of its power supply cost recovery (PSCR) plan, five-year forecast, and PSCR factors for calendar year 2006, all pursuant to section 6j of 1982 PA 304 (Act 304), as amended, MCL 460.6j. According to that application, Consumers sought authority to apply, for each month in 2006, a maximum \$0.01011 per kilowatt-hour (kWh) PSCR factor.¹

On October 13, 2005, Consumers supplemented its application by indicating that it had overlooked an upward adjustment in the PSCR factors to be paid by residential customers of \$0.00139 per kWh to reflect termination of the 5% rate reduction

¹ Previously, the Commission's June 30, 2005 order in Case No. U-14274 authorized Consumers to implement a PSCR factor of up to \$0.00737 per kWh in its monthly bills to its retail electric customers who were not subject to the rate caps set forth in Section 10d(2) of 2000 PA 141 (Act 141) during the company's 2005 plan year. However, in order to maintain compliance with Section 10d(2) of Act 141, the applied factor was capped at \$0.00350 per kWh for residential customers.

mandated by Act 141. In so doing, Consumers stressed that this matter would be moot if the Commission issued a final rate order in Case No. U-14347 by January 1, 2006.²

Consumers submitted a second supplemental filing on November 2, 2005 (November 2 filing). This filing indicates that the utility's electric transmission provider, Michigan Electric Transmission Company, LLC, (METC) filed--with the Federal Energy Regulatory Commission (FERC)--a request to increase its electric transmission rates for 2006.³ The November 2 filing further reflects that Consumers' projected 2006 coal costs increased subsequent to the utility's initial filing. Finally, it points out that Consumers recently entered into various power purchase agreements pursuant to its renewable resources program approved in Case No. U-13843, thereby raising the utility's expected PSCR costs. The result of the increased cost projections set forth in the November 2 filing would, Consumers states, justify imposing a PSCR factor of up to \$0.01163 per kWh during 2006.

Pursuant to due notice, a prehearing conference was held on November 9, 2005, at which time Administrative Law Judge Mark E. Cummins (ALJ) granted the petitions to intervene filed on behalf of the following: the Michigan Environmental Council and the Public Interest Research Group in Michigan (MEC/PIPRGIM); Attorney General Michael A. Cox (Attorney General); the Residential Ratepayer Consortium (RRC); Michigan Power Limited Partnership and Ada Cogeneration Limited Partnership; (collectively

² The Commission subsequently issued that rate case order on December 22, 2005, increasing the base PSCR factor contained in Consumers' general rates to \$0.03057 per kWh (\$0.02814 per kWh at generation) for all customers. As a result, the October 13, 2005 supplement need not be addressed in this proceeding.

³ Consistent with the requirements of Section 10w of Act 141, Consumers sold its transmission system to METC by the close of 2001 and now purchases its transmission service requirements pursuant to the rates, terms, and conditions of service set forth in the Midwest Independent Transmission System Operators, Inc.'s (MISO) Open Access Transmission Tariff.

referred to as the QFs); Energy Michigan; and the Midland Cogeneration Venture Limited Partnership (MCV).⁴ Consumers and the Commission Staff (Staff) also participated in the proceedings, during which a schedule was established for the remainder of the case.

On November 10, 2005, the Commission issued an order directing the parties to participate in an expedited hearing to determine whether it should establish a temporary PSCR factor for Consumers--pursuant to Section 6j(8) of Act 304--or allow self-implementation of the factor requested in the utility's filings--pursuant to Section 6j(9) of the Act. In so doing, the Commission directed Consumers to file a statement identifying the specific factor it intended to implement on January 1, 2006, along with any additional testimony supporting use of that factor. The Commission further directed the ALJ to set a schedule that provided for the hearings on the issue of a temporary order to be completed and for all briefs to be filed no later than December 16, 2005.

Toward that end (1) a second prehearing was conducted on November 22, 2005, (2) testimony concerning the necessity of establishing a temporary factor was sponsored by witnesses for Consumers, the Attorney General, and the Staff, (3) all such testimony was cross-examined on December 7, 2005, (4) initial briefs concerning the establishment of a temporary factor were filed on December 12, 2005 by Consumers, the Attorney General, MEC/PIRGIM, and the Staff, and (5) reply briefs concerning that issue were submitted on December 16, 2005 by Consumers, the Attorney General, and the Staff. On December 22, 2005, the Commission issued an order in this proceeding (the December 22 order) authorizing the utility to implement temporary PSCR factors

⁴ The RRC, the QFs, and the MCV subsequently elected not to actively participate in this case beyond the initial prehearing.

during 2006 in the amounts of \$0.00291 per kWh for January through March, \$0.00830 per kWh for April through June, \$0.00766 per kWh for July through September, and \$0.00676 per kWh for October through December, or until such time as the Commission issues its final order in this proceeding.⁵ As expressed in that order, the Commission's decision to establish a significantly lower factor for the first quarter of 2006 was based on its desire to "delay the majority of the rate effect until the warmer months when electricity is not needed for heating, and customers will no longer be making large expenditures for home heating." December 22 order, p. 8.

On January 26, 2006, the Attorney General filed a motion to compel responses to discovery, as well as a motion to amend the schedule. In the course of a hearing held on February 2, 2006, the ALJ granted the motion to compel--in substantial part--and extended the deadlines for filing all Staff and Intervenor direct testimony, rebuttal testimony, and motions to strike.

Pursuant to the revised schedule, testimony and exhibits were submitted by Consumers, the Staff, the Attorney General, and MEC/PIRGIM on February 10 and March 3, 2006. On March 7, 2006, the Staff filed a motion to strike all testimony submitted on behalf of MEC/PIRGIM's witness Martin G. Kushler, as well as a portion of the testimony offered on behalf of Mr. Geoffrey C. Crandall. On March 10, 2006, Consumers filed a motion to strike all testimony sponsored by those two witnesses, as well as that offered by a third MEC/PIRGIM witness, Ronald C. Callen.

MEC/PIRGIM filed responses to those motions on March 16, 2006. At the same time, it submitted: (1) a motion for a declaratory ruling to the effect that Consumers'

⁵ As specifically noted on page 9 of the December 22 order, those temporary PSCR factors were adjusted to reflect the Commission's concurrent issuance of Consumers' general rate case order in Case No. U-14347.

failure to include energy conservation programs as a specific part of its 2006 PSCR plan filing renders both that plan and its accompanying five-year forecast so deficient and incomplete as to necessitate their revision and resubmission; and (2) a motion for postponement of hearings pending Consumers' filing of an amended plan and forecast reflecting the potential effect of such conservation programs, as well as the utility's possible sale of its Palisades Nuclear Generating Plant, on projected 2006 PSCR costs. Finally, on March 17, 2006, MEC/PIRGIM submitted supplemental testimony and exhibits from Mr. Callen.

At the evidentiary hearing on March 21, 2006, the ALJ granted the motions to strike on the grounds that the testimony sponsored by Messrs. Kushler, Crandall, and Callen was either irrelevant or immaterial to the present Act 304 proceeding, in part because of its speculative nature. The ALJ further denied MEC/PIRGIM's motion for a declaratory ruling on the grounds that under Rule 701 of the Commission's Rules of Practice and Procedure, 1999 AC, R 460.17101 (Rule 701), as well as the Administrative Procedures Act of 1969, as amended, MCL 24.201 et seq. (APA), he lacked authority to issue declaratory rulings. Finally, the ALJ rejected MEC/PIRGIM's request to postpone the hearings on the basis that: (1) Consumers is not obligated to address energy conservation programs as part of its PSCR plan case, (2) because such cases are time-sensitive, requiring Consumers to revise and refile its plan at that late date would undermine the intent of Act 304, and (3) any information provided regarding the potential effect of Consumers' recently-announced desire to sell the Palisades

nuclear plant would, at least with respect to the 2006 PSCR plan, constitute pure speculation.⁶

Following issuance of those rulings, direct, supplemental, and rebuttal testimony of 13 witnesses was bound into the record. Based on agreement of the parties, no cross-examination was conducted with regard to those witnesses. The resultant record consists of 386 pages of transcript and 41 exhibits. On April 14, 2006, Consumers, the Attorney General, MEC/PIRGIM, and the Staff filed briefs. Reply briefs were filed on April 28, 2006 by Consumers, the Attorney General, and MEC/PIRGIM.

II.

STATUTORY REQUIREMENTS

Subsection 6j(3) of Act 304 requires a utility with a PSCR clause to annually file a complete PSCR plan describing the expected sources of electric power supply and the changes in the cost of power supply anticipated over a future 12-month period. Based on this information, the utility is to request specific PSCR factors for each of the 12 months covered by its PSCR plan. The PSCR plan must also describe all major contracts and power supply arrangements for the 12-month period.

Subsection 6j(4) of Act 304 requires the utility to file--contemporaneously with the submission of its PSCR plan--a five-year forecast of its power supply requirements, its anticipated sources of supply, and its projections of power supply costs, all in light of its existing sources of electric generation and sources of electric generation under construction.

⁶ On April 4, 2006, MEC/PIRGIM filed an application for leave to appeal the ALJ's rulings. Consumers and the Staff filed responses to that application on April 18 and 27, 2006, respectively. As of this date, no decision has been issued with regard to MEC/PIRGIM's request for interlocutory relief.

Subsection 6j(5) of Act 304 provides that, after a utility files its PSCR plan and five-year forecast, the Commission is to conduct a proceeding to review the reasonableness and prudence of the PSCR plan and to establish PSCR factors for the period covered by the plan. It further provides that this review shall be conducted as a contested case proceeding pursuant to Chapter 4 of the APA.

Subsection 6j(6) of Act 304 provides that, in its final order in a PSCR plan case, the Commission shall evaluate the reasonableness and prudence of the decisions underlying the plan and shall approve, disapprove, or amend the plan accordingly. In evaluating the decisions underlying the utility's plan, this subsection continues, the Commission shall consider the cost and availability of the electrical generation open to use by the utility; the cost of available short-term firm purchases; the availability of interruptible service; the ability of the utility to reduce or eliminate any firm sales to out-of-state customers (if the utility is not a multi-state utility whose firm sales are subject to other regulatory authority); whether the utility has taken all appropriate steps to minimize the cost of fuel; and other relevant factors. This subsection also provides that the Commission must, in its final order regarding this plan, specifically approve, reject, or amend the 12 monthly PSCR factors requested by the utility. Moreover, it demands that those factors shall not reflect any items that the Commission could reasonably anticipate would be disallowed under Subsection 6j(13), which sets forth the criteria to be considered in a subsequent PSCR reconciliation concerning the 12-month period covered by the plan in question.

Finally, Subsection 6j(7) of Act 304 provides that--when evaluating the decisions underlying the five-year forecast--the Commission may identify any cost items that, on

the basis of the present evidence, it would be unlikely to permit the utility to recover from its customers in rates, rate schedules, or PSCR factors established in the future.

III.

TESTIMONY AND POSITIONS OF THE PARTIES

Excluding that offer regarding the establishment of a temporary factor, Consumers presented testimony from 10 witnesses in support of its 2006 PSCR plan. The utility claims that this testimony, along with its related exhibits, demonstrates that the decisions underlying both its PSCR plan and its five-year forecast are reasonable and prudent. Thus, Consumers contends, the Commission should approve the utility's proposal to supply its estimated total system requirements of 37,485,533,000 kWh by incurring system supply costs in the amount of \$1,363,707,008, resulting in an average cost of \$0.03637 per kWh for 2006. See, Exhibit A-1. Reducing that figure by the new base PSCR factor approved in Case No. U-14347 (namely, \$0.02814 per kWh at generation), and then multiplying the difference by the 1.086 line and transformer loss factor set forth in its tariffs, Consumers asserts, produces an average monthly PSCR factor of \$0.00894 per kWh for 2006. See, Consumers' brief, pp. 11-12.

However, the utility notes, the Commission's imposition of temporary factors below the above-mentioned figure has thus far resulted in a significant underrecovery of its 2006 PSCR costs. As reflected on line 2 of Exhibit A-24, this underrecovery will total \$42,169,467 by the start of July and will continue climbing through the end of 2006. According to Charles F. Belknap, Jr., Supervisor of Planning and Financial Analysis in Consumers' Rates Department, "assuming a July implementation," a PSCR factor of

\$0.01212 per kWh is “necessary to collect the Company’s remaining filed-for power supply costs, including the cumulative underrecovery from the months prior to the factor’s implementation, over the remaining months of the year.” 5 Tr. 190. Consumers concludes by asserting that approving this higher factor for use from July⁷ through December would be consistent with the principle of assigning cost recovery to the customers for whom those costs were incurred, and would further ensure that millions of dollars in unrecovered costs are not shifted from 2006 to some later PSCR period.

The Attorney General expresses concern with several parts of Consumers’ plan case. According to his witness, Charles W. King, the following nine aspects of the utility’s initial filing warrant further explanation: (1) Consumers’ proposed accounting for the cost of futures contracts; (2) an alleged conflict between generating plant dispatch and the recovery of plant fuel costs; (3) the recovery of costs from certain peaking facilities; (4) the potential elimination of the utility’s ability to self-supply reactive power; (5) Consumers’ use of spot market gas purchases instead of making use of its Gas Division’s extensive storage fields; (6) the manner in which nitrogen oxide (NO_x) emission allowances are used; (7) an apparent jump in expected nuclear fuel costs for 2006; (8) the possibility that Consumers is being overcharged for the transportation of Eastern coal; and (9) the utility’s potential underestimate of its true 2006 sales and peak load due to the expected return of many retail open access (ROA) customers to

⁷ Consumers’ selection of July as the proposed implementation month is based on its belief that this would provide sufficient time for the PFD’s preparation, the submission of exceptions and replies, and the issuance of the Commission’s final order in this matter. See, Consumers’ brief, p. 12, fn. 12. In the event that a July implementation is not achievable, Mr. Belknap (in the context of Exhibit A-24) provided alternative factors for use during whatever remains of 2006. See, Id., p. 13.

Consumers' tariff sales.⁸ Based on testimony provided by Mr. King, the Attorney General recommends reducing the estimate of recoverable PSCR costs, further examining several of the above-noted issues in the context of Consumers' 2006 PSCR reconciliation case, and requiring the utility to update its filing. Finally, the Attorney General contends that the utility should not be allowed to increase its PSCR factor for the remainder of the year to reflect the alleged underrecovery arising from January to June, 2006.

The Staff appears to agree, in at least one aspect, with the Attorney General's concerns regarding the proposed accounting treatment for futures contracts. Based on testimony provided by William G. Aldrich, Manager of the Accounting and Auditing Section of its Regulated Energy Division, the Staff "opposes Consumers' implicit request to institute mark-to-market accounting" for purposes of financial reporting to the Commission, and for "deferred accounting authority for interim gains and losses" on its financial transmission rights (FTRs).⁹ 5 Tr. 374-375. Nevertheless, the Staff concurs with the utility's underlying belief that "the final, settled value of the FTRs" should be included as part of the PSCR costs to be recovered in this case, and simply proposes using a different accounting methodology that will yield the same results. See, Staff's brief, pp. 5-6. Moreover, through testimony provided by Robert G. Ozar, the Staff took issue with the Attorney General's claim that Consumers should immediately eliminate

⁸ In addition, the Attorney General listed five legal issues, each involving matters in which the Commission ruled against him during Consumers' prior PSCR plan case. Because these issues were raised solely to "preserve them for appellate purposes" while appeals in Case No. U-14274 are pending, they have not been specifically addressed in the present case. See, Attorney General's brief, p. 3.

⁹ As noted on page 5 of the Attorney General's brief, FTRs are derivative instruments that allow utilities like Consumers to hedge against future congestion costs on MISO's electric transmission system.

most--if not all--of its spot market gas purchases, and instead make use of its affiliate's storage facilities.

As a result, the Staff supports adopting in full Consumers' projections regarding its PSCR costs and requirements for 2006. The Staff further contends that, in light of the underrecovery arising from "the temporary factor phase of this proceeding," the Commission should grant the utility's request to apply a PSCR factor of \$0.01212 per kWh from July through December, 2006 (or, assuming later issuance of the final order in this case, the corresponding factor set forth on Exhibit A-24).

As for MEC/PIRGIM, it spends much of its brief and reply brief summarizing the stricken testimony submitted by Messrs. Kushler, Crandall, and Callen, as well as reasserting that this testimony should be included as part of the record. In addition to arguing that each of the ALJ's March 21, 2006 rulings should be reversed, MEC/PIRGIM cites this extra-record evidence as support for its claim that Consumers should be ordered to immediately initiate resource planning and energy efficiency programs, the utility should be warned that its future PSCR factors may be cut unless it undertakes such programs, and the factors approved in this case should be reduced.

IV.

DISCUSSION AND FINDINGS

This is only the third PSCR plan case filed by Consumers since 1998, when the Commission suspended the utility's PSCR clause. Moreover, it comes at a time when the ultimate economic effects--both expected and unexpected--of the industry's move toward competition are becoming more clear, as well as during a period of

hurricane-induced natural gas price spikes. As a result, several matters must be addressed in this case beyond those typically arising during a PSCR plan proceeding. The parties' summaries of the evidence and related arguments regarding this range of issues are fully set forth in their respective pleadings, briefs, and reply briefs, as well as the evidentiary record. In the interest of issuing this Proposal for Decision (PFD) in a timely manner, not all of the material presented by the parties will be addressed. However, while only those arguments and testimony necessary for a reasoned analysis of pertinent issues will be specifically discussed, the ALJ--in arriving at his findings and conclusions--considered the entire record developed in this proceeding. Thus, any arguments or proposals not addressed in this PFD were deemed to be either irrelevant or unnecessary to the ALJ's ultimate recommendations.

MEC/PIRGIM's Response to Prior Rulings and Requests for Relief

As with its previously-filed request for interlocutory relief, MEC/PIRGIM contends that the ALJ should reverse all rulings issued at the start of the March 21, 2006 evidentiary hearing. These consist of the ALJ's decisions to deny MEC/PIRGIM's request for a declaratory ruling, grant various motions to strike testimony submitted by its witnesses, and deny MEC/PIRGIM's motion to postpone all further action in this case pending Consumers' preparation and submission of a revised PSCR plan and five-year forecast. Moreover, as noted above, MEC/PIRGIM goes on to assert that the ALJ should recommend ordering Consumers to "implement appropriate resource planning and energy efficiency programs," issue a warning--pursuant to Section 6j(7) of Act 304--to the effect that the utility's "PSCR rate factors may be reduced in the future" should it fail to implement such conservation-based programs, and reduce Consumers' PSCR

rate request . . . in the amount of \$0.01058 per kWh” to reflect the cost reductions that could have been achieved by undertaking conservation efforts. MEC/PIRGIM reply brief, p. 3. Each of these issues is addressed below.

a. Motion for Declaratory Ruling

MEC/PIRGIM’s first challenge concerns the ALJ’s March 21, 2006 ruling in which he denied the Intervenor’s “Motion for a Declaratory Ruling.” Essentially, MEC/PIRGIM claims that the ALJ should have granted that motion on the grounds that:

[A]n important predicate to the lawfulness and reasonableness standard, and to cost recovery under Act 304, includes the duty of the utility to include in its plan and forecast case alternative resource options and programs to promote minimization of energy costs and greater energy supply reliability through energy efficiency, conservation, and load and peak demand mitigation programs.

MEC/PIRGIM’s brief, p. 16 [emphasis added].

According to MEC/PIRGIM, the above-mentioned “duty” to include conservation-based programs as part of both its 2006 PSCR plan and its five-year forecast is evidenced by: (1) past Commission orders directing utilities to undertake integrated resource planning and implement demand-side management, generally referred to as IRP and DSM; (2) appellate decisions upholding, to a significant degree, the Commission’s rulings advocating such efforts; (3) statutes concerning utility regulation in Michigan; and (4) a recent Staff report endorsing the use of IRP and DSM as a potential means of satisfying the state’s future capacity and energy needs. Moreover, MEC/PIRGIM asserts, the ALJ incorrectly concluded that--based on the language of Rule 701--he lacks the power to rule on this request. MEC/PIRGIM therefore contends that the ALJ’s failure to issue the requested declaratory ruling was in error, and that he

should require Consumers to “file adequate plans and forecasts to incorporate these resource options in this and future cases,” as well as recommend that the Commission “reduce [Consumers’] PSCR rates in this case accordingly.” Id., p. 35.

Consumers and the Staff respond by noting (albeit, in their responses to MEC/PIRGIM’s application for leave to appeal) that the Commission’s ruling in Case No. U-9172 specifically extinguished the duty MEC/PIRGIM now seeks to impose. Moreover, they point out that Rule 701 vests the Commission, and not the ALJ, with sole discretion to decide whether a request for declaratory ruling should be entertained. Because the ALJ lacks the authority to rule on such matters, they continue, his refusal to grant the declaratory ruling sought by MEC/PIRGIM was entirely correct.

The ALJ agrees with Consumers and the Staff, and again concludes that MEC/PIRGIM’s request for a declaratory ruling must be denied. The Commission has, in the past, required utilities to develop IRPs to be used as a guide in preparing their respective Act 304 filings. However, the January 28, 1997 order in Case No. U-9172 specifically relieved Consumers of any obligation to file IRPs for use in developing its PSCR plans and five-year forecasts. Thus, at least at the present time,¹⁰ the utility is under no obligation to include the potential effect of conservation-based programs as part of the filings submitted in this case.

Moreover, and as noted by both Consumers and the Staff, MEC/PIRGIM’s current request is procedurally flawed. Notwithstanding this Intervenor’s belief to the contrary, Rule 701 does not grant ALJs the power to issue declaratory rulings. Rather,

¹⁰ As a result of the investigation being conducted in Case No. U-14667, the Commission may ultimately revise its current position regarding the necessity of including conservation-based programs as part of utilities’ Act 304 filings. However, unless and until that occurs, the ALJ is bound to adhere to the Commission’s most recent directive on this matter, namely that provided in Case No. U-9172.

as clearly stated in subsection 3 of that rule, the decision as to whether or not a request for a declaratory ruling should even be addressed is within the sole discretion of the Commission. Furthermore, the overall structure of the Commission's rules of practice and procedure rebuts MEC/PIRGIM's assertion that its request can and should be considered in the context of an existing case. Rather than including requests for declaratory rulings within either Parts 3, 5, or 6 of these rules (which deal with general hearings, complaints, and utility system extension proceedings, respectively), they are addressed separately as part 7. When viewed in conjunction with the fact that Rule 701 provides the potential for both notice and hearing following receipt of such a request, this clearly indicates that declaratory rulings should be dealt with on a stand-alone basis, and not as part of some other Commission proceeding.

For these reasons, the ALJ recommends that the Commission uphold his ruling regarding the March 16, 2006 "Motion for a Declaratory Ruling" filed by MEC/PIRGIM.

b. Motions to Strike

On brief, MEC/PIRGIM renews its assertion that the testimony offered by its three witnesses should not have been stricken. According to it, excluding this testimony from the record violates the "full and complete hearing requirements" imposed by Section 6j of Act 304 and Section 6a of 1952 PA 243, as amended, MCL 460.6a, as well as various constitutional principles. MEC/PIRGIM therefore contends that the ALJ should reverse his rulings regarding the other parties' motions to strike and, instead, receive all of the testimony offered by its witnesses.

Consumers and the Staff respond by again noting that, at least with regard to testimony addressing conservation and energy efficiency, recent Commission orders

support its exclusion from Act 304 cases. As for the rest of the stricken evidence, the utility points out that MEC/PIRGIM “fails to address any of the reasoning articulated by the ALJ for his decision striking the testimony of these witnesses.” Consumers’ response to the application for leave to appeal, p. 7. “Simply reciting legal platitudes concerning due process,” the utility continues, “does not provide a basis for the Commission to reverse the reasoned decision of the ALJ.” Id.

The testimony in question relates exclusively to three issues. These are (1) the possible economic benefits that may be derived from conservation, energy efficiency, and DSM projects, (2) the utility’s recent announcement that it would like to sell its Palisades nuclear plant during 2007 and buy-back the facility’s capacity and energy through some type of power purchase agreement, and (3) MEC/PIRGIM’s often-repeated claim that Consumers should either cease collecting the one mill per kWh surcharge mandated by the Nuclear Waste Policy Act of 1982, 42 USC 10101 et seq., or--at a minimum--cease forwarding the funds collected by that surcharge to the United States Department of Energy (DOE) for use in establishing and operating a permanent spent nuclear fuel (SNF) repository. Upon review of this proposed testimony and the parties’ arguments regarding its admissibility, the ALJ remains convinced that the information MEC/PIRGIM sought to introduce through its witnesses is either irrelevant or immaterial to the present Act 304 proceeding.

As noted in the previous discussion regarding MEC/PIRGIM’s request for a declaratory ruling, the January 28, 1997 order in Case No. U-9172 relieved Consumers of any duty to file IRPs for use in developing its PSCR plans and five-year forecasts. Furthermore, as part of its March 12, 2003 order in Case No. U-13060, the Commission

reasserted that--at least until further notice--testimony regarding energy efficiency and conservation programs should be excluded from Act 304 cases. Thus, because the conservation-based testimony that MEC/PIRGIM sought to introduce was beyond the scope of this proceeding, it was properly stricken.

Turning to the utility's announced desire to sell the Palisades plant in 2007 and buy back at least some portion of its capacity and energy, the problem with MEC/PIRGIM's proposed testimony is not one of relevance, at least in the long term. As stated in the course of the March 21, 2006 hearing, the ALJ concedes that "the effect that the actual sale of the plant and [the] successful signing of a Power Purchase Agreement might have on ratepayers is something that . . . could be investigated in the context of an Act 304 case." 5 Tr. 140-141. However, at the present time, no sale has occurred and no power purchase agreement has been negotiated--let alone approved by the Commission, as would likely be required pursuant to Section 6j(13) of Act 304. Instead, all we have is the utility's announcement that it would "like" to sell the plant at some time following the close of the PSCR plan year at issue in this proceeding.¹¹ Thus, MEC/PIRGIM's currently proposed testimony on this issue--as well as any that might be obtained by requiring Consumers to supplement its current five-year forecast to include the effects of the plant's potential sale--constitutes pure speculation. Due to its overtly speculative nature, the ALJ again finds that all testimony regarding the utility's hoped-for sale of the Palisades generating plant is immaterial to the resolution of Consumers' 2006 PSCR plan case.

¹¹ Based on statements made in the course of the March 21, 2006 hearing, it appears that no specific purchaser has been identified, no sale price has been established, and no negotiations have been scheduled with regard to a power purchase agreement concerning the plant's electric generation.

With regard to MEC/PIRGIM's proposed testimony concerning SNF disposal costs, it bears noting that the Commission has addressed this issue in numerous PSCR cases. In every instance, it has rejected MEC/PIRGIM's recommendations to either cease collecting the statutorily-imposed SNF fees or refrain from forwarding them to the DOE. See, the Commission's November 20, 2001 orders in Cases Nos. U-12613 and U-12615, its September 16, 2002 order in Case No. U-12725, the February 28, 2005 order in Case No. U-13917, the April 28, 2005 order in Case No. U-13919, the June 30, 2005 order in Case No. U-14274, the September 20, 2005 order in Case No. U-13771, and the April 13, 2006 order in Case No. U-13919-R. The ALJ therefore recommends upholding the decision to strike this testimony (as well as that concerning the potential effects of conservation and the offer to sell Palisades).

c. Motion for Postponement of Hearings

MEC/PIRGIM also reasserts its claim that, due to Consumers' failure to include as part of its application the potential effects of conservation programs and its desired sale of the Palisades plant, evidentiary hearings in this case should have been postponed and the utility should have been required to submit proofs concerning those matters. According to MEC/PIRGIM, Consumers' decision not to address such issues constitutes a failure "to meet its burden of proof in its plan and forecast case to demonstrate the necessary reasonableness and prudence . . . under Act 304." MEC/PIRGIM's brief, p. 40. As a result, MEC/PIRGIM effectively requests that the Commission reopen the record and order Consumers to file an amended PSCR plan and five-year forecast that includes consideration of conservation-related programs and the possible effect of selling the Palisades plant.

Consumers responds by asserting that, for reasons discussed earlier, the information that MEC/PIRGIM seeks to have added to the record by way of this request is not relevant to the present proceedings. As for the Staff, it questions why--with Consumers' PSCR plan having been filed in September 2005--MEC/PIRGIM waited until only 5 days before the date set for evidentiary hearings before objecting to the alleged deficiency. As such, these parties continue to oppose reopening the record and requiring the utility to refile its PSCR plan.

Once again, the ALJ agrees with Consumers and the Staff, and recommends that the Commission uphold his previous decision denying MEC/PIRGIM's request. As noted earlier, Consumers is currently under no obligation to include (as part of its 2006 PSCR plan or the accompanying five-year forecast) an assessment of energy efficiency, conservation, or DSM programs. As also discussed above, the fact that Consumers has neither identified a buyer for its Palisades plant nor begun negotiations regarding any power purchase agreement necessitated by the plant's potential sale would, at the present time, render testimony on this issue wholly speculative. Moreover, although little, if any, benefit would be derived from granting MEC/PIRGIM's request, a significant detriment could occur; namely, the ultimate resolution of this case would likely be delayed by several months. Because Act 304 plan cases like this are--by nature--time sensitive, such a delay could prove detrimental to the parties and ratepayers alike.

d. MEC/PIRGIM's Miscellaneous Requests for Relief

The final matter relating to MEC/PIRGIM is its request that the Commission direct Consumers to immediately implement IRP, DSM, and/or other conservation-related programs, issue a Section 6j(7) warning due to the utility's failure to have already done

so, and reduce Consumers' requested PSCR factor for 2006 by \$0.01058 per kWh. However, as repeatedly noted above, the utility is under no current duty to include the potential effect of resource planning and energy efficiency programs as part of its plan case. Moreover, the requested reduction in its 2006 PSCR factor is based entirely on extra-record information (namely, the stricken testimony of Messrs. Crandall and Kushler). See, MEC/PIRGIM's reply brief, p. 2. The ALJ therefore recommends rejecting each of these requests for relief.

Treatment of Futures Contracts/FTRs

Futures contracts are agreements under which an entity agrees to buy or sell a commodity or service that will be provided on a future date at a specified price. The only futures contracts discussed in Consumers' current PSCR filing are FTRs, which--as noted earlier--are derivative instruments that allow the utility to protect itself against future congestion costs on the transmission system. Specifically, MISO, which oversees the transmission system in Michigan's lower peninsula, imposes a marginal congestion charge whenever there is a threat of congestion at certain points on the system. Consumers FTRs work as a hedge, allowing the utility to avoid paying that charge if congestion should ultimately occur at a specific pricing node on MISO's system.

Based on Consumers' responses to data requests, it appears that MISO allocates FTRs on an equal priority basis among the users of its transmission system on June 1 of each year. Thereafter, monthly auctions are held at which the system's users may trade FTRs among themselves at prices set by supply and demand. When initially allocated, each FTR is assigned a "fair price" by MISO, based on the estimated

likelihood that there will be congestion between a specific electric generating plant and load node during a particular time frame. See, Tr. 352-353. As the settlement date approaches, an FTR's value may increase (if the probability of congestion rises) or decrease (if the demand for transmission between those two points drops).

In its filing, Consumers requested a change in the way it accounts for these increases and decreases in fair value. Instead of treating these changes in value as income or losses outside the PSCR process, as it currently does, the utility seeks to include them in the calculation of the overall transmission costs recovered through its PSCR factor. Consumers' proposed methodology would be to treat all gains as regulatory assets and all losses as regulatory liabilities, to be credited or charged--respectively--to the cost of transmission at the time each FTR is settled.

The Attorney General claims that Consumers failed to adequately identify the fair value of its FTRs and fully explain how it will treat those that are acquired in one calendar year and settled in another. This failure, he contends, warrants rejecting the utility's proposal and continuing to treat all changes in the value of its FTR hedges as general income or losses, rather than including them among PSCR costs. This, the Attorney General notes, corresponds to his view that all transmission costs (including any related FTR gains and losses) are beyond the scope of Act 304. See, Attorney General's brief, p. 7.

The Staff, apparently finding sufficient nexus between Consumers' FTRs and other PSCR costs, supports recovering changes in these futures contracts' value through the PSCR process. This is expressed by Mr. Aldrich's statement that the Staff agrees with the utility that "the final, settled value of these FTRs should be included in

Consumers' power supply costs." 5 Tr. 376. "Of course," he continued, "the costs of these derivative instruments would be subject to the same scrutiny as other fuel and purchased power costs, both in future PSCR plan and PSCR reconciliation cases." Id. Nevertheless, the Staff recommends using a different method of accounting for FTR costs, albeit one that yields the same results for purposes of the PSCR process. On page 3 of its reply brief, Consumers adopts the Staff's position (effectively withdrawing its request for authority to initiate what Mr. Aldrich referred to as mark-to-market accounting).

The ALJ finds that, with the change in methodology proposed by the Staff, Consumers' request should be approved. The FTRs in question are directly related to the transmission service provided Consumers by MISO. As such, the Commission's repeated rulings in favor of recovering transmission-related expenses through the PSCR process¹² apply equally to these FTRs. The ALJ therefore recommends that the Commission authorize Consumers to account for FTRs in a manner that ensures that their final, settled value is included as part of the utility's 2006 PSCR costs.

MISO-Related Cost Concerns

Two of the concerns expressed by the Attorney General arise from Consumers' participation in MISO and the potential effect of that participation on PSCR costs. The first concern relates to an alleged conflict between plant dispatch and fuel cost recovery, while the second relates to the recovery of costs from certain of Consumers' peaking facilities.

¹² See, the Commission's September 16, 2002 order in Case No. U-12725, March 12, 2003 order in Case No. U-13107, July 23, 2003 order in Case No. U-13688, November 23, 2004 order in Case No. U-13808, February 28, 2005 order in Case No. U-13917, and June 30, 2005 order in Case No. U-14274.

According to the Attorney General's witness, Mr. King, the first of these issues arises because of the apparent disconnect between the description of MISO's generating plant dispatch system (as provided by David F. Ronk, Jr., Consumers' Director of Electric Strategies) and the specific fuel costs identified for these plants (through testimony provided by other utility witnesses). Specifically, Mr. King cites testimony from Mr. Ronk to the effect that MISO dispatches each of the plants within its system--including those owned by Consumers--based on the collective demand of all utilities participating in the system. According to Mr. King:

This means that MISO would dispatch, say, [Consumers'] Karn 1 unit not based on the demands of Consumers' customers, but on the demands of all customers on the MISO system, notably including Detroit Edison.

Yet, quite regardless of this dispatch system, all of the fuel costs for the Karn 1 unit are presumed to be the responsibility of Consumers' customers.

5 Tr. 355. He went on to assert that the same condition applies to Consumers' long-term purchased power contracts. Specifically, he noted, the independent power producers with whom Consumers has contracts are either dispatched by MISO or they self-dispatch based on the hourly price of power on MISO's system, and "are not dispatched on the basis of the demand imposed by Consumers' customers." Id.

Mr. King went on to concede that he could not testify as to the financial impact of this disconnect between MISO-based dispatch and Consumers-only fuel cost recovery. Nevertheless, he urged the utility (and, by extension, the Commission) to "consider whether there is any way that fuel and purchased power costs can be assigned to Consumers' PSCR customers more directly on a cause-and-effect basis." 5 Tr. 356.

As such, the Attorney General contends only that this matter may warrant further examination during Consumers' 2006 reconciliation case.

On a related matter, the Attorney General's witness notes that the generation cost per megawatt-hour for the utility's peakers and its Karn 3 and 4 gas- and oil-fired units was 3 to 3½ times higher than the cost of on-peak power purchases. When he asked the utility why it would dispatch those units instead of buying on-peak power from the market, Mr. King continues, he was advised that this was necessitated by MISO's Reliability Assessment Commitment process, wherein MISO ensures that it has enough capacity available and on line to meet the forecasted MISO load for each hour of the next operating day. According to Mr. King, this is another example of "MISO driving costs that are absorbed by Consumers' PSCR customers." 5 Tr. 357. Although the utility believes that it is fully reimbursed for the use of these units (meaning that there would be no financial harm created by maintaining these units on line for MISO's benefit), Mr. King questions whether Consumers is actually compensated for all fixed costs relating to those generating plants. Regardless, the Attorney General contends, the high operating costs of these plants alone justifies retiring these units and replacing them with less-costly on-peak power purchases. See, Attorney General's brief, p. 12.

Consumers responds by noting that, as explained by Mr. Ronk, there should be no "disconnect" between the fuel costs that its PSCR customers bear and the manner in which the utility's plants are dispatched. This is due to the fact, Consumers continues, that the total value of MISO-dispatched generation is either used to serve its PSCR customers or credited back to those customers. As for Mr. King's claim that the utility

should think about whether fuel costs can be assigned to its customers on a more direct cause-and-effect basis, Mr. Ronk specifically noted that:

The Company has considered this issue. In some respects the dispatch of the Company's generating units to serve MISO load is not that much different than the dispatch of the Company's generating units to serve sales to third parties. The Company sets the minimum price it will accept for the use of generators to serve MISO load so that it recovers its fuel and variable expense. Any revenue received in excess of that minimum price (with the potential exception of revenues used to cover stranded costs) is credited to PSCR costs so that the PSCR customer receives a credit for one hundred (100) percent of the economic value of the generators controlled by the Company. While the MISO market structure complicates this construct, the basic premise remains that all fuel and variable costs are recovered as part of the price received from MISO and any additional value received as a result of receiving a locational marginal price is used to reduce customer costs.

5 Tr. 314.

Turning to the Attorney General's concerns regarding continued use of Consumers' peaking and oil- and gas-fired units, Consumers points out that MISO's FERC-approved tariff requires all load serving entities to designate sufficient network resources to serve peak customer demand, and MISO then dispatches those resources to produce the lowest variable cost of generation throughout its territory. Moreover, Mr. Ronk notes, "[Consumers'] fixed costs are not any greater as a result of MISO's use of those resources and such costs cannot be avoided as a result of being dispatched by MISO." 5 Tr. 316-317. According to Consumers, the mandatory nature of its participation in MISO, coupled with the matching economic goals of MISO and the utility where dispatch is concerned, reflects the reasonableness and prudence of Consumers' proposed actions.

The ALJ agrees with Consumers, and concludes that the Attorney General's concerns fail to adequately reflect either the mandatory nature of the utility's

participation in MISO or the apparent lack of reasonable alternatives to taking service under MISO's FERC-approved tariff. Granted, Consumers loss of control regarding dispatch of its native generation and the continued use of a few high-cost units is disconcerting. However, unless and until it can be shown that Consumers has some other option, the selection of which would result in costs below those assigned to its customers through the use of MISO's system, the actions proposed in its 2006 PSCR plan cannot be found to be unreasonable or imprudent. The ALJ therefore recommends rejecting the Attorney General's proposals regarding these two MISO-related concerns.

Reactive Power Ancillary Service

Included in Consumers' initial filing was a document, Exhibit A-3, listing four ancillary services that it self-supplies, but for which it receives credit from MISO for the wholesale and ROA portion of those activities. The total expected credit for all four services was expected to exceed \$4 million during 2006. See, Exhibit A-3, line 6. However, the utility witness sponsoring this document, Andrew C. Dotterweich, indicated that MISO had proposed, as part of its recently requested tariff revisions, to eliminate the self-service option for reactive power included on Schedule 2.

In the course of discovery, the Attorney General inquired as to the effect that this proposed change would have on PSCR costs, and was advised that it would increase PSCR expenses by \$2,154,000. Thus, although unsure whether Consumers had the option of continuing to self-supply Schedule 2 services, he suggested that the utility decline transferring reactive power service to MISO. However, as part of his rebuttal testimony, Mr. Dotterweich noted that--the FERC having approved MISO's tariff request--Consumers no longer has the option of self-supplying this service. See, 5 Tr.

214. This, the Attorney General ultimately agreed, “would appear to resolve [the] issue.” Attorney General’s brief, p. 12.

The ALJ agrees, and recommends that no change be made to Consumers’ ultimate PSCR cost proposal due to its transfer of reactive power ancillary service to MISO.

Affiliate Gas Storage

The next concern expressed by the Attorney General involves the fact that, of the natural gas Consumers expects to burn in its generating units during 2006, a vast majority will be purchased either on the spot market or pursuant to spot pricing terms. Mr. King questioned whether such significant reliance on the spot market is prudent, particularly where Consumers’ expected gas purchases would likely coincide with spikes in demand caused by other utilities’ use of their own gas-fired peakers. In response to Consumers’ assertion that it lacks the storage capacity necessary to shift these purchases to off-peak periods, Mr. King noted that “Consumers’ Gas Division has extensive storage fields” that could be used for this purpose, thus reducing the utility’s overall PSCR costs. 5 Tr. 359. Based on this testimony, the Attorney General asserts that the utility has failed to demonstrate the reasonableness and prudence of its natural gas purchasing strategy, and that the Commission should therefore “amend or disapprove Consumers’ PSCR plan on the issue.” Attorney General’s brief, p. 15.

Consumers responds by asserting, among other things, that the Attorney General fails to recognize the potential adverse impact his proposal could have on the utility’s gas customers. Likewise, it continues, he ignores the fact that if storage were obtained from Consumers’ gas division, there would still be a cost associated with that

service. Moreover, the utility points out that the use of its affiliate's storage would be rather limited in scope. According to Brian D. Gallaway, Consumers' Director of Fuels Transportation and Planning, only the Karn 3 and 4 units are physically connected to its affiliate's gas storage system, the gas line providing that connection is too small to supply all of the units' needs, and the line itself is subject to seasonal operating limitations. See, 5 Tr. 219. Consumers therefore concludes that the Attorney General "has not shown that employing the Company's gas utility's gas storage fields is feasible and, if feasible, that such a transaction could be conducted economically." Consumers' reply brief, p. 5.

For its part, the Staff concedes that the appropriate degree of reliance on spot pricing for the utility's natural gas purchases is a relevant issue. Moreover, based on testimony provided by Mr. Ozar, it agrees that "hedging strategies, including gas storage, that result in lower natural gas price-risks should be explored." 5 Tr. 383. Nevertheless, the Staff believes that further experience under the newly-implemented MISO operating structure is needed in order to develop an appropriate hedging strategy for use by Consumers.¹³ It therefore concludes that no change should be made to the utility's natural gas purchasing plan for 2006.

The ALJ agrees, in great part, with the Staff's position. As noted by Mr. Ozar, the fact that MISO now dispatches the entire region's generating units based upon its total system requirements, rather than any particular utility's load demands, greatly

¹³ It further notes that, in any future attempt to use its affiliate's gas storage facilities, the utility should be careful to avoid cross-subsidization. As stated by Mr. Ozar, and cited on page 8 of Staff's reply brief, "any use of Consumers' underground natural-gas storage facilities by its Electric Division should be on a contractual basis comparable to services from a third party," such as Michigan Consolidated Gas Company or ANR Pipe Line Company. 5 Tr. 384.

complicates Consumers' ability to establish reasonable hedging parameters with regard to the cost of fuel. Specifically, he points out:

[S]hould MISO dispatch Consumers' peaking facilities, Consumers will be fully compensated. Thus, in instances of a MISO reliability dispatch, savings in fuel costs due to natural gas price-hedging will not impact Consumers' PSCR costs. In contrast, if Consumers self-dispatches its peaking facilities in order to meet its own system demand, then fuel price-hedging could have an impact, albeit nominally, on PSCR costs [Moreover], during peak summer periods, MISO market prices can be very high (multiples of the cost of spot natural-gas generated power). Under these conditions, cost savings derived from self-dispatched peak generation [are] virtually guaranteed, even if natural gas purchases are made on the spot market.

5 Tr. 383-384. As a result, the utility's ability to accurately predict the extent and timing of how peaking units will be dispatched under the newly-instituted MISO operating structure is a prerequisite to Consumers' establishment of a successful natural gas hedging strategy. At present, it appears, that ability does not exist. The ALJ therefore concurs with the Staff that, at this early stage of MISO's operation, Consumers' plan to purchase most of its natural gas either on the spot market or pursuant to spot pricing terms (rather than making more use of affiliated gas storage) is reasonable and should be approved.

Nevertheless, the ALJ is mindful of the fact that relatively high natural gas costs have been a recurring theme in Consumers' recent PSCR plan and reconciliation cases. This has led, among other things, to the Commission's ruling that although "Karn-related natural gas costs will be included in the company's PSCR factor, [they will be] subject to reconsideration in the company's 2004 and 2005 reconciliation proceedings." June 30, 2005 order in Case No. U-14274, p. 17. The ALJ therefore recommends that the Commission, in addition to adopting Consumers' projected gas costs for purposes of its

2006 PSCR proceedings, direct the utility to look carefully at this issue and more fully describe--in the context of its next PSCR plan case filing--all steps taken to minimize its natural gas-related costs. In so doing, however, Consumers should avoid all forms of cross-subsidization that might arise from intra-affiliate transactions.

NO_x Allowances

A national system of emission allowances, developed as a way to improve air quality, allows every power plant to emit pollution up to a designated level. Specifically, each plant is allotted a base number of allowances for use over the course of a 12-month period. These allowances serve as a ceiling on the amount of pollutants respective plants can emit. If a plant exceeds the ceiling level of allowances assigned for that year, it can either make use of previously-assigned (but as-of-yet unconsumed) allowances that it banked in prior years or purchase additional allowances from others who have no need to utilize their full allotments.

Consumers proposes including, as part of its total 2006 PSCR expenses, \$10,002,647 in NO_x emission allowance costs. In support of this proposal, the utility offered testimony and exhibits from David B. Kehoe, its Director of Staff, Electric Generation. As reflected on page 1 of Exhibit A-10, the utility's proposed expense item reflects the total cost of all previously-obtained NO_x emission allowances that Consumers plans to use during 2006, as well as all allowances to be allocated to Consumers from the United States Environmental Protection Agency (EPA) or purchased from other entities for use during the plan year. The exhibit goes on to describe the utility's plan for acquiring and using its emission allowances over the rest of the period covered by its five-year forecast. According to the utility, its proposal in the

present case is consistent with the Commission's treatment of NO_x-related costs in each of its last two PSCR plan proceedings (namely, Cases Nos. U-13917 and U-14274).

The Attorney General's witness, Mr. King, pointed out that Consumers' plan would leave it with 1,599 banked NO_x allowances at the close of 2006. He went on to assert that if the utility simply used these extra allowances during 2006, it could reduce its spot market allowance purchases by the same amount, thus saving the utility (and, ultimately, its PSCR customers) approximately \$4.9 million. See, 5 Tr. 361-362. This would leave the utility with no banked allowances to carry over to 2007, thereby also ending what he referred to as Consumers' "practice of passing past years' costs on to subsequent years' ratepayers." 5. Tr. 362.

In his rebuttal testimony, Mr. Kehoe stated that Mr. King's analysis failed to adequately account for the effect that the EPA's Progressive Flow Control program would have on overall NO_x allowance expenses incurred over the period from 2006 to 2010. Specifically, Mr. Kehoe testified that:

[Progressive Flow Control] is a means to discourage extensive use of banked allowances in a particular ozone season. Flow control is triggered if the total number of banked allowances from all sources exceeds 10 percent of the region-wide NO_x allowance allocation. If the total bank is greater than 10 percent of the region-wide NO_x allowance allocation, the [EPA] calculates a flow control ratio. This ratio indicates the percentage of banked allowances that sources can use with no discount for compliance in the following ozone season ("1-for-1") and the percentage of banked allowances that, if used, must be deducted at a rate of two allowances for each ton of emissions ("2-for-1"). The ratio only applies to allowances when a source uses them for compliance purposes. Allowances sold or traded on the allowance market are never subject to flow control at the time they are traded.

* * *

[Consumers] has determined that the most economical strategy is to use only the banked allowances that can be used without reducing their value in the current year and to roll over the remaining allowances to next year. This approach will conserve the value of the banked allowances and assure that the banked allowances retain their full value.

5 Tr. 272-273. He then noted that, by correcting this error in Mr. King's analysis, the potential savings in 2006 (resulting from the liquidation of all banked NO_x allowances) would total only \$1.2 million. See, 5 Tr. 274 and Exhibit A-25. Moreover, Mr. Kehoe continued, allocating Consumers' banked allowances to only those periods where they could be used on a 1-for-1 basis--as would occur under the utility's proposal--will actually save ratepayers \$2,597,714 over the next five years. See, 5 Tr. 275, as well as Exhibits A-26 and A-27.

The Attorney General now concedes that Mr. Kehoe's analysis "appears acceptable, provided his explanation is accurate." Attorney General's brief, p. 18. Thus, he simply asks that this issue be studied carefully in the reconciliation phase of this proceeding.

Due to the absence of disagreement regarding this matter, the ALJ recommends that the Commission approve Consumers' proposal regarding the use of NO_x emission allowances, and allow the utility to recover \$10,002,647 in NO_x-related costs during 2006. He further recommends that the Commission direct Consumers to provide, as part of the initial filing in its next PSCR reconciliation case, a detailed analysis regarding its actual use of NO_x emission allowances in 2006.

Nuclear Fuel Costs

John A. Hughes, the Manager of Nuclear Fuel Business Systems for Nuclear Management Company--the company that operates Consumers' Palisades nuclear

generating plant--provided the utility's nuclear fuel cost estimates for 2006 through 2010. Specifically, Mr. Hughes estimated that Consumers' total 2006 nuclear fuel costs will be 4.09 mills per kWh. 5 Tr. 255. Moreover, he described various steps taken by the utility to minimize these costs, including the renegotiation of contracts for the procurement and enrichment of uranium and uranium concentrates, as well as fuel assembly fabrication.

According to the Attorney General's witness, Mr. King, the assumption to be drawn from that list of cost-saving initiatives is that Consumers' renegotiated contracts "will result in savings in nuclear costs, either [as] a reduction in cost or a slowing of the rate of cost increase." 5 Tr. 363. However, he went on to note, the record assembled in this case suggests otherwise. Based on figures supplied by the utility, Mr. King developed a document reflecting changes in the four cost components (e.g., uranium purchase, conversion, enrichment, and fabrication) for each batch of nuclear fuel beginning with Batch S in 1999 and running through Batch Z in 2010. This document, received as Exhibit AG-9, reveals that the percentage increase in costs from Batch V to Batch W (the one being installed during 2006) "is extraordinarily large" for each of those four components. Id.

Although the Attorney General specifically requested an explanation concerning this large cost increase, Mr. King noted, the utility merely responded by stating that "nuclear fuel prices have been going through a period of market volatility, characterized by sharp price increases." Exhibit AG-10. No other explanation was provided regarding why, despite Mr. Hughes' claim that Consumers renegotiated its contracts in an effort to reduce expenses, those alleged efforts "failed to tamp, or even moderate the costs that

Consumers is to pay for its nuclear fuel in 2006.” Attorney General’s brief, p. 19. The Attorney General therefore requests that the Commission “seek a more complete explanation for the sudden jump in nuclear fuel costs” for which the utility desires recovery in this proceeding. Id., at 20.

The ALJ shares the Attorney General’s concerns regarding the near-term spike in Consumers’ nuclear fuel expense. As noted on Exhibit AG-9, the costs of purchasing and converting uranium are expected to jump 46.3% and 118.2%, respectively, between Batch V and Batch W. Similarly, the costs of enrichment and fuel assembly fabrication are predicted to rise by approximately 20% over the same period, before moderating noticeably for Batches X through Z. Nevertheless, the record identifies no less-expensive alternatives to Consumers’ proposed actions. The ALJ therefore has no recourse but to recommend that the Commission approve recovery of the utility’s projected nuclear fuel costs for 2006, albeit with the directive that Consumers provide (in the reconciliation phase of this case) a more detailed analysis regarding why those costs rose so dramatically with regard to Batch W.

Coal Transportation Costs

Mr. Gallaway provided, among other things, Consumers’ proposed plan regarding the purchase, transportation, and use of coal as a generating plant fuel source during 2006, as well as the utility’s estimate of its as-burned price for the entire period covered by the five-year forecast.

Using that information as a starting point, the Attorney General presented a report (admitted as Exhibit AG-11) analyzing the cost of transporting coal to the utility’s five coal-fired generating plants. According to the Attorney General’s witness, Mr. King,

this report indicates that although its overall transportation rates “appear to be in the middle of the pack” and “it does not appear that Consumers is overpaying for the transportation of its coal from Western mines,” it is possible that the utility is being overcharged for transportation of its Eastern coal purchases. 5 Tr. 364-365. However, Mr. King continued, “a much more refined cost analysis of the specific traffic lanes is required to confirm this conclusion.” Id. Lacking such an analysis, the Attorney General simply suggests that Consumers be instructed to consider filing a rate appeal or a request for mediation with the United States Surface Transportation Board in hopes of convincing the transporters of Consumers’ Eastern coal to accept a reduced rate.

Consumers responds by asserting that, as discussed in Mr. Gallaway’s rebuttal testimony, the Attorney General’s report is flawed in several ways. The most significant of these, the utility asserts, is that the report’s comparison of 2006 projected coal transportation costs to historical 2004 expenses constitutes “an ‘apples’ to ‘oranges’ comparison.” 5 Tr. 243. According to Consumers’ witness, this is shown by the report’s failure to indicate whether, and in what way, the 2004 data was escalated to reflect increases in the industry’s costs (such as the doubling of diesel fuel prices) over the last two years. See, Id. Moreover, Consumers notes that the Attorney General offered no evidence to the effect that either (1) the utility’s estimated coal transportation costs or (2) its efforts to control them are unreasonable. Rather, Consumers points out, the Attorney General specifically recognized that its report “raises more questions than it answers.” Consumers’ reply brief, p. 6, citing the Attorney General’s brief at p. 22.

The ALJ finds Consumers’ arguments persuasive with regard to this issue. In the absence of a showing that the utility failed to take all reasonable steps to ensure that its

coal transportation expenses are reasonable, and in light of the discussion provided in Mr. Gallaway's direct testimony, Consumers' estimated costs should be slated for recovery through the PSCR factor approved in this case. The ALJ thus recommends that the Commission grant recovery of the coal transportation costs previously outlined by the utility.

Energy and Demand Forecast

The Attorney General next contends that the forecast upon which Consumers' based its plan case understates the amount of energy and demand that will be required to satisfy the needs of its PSCR customers during 2006. Specifically, he asserts that a forecast prepared by the utility in December of 2005 (three months after the forecast upon which Consumers relies in this proceeding) indicates that a number of its ROA customers may return to the utility as full PSCR customers during 2006. According to his witness, Mr. King, this change likely reflects the fact that the Commission's December 22, 2005 order in Case No. U-14347 (Consumers' general rate case) "leveled the playing field between ROA and full retail service, such that the advantage of ROA service was significantly reduced." 5 Tr. 367. Mr. King went on to assert that the effect of this change "is to render obsolete almost every number submitted by Consumers, not only in its September 30, 2006 filing, but the supplemental filings of October 13 and November 2, 2005." Id. As a result, the Attorney General argues that the utility should be required to revise and re-file its entire plan case.

Consumers responds by noting that its September 2005 energy and demand estimate was developed based on the best information available at the time, and that insufficient information exists regarding the potential migration of ROA customers to

warrant re-starting this proceeding. Moreover, as specifically noted by Mr. Ronk, any variation in the forecasts underlying Consumers' PSCR plan "can be reconciled as part of the reconciliation case for 2006." 5 Tr. 318. This is, the utility points out, "the same methodology that has been used previously to adjust and reconcile actual performance to forecasted performance." Consumers' reply brief, pp. 6-7. Because no adequate basis has been provided for deviating from the Commission's established practice, the utility concludes, the Attorney General's request should be denied.

The ALJ agrees with the utility and finds that the Commission should reject the Attorney General's proposal. As correctly noted by Consumers, differences always exist between the forecasts set forth in the PSCR plan and what actually occurs during the plan period. In this instance, all such differences will be addressed in the course of Consumers' subsequent 2006 PSCR reconciliation. Moreover, as mentioned in the earlier discussion of MEC/PIRGIM's motion for postponement of hearings, Act 304 plan cases are inherently time sensitive. Specifically, it does neither the parties nor the ratepayers much good to issue a plan case order at or near the close of the period covered by that plan. Unfortunately, that is what would likely occur should the Commission adopt the Attorney General's proposal to essentially re-start these proceedings at such a late date. The ALJ therefore recommends rejecting the request to have Consumers' revise and re-file its 2006 PSCR plan case.

Treatment of the Intra-period Underrecovery

Based on the analysis provided above, the ALJ is recommending no numerical adjustments to either Consumers' plan case or the utility's five-year forecast. Nevertheless, establishing a specific PSCR factor for use during the remainder of the

plan year necessitates the resolution of one final issue. Specifically, the Commission must decide whether to allow the utility to increase its PSCR factor to capture the alleged intra-period underrecovery incurred from January to June 2006.

As mentioned previously, dividing Consumers' projected system supply costs by its estimated total system requirements, and then adjusting that quotient to reflect the utility's base PSCR factor and its line and transformer loss factor, results in an average monthly PSCR factor of \$0.00894 per kWh for 2006. However, Consumers asserts, the Commission's imposition of temporary PSCR factors of only \$0.00291 per kWh for January through March and \$0.00830 per kWh for April through June will leave the utility with an underrecovery estimated at \$42,169,467 (including interest) by the close of that six-month period. See, Exhibit A-24, line 2. In order to eliminate that intra-period underrecovery, Consumers continues, the previously-computed PSCR factor must be increased by a little over 3 mills per kWh. Specifically, Consumers contends, "it will be necessary for the Commission to approve a 2006 PSCR factor for July through the remaining months of 2006 in the amount of \$0.01212/kWh in order for the Company to fully recover its 2006 PSCR costs in 2006." Consumers' brief, p. 12.

According to the utility, making this upward adjustment in its maximum PSCR factor is consistent with the reasons expressed by the Commission when it first imposed temporary factors in this case. Namely, Consumers points out, the Commission intended to delay much of the rate effect caused by rising PSCR costs until the warmer months, at which time customers would no longer be making large expenditures for home heating. See, Consumers' brief, pp. 12-13; citing page 8 of the December 22 order. Imposing this higher factor (including the amount needed to eliminate the intra-

period underrecovery) at the start of July would, the utility claims, further that goal. Moreover, Consumers continues, its use would “be consistent with the principle of assigning cost recovery to the customers who cause the costs” and would ensure that, “in a future PSCR case, there would not be a large ‘overhang’ of unrecovered costs from a previous period that would have to be included in that later period’s recovery.” Id., p. 13. The utility therefore argues that the Commission should approve a maximum PSCR factor of \$0.01212 per kWh for the months of July through December 2006.

The Staff supports Consumers’ position regarding collection of the intra-period underrecovery and--like the utility--recommends approving the \$0.01212 per kWh factor, assuming issuance of the Commission’s final order in this case by July 2006. It also concurs with Consumers in advocating use of the corresponding factor set forth on Exhibit A-24, should the order be issued later than July.

The Attorney General objects to this proposal on the grounds that it would conflict both with the intent expressed in the December 22 order and the Commission’s past practice. In the first instance, he points to the Commission’s specific statement that “unintended consequences, if any, arising from the implementation of the approved factors may be addressed in the reconciliation proceeding.” Attorney General’s reply brief, p. 2; citing page 8 of the December 22 order. According to him, this statement recognizes that any underrecovery arising from application of the temporary factors should be addressed in Case No. U-14701-R (once it is filed) and not in the present case, as Consumers and the Staff suggest.

Moreover, the Attorney General contends, the Commission has consistently denied requests to address intra-period underrecoveries in the context of Act 304 plan

case proceedings. For example, in Case No. U-7785, where Consumers' requested a second-quarter supplemental PSCR factor to offset underrecoveries incurred during the first quarter of the plan year, it was held that:

The Commission agrees with the Staff that this controversy centers on one issue -- whether, in a PSCR case under Act 304, a utility may, during a plan year for which the factors are proposed, increase its filed factors in order to generate revenues in the remaining portion of the plan year sufficient to offset an estimated amount of underrecovery of allowable power supply costs actually experienced in the elapsed portion of the year. Based on a review of the case and mindful of legislative intent, the Commission finds a utility may not adjust its filed factors for such purposes.

* * *

Act 304 . . . anticipates a forward going plan. It does not, in any way, support the filing of a plan under which a utility can charge its customers a factor to recover alleged underrecovered costs from a prior period.

* * *

To allow Consumers to, in effect, conduct its own reconciliation would be the equivalent of authorizing retroactive ratemaking outside the very limited exception expressed in Act 304.

Attorney General's reply brief, p. 2; citing the July 3, 1984 order in Case No. U-7785, at pps. 8 and 10. He further notes that, in its October 29, 2003 order in Case No. U-13500, the Commission similarly ruled that gas utilities cannot recover intra-period underrecoveries in the context of gas cost recovery (GCR) plan cases filed pursuant to Act 304. The Attorney General therefore argues that the Commission should reject, as violative of both Act 304 and its related orders, Consumers' attempt to include an intra-period underrecovery as part of the costs to be collected through the 2006 PSCR factor approved in this plan case.

The ALJ finds the Attorney General's arguments persuasive on this issue. As noted in the orders cited as part of his reply brief, Act 304 clearly distinguishes between plan and reconciliation proceedings. Moreover, while it provides a narrow exception to the ban on retroactive ratemaking, the Act restricts the collection of underrecoveries or refunding of overcollections to reconciliation cases only. See, Subsections 6j(14) and (15), with regard to PSCR cases, and Subsections 6h (13) and (14) for GCR proceedings. This is likely why the Commission "has never endorsed the concept of including current plan known and projected underrecoveries in the current plan year factor." October 29, 2003 order in Case No. U-13550, p. 11. It also helps explain the Commission's statement that any unintended consequences caused by its approval of temporary factors in the present case "may be addressed in the reconciliation proceeding." December 22 order, at 8.

As a result, the ALJ recommends that the Commission deny Consumers' request to include, as part of the PSCR factor to be authorized in this plan case, an amount designed to collect the utility's alleged intra-period underrecovery.

V.

CONCLUSION

Based on the testimony and exhibits received in this case, the ALJ recommends finding that Consumers' 2006 PSCR plan is reasonable and prudent, and should be approved. Thus, as discussed previously, the ALJ suggests that the Commission approve--for use during the utility's 2006 plan year--a maximum PSCR factor of \$0.00894 per kWh.

The ALJ further recommends that the Commission (1) uphold his March 21, 2006 rulings concerning MEC/PIRGIM, (2) direct Consumers to describe, in the context of its next PSCR plan case filing, all steps taken to minimize its natural gas-related costs, including the potential use of gas storage service, and (3) require the utility to provide, as part of its initial filing in its 2006 PSCR reconciliation case, a detailed analysis of its actual use of NO_x emission allowances and a full explanation of why its “Batch W” nuclear fuel costs are expected to be so much higher than those incurred with regard to “Batch V.”

Finally, it should again be noted that any arguments not specifically addressed in this PFD were deemed to be irrelevant to the ALJ’s ultimate findings and conclusions in this proceeding.

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

**Mark E.
Cummins**

Mark E. Cummins
Administrative Law Judge

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ISSUED AND SERVED: May 25, 2006

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

STATE OF MICHIGAN	)		
	)	SS.	Case No. U-14701
County of Ingham	)		
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P R O O F O F S E R V I C E

Dawn M. Prawdzik deposes and says that on the 25th day of May 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**

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Subscribed to before me this 25th
day of May, A.D. 2006.

**Gloria Pearl
Jones**

Digitally signed by Gloria Pearl Jones
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O = DLEG/MPSC, OU = Executive
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Notary Public, Eaton County, Acting in
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My Commission expires 6-5-07.

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