

A CMS Energy Company

June 20, 2006

Ms. Mary Jo Kunkle
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
P.O. Box 30221
Lansing, MI 48909

Re: Case No. U-14526

Dear Ms. Kunkle:

Included in this electronic file are the **Exceptions of Consumers Energy Company** and a Proof of Service. This is a paperless case and is therefore being filed only in PDF format.

Sincerely,



 Digitally signed by Jon R. Robinson
Date: 2006.06.20 14:20:15 -04'00'

Jon R. Robinson

CC: Hon. Sharon L. Feldman
Parties per Attachment 1 to Proof of Service

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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
for determination of net stranded costs for)
the year 2004)
_____)

Case No. U-14526

EXCEPTIONS OF CONSUMERS ENERGY COMPANY

1. The Administrative Law Judge Erred in Recommending a Finding that Consumers Energy Incurred No Stranded Costs in 2004

The Administrative Law Judge (“ALJ”) erred in recommending adoption of a position advocated by the Attorney General in this case. In summary, she recommends that the Commission modify the previously used calculation method by imposing an additional “threshold test.” This test would, if the application of the accepted method indicates a revenue deficiency, require a further demonstration that the unrecovered costs are “costs that would have been recovered under regulation but cannot be recovered under competition.” The ALJ concluded that evidence demonstrating that this threshold test was satisfied is an additional requirement before a finding of stranded costs can be made, and concluded that there was insufficient evidence in this case making that demonstration. Consumers Energy contends (i) that this “threshold test” is not part of the Commission-approved stranded cost calculation method, (ii) that it has never before been approved or utilized by the Commission, and indeed, has been expressly rejected by the Commission, (iii) that the evidence already presented in this case demonstrates that the revenue deficiency identified by the previously-accepted calculation method represents “costs that would have been recovered under regulation but cannot be recovered under competition,” and (iv) that before the application of this test in this case could

be considered lawful, the record must be reopened to allow evidence to be presented concerning this new test.

A brief history of prior stranded cost cases demonstrates that the stranded cost calculation method adopted by the Commission was intended to be straightforward and easy to apply. Case No. U-12639 was the first post-PA 141 case, and is the case in which the Commission adopted the basic stranded cost calculation method that has been applied in subsequent cases. In its order in Case No. U-12639, the Commission described what was then “the Staff proposal:”

“The Staff proposed that the Commission annually compute net stranded costs on a historical basis. Stranded costs would be the difference between each year’s revenue requirement associated with fixed generation assets, generation-related regulatory assets, and capacity payments associated with PPAs and that year’s revenues available to cover those costs. . . . *When the revenue requirement for a specific year exceeds the revenues available to cover those costs, the utility has stranded costs for that year.*” [December 20, 2001 Opinion and Order in Case No. U-12639, p. 4. Emphasis added.]

The Commission then explicitly found that the Staff approach should be adopted:

“The Commission finds that it should adopt the Staff’s proposed methodology for determining net stranded costs. *The Staff has proposed the most direct approach to determining net stranded costs, i.e., costs that would have been recovered under regulation that 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 assets with below-market costs). The Staff’s approach also has the advantage of using the same approach for both utilities.” [December 20, 2001 Opinion and Order in Case No. U-12639, p. 10. Emphasis added.]

There was no discussion in the U-12639 order that suggested a “threshold test” would apply to the results of the described revenue requirement calculation. To the contrary, the order makes it clear that the Staff proposal was a straightforward revenue requirement-style calculation, and that the Commission believed this was the “most direct approach” for accomplishing its

objectives—i.e., to measure those costs that would have been recovered under regulation but were not recovered under competition..

In subsequent stranded cost case orders, there is similarly a total absence of any mention of any threshold test. In Case No. U-13380, the Commission reviewed evidence concerning stranded costs for 2000 and 2001. Again, the Commission offered a description of the accepted calculation method:

“The Commission previously addressed stranded costs in the December 20, 2001 order in Case No. U-12639, which accepted the Staff’s methodology for determining those costs. *The Staff approach computes net stranded costs as the difference between the utility’s revenue requirement necessary to recover the year’s fixed production costs and the contribution provided by the utility’s yearly revenues toward the recovery of fixed production costs.* The fixed cost revenue requirement sums the utility’s return on net generation plant and regulatory assets, related depreciation and amortization, plant property taxes and insurance, and capacity charges incurred for purchased power. The contribution to fixed costs is the portion of revenues from sales to ultimate customers that is allocable to the recovery of fixed production costs, plus net revenues from third-party wholesale transactions. (In this context, sales to ultimate customers mean bundled sales subject to Commission jurisdiction.) See Case No. U-12639, Exs. S-23, S-25, S-27, S-29.” [December 20, 2002 Opinion and Order, Case No. U-13380, p. 3. Emphasis added.]

Again, there is no mention of a threshold test that must be applied to the results of the revenue requirement calculation described by the Commission. In this U-13380 case, the Staff recommended a finding of stranded costs of \$5.1 million in 2000 and \$2.8 million in 2001, and again never utilized any threshold test. While the Commission ultimately adopted other adjustments that reduced stranded costs in those years to zero, the Commission never adopted any standard remotely like the threshold test that has been recommended by the ALJ in this 2004 proceeding.

In Case No. U-13720, the Commission reviewed evidence concerning stranded costs for 2002. In its November 23, 2004 Opinion and Order, the Commission consolidated, for

purposes of a final decision, the 2002 case with the 2003 stranded cost proceeding, Case No. U-14098. In that Order, the Commission stated that “the PFD [in Case No. U-13720] is well reasoned and should be accepted.” A review of the U-13720 PFD reveals that arguments were made that are virtually identical to that presented by the Attorney General in this 2004 case. The PFD states as follows:

“He [the Attorney General] contends that Consumers has no stranded costs within the scope of the Commission’s original definition that have not been securitized. Instead, the Attorney General submits, Consumers has identified what is, at best, a revenue deficiency. He maintains that Consumers inappropriately continues to define stranded costs as any underrecovered fixed generation assets.”

“The Administrative Law Judge finds that the arguments presented by Energy Michigan, ABATE, and the Attorney General should be rejected, because they rely on a definition and methodology for the calculation of stranded costs that the Commission adopted prior to the enactment of Act 141 but effectively rescinded in Case No. U-12639. Although the Commission originally defined stranded costs, in part, as ‘costs incurred during the regulated era,’ it altered that definition in Case No. U-12639. In its December 20, 2001 order in that case, the Commission described net stranded costs as:

‘Costs that would have been recovered under regulation that 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 assets with below-market costs). (Order, p. 10.)’

“The Commission further found that the Staff’s methodology, which compares current revenues to current fixed production costs, was the most direct approach to determining stranded costs and preferable to the approach it has adopted in Case No. U-11290. This methodology requires that each year’s stranded costs calculation be performed using the actual production fixed costs incurred during that year. In explaining this methodology, the Commission explicitly stated that

‘Stranded costs would be the difference between *each year’s* revenue requirement associated with fixed generation assets, generation-related

regulatory assets, and capacity payments associated with PPAs and *that year's* revenues available to cover those costs.

* * *

‘When the revenue requirement for *a specific year* exceeds the revenues available to cover those costs, the utility has stranded costs for *that year*.’” [December 20, 2001 order, p. 4, emphasis added.]

In the U-13720 PFD, the ALJ recommended a finding that Consumers Energy incurred \$10,541,000 in stranded costs for 2002. The ALJ did not apply any threshold test, but simply adopted the results of the U-12639 calculation. In the November 23, 2004 Order, the Commission adopted this recommendation, noting that “the PFD is well reasoned and should be accepted.” The Commission did not apply any threshold test. November 23, 2004 order, p. 13. Further, in resolving the 2003 stranded cost proceeding, the Commission found that Consumers Energy had incurred stranded costs of \$46,225,000 in 2003, and again did not apply any threshold test. *Id.* It is beyond dispute that the threshold test that the ALJ has recommended in this U-14526 proceeding was not utilized in the 2002 and 2003 cases.

Finally, in response to a late-filed petition to reopen the records in Cases No. U-13380, U-13720 and U-14098, the Commission again rejected attempts to graft additional requirements onto the straightforward revenue requirement calculation method. In an order issued January 10, 2006 Order, the Commission again described this method:

“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 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. The stranded cost method adopted by the Commission in Case No. U-12639 has been affirmed on appeal.” [January 10, 2004 Order, Cases No. U-13380, U-13720, U-14098, p. 11.]

Again, the Commission described the approved calculation method as a straightforward revenue requirement model, and did not reference any further threshold test or additional demonstration.

Notwithstanding the clear history of the U-12639 stranded cost method as set forth in the prior Commission orders, the ALJ concludes that the Commission really intended to create a “threshold test” that requires not merely evidence showing that the U-12639 method produces a generation-related revenue deficiency, but also requires additional evidence that the revenue deficiency represents “costs that would have been recovered under regulation that cannot be recovered under competition.”

A review of the prior Commission orders on this subject reveals that the Commission never intended to subject the calculation result to some further test, and perhaps more to the point, never applied such a test in any of the prior orders. The clearest demonstration of this is the November 23, 2004 order in Cases No. U-13720 and U-14098 where the Commission found that Consumers Energy had incurred stranded costs of \$10,541,000 in 2002 and \$46,225,000 in 2003. In so finding, the Commission did not apply the threshold test that the ALJ now recommends be applied in this case.

The Commission Staff also has indicated in this case its disagreement with the position adopted by the ALJ. In its briefs filed in this proceeding, the Staff stated that the Attorney General position “essentially produces a new methodology that was not approved by the Commission and Staff disagrees with this reasoning.” [See Reply Brief of Michigan Public Service Commission Staff, pp. 9-11.]

As noted earlier in these exceptions, a review of the Commission’s prior orders indicates that, when the Commission used the phrase “costs that would have been recovered under regulation that cannot be recovered under competition,” it was providing a general statement of the basic objective of any stranded cost measurement method. In the U-12639

Order, the Commission specifically found that the Staff proposal in that case met that objective in a satisfactory manner. Thus, the Commission did not intend that this phrase create some additional test that must be satisfied; rather, it was concluding that the Staff calculation proposal met its objective. Its actions in subsequent stranded cost orders confirm that this was the Commission's intent.

In any event, it is clear that the approximate \$24 million of stranded costs produced by the application of the U-12639 method represents costs that would have been recovered under regulation that were not recovered under competition. There was a substantial and expanding amount of ROA load in 2004. Total ROA load in 2004 was 4,151,617 MWh. Exhibit EM-6. Had that load not departed for ROA service, Consumers Energy's fixed cost recovery would have been substantially greater. Thus, the ALJ is simply incorrect when she states that there was no evidence that indicated any part of the revenue deficiency shown by the U-12639 method was due to competition. If the ROA load had received service under Consumers Energy's full service rates, the Company's revenues would have been \$67 million greater.¹ This is obviously vastly in excess of the \$24,126,000 that is produced by application of the U-12639 calculation, and (i) demonstrates that the U-12639 method produces a result that is conservative, and (ii) confirms that the U-12639 calculation used in this case identifies costs that would have been recovered under regulation but were not recovered due to ROA competition.

It is also instructive to consider the overall generation-related revenue deficiency experienced in 2004 when various generation costs that were excluded from the stranded cost calculation are added back. That is, the 2004 annual revenue requirement of the Clean Air Act

¹ This amount is computed using (i) the 2004 ROA load from Exhibit EM-6, (ii) the average full service rate for large customers from CFB WP 17 and 18 (which are pages 300 and 301 from the 2004 MPSC Annual Report, (iii) the average ROA distribution service revenue from CFB WP 65a, and (iv) the average PSCR rate calculated from information on Exhibit EM-7, p. CFB WP-62a. This calculation is extremely conservative. If the calculation was done using the actual ROA customer billing determinants for 2004, it would show that the actual impact of ROA on Consumers Energy was to reduce revenues by over \$80 million.

costs that have been excluded from the stranded cost calculation is \$21,131,000. Exhibit A-3; 2 TR 61.² The amount of seasonal capacity costs excluded from the stranded cost calculation is \$5,057,616. 2 TR 49-50. When these amounts are added back to the \$24,126,000 annual revenue requirement produced by the adjusted stranded cost calculation (before the allocation of any amount of third party sales revenue as an offset), (see Exhibit A-1), the total *actual* generation fixed cost revenue deficiency experienced in 2004 was \$50,314,616, a further demonstration of the conservative nature of the U-12639 method.

Thus, the fixed costs that were not recovered in 2004 due to ROA competition were approximately \$67 million. The total actual generation fixed cost revenue deficiency in 2004 (if all generation-related costs are included) was \$50,314,616. All of these costs would have been recoverable under regulation. A strict application of the “threshold test” that the ALJ believes should be applied would suggest that the U-12639 calculation is, if anything, significantly understating Consumers Energy’s true stranded costs. At a minimum, the magnitude of the lost revenues associated with ROA load eliminates any reasonable claim that the revenue deficiency produced by the U-12639 method was not the result of the introduction of competition. *If that ROA load had remained full service load of Consumers Energy*, the U-12639 revenue requirement calculation for 2004 would not show a deficiency, and indeed, might have resulted in a revenue *sufficiency*.

In any event, the application of the threshold test as recommended by the ALJ invites endless argument. “Costs that would have been recovered under regulation but cannot be recovered under competition” is not a standard that, by itself, is capable of being consistently applied in a predictable manner. The measurement of “costs that would have been recovered under regulation” would, under the ALJ’s interpretation, require assumptions to be made about

² This is the difference between the total Clean Air Act revenue requirement shown on Exhibit A-3, and the amount that was allowed to be recovered in Case No. U-14148 (Section 10d(4)) of \$16,289,000. 2 TR 61.

the timing and substantive outcome of rate increase requests that never occurred. In addition, this phrase seems to include costs such as the Clean Air Act costs that have been the subject of much debate in these cases. Certainly the Clean Air Act investments are “costs that would have been recovered under regulation,” but that have not been recovered under the competitive regime introduced by PA 141. How are these costs to be treated under the ALJ’s recommended approach?

The ALJ further renders her new standard infeasible when she states that “underrecoveries due strictly to the legislatively imposed rate freeze are not ‘stranded’ within the meaning of the Commission’s formula.” Under this interpretation, even generation-related costs that are reasonable and prudent but not recoverable from full service customers due to a statutory rate freeze imposed in a competition statute, and not recoverable from ROA customers who switch generation service suppliers, cannot be considered “stranded.” The ALJ’s interpretation of the Commission’s prior orders effectively renders meaningless the statutory promise of recovery of stranded costs, and cannot fairly be adopted to excuse applying the U-12639 stranded cost method in a fair and consistent manner.³

MCL 460.10a(1) states that the Commission shall issue orders that “*shall provide for full recovery of a utility’s net stranded costs* and implementation costs as determined by the Commission.” MCL 460.10a(16) states that the Commission “shall, after a contested case

³ The ALJ further confuses the issue when she cites to a passage in an attachment to the Staff reply brief filed in this case. The attachment is apparently a portion of testimony filed by a Staff witness in U-12639. This is obviously not testimony in this U-14526 proceeding, and the fact that it was not even mentioned until the reply brief stage makes reliance upon it even less justified. Further, the ALJ apparently relied upon this excerpt of testimony to support a point different from that made by the Staff in its reply brief. In any event, the testimony to which the ALJ refers simply says that, “[i]f a company’s sales should fall for reasons other than a loss of customers due to retail open access,” it might not be appropriate to always characterize the shortfall as stranded costs. This clearly refers to a rather limited circumstance which does not even exist in this 2004 stranded cost proceeding. The evidence in this case is very clear that Consumers Energy’s full service sales were much less than they would otherwise have been *because of retail open access*. As noted above, ROA sales in 2004 were over 4 million MWh. This obviously contributed to the revenue deficiency that the application of the U-12639 method produced. For the ALJ to rely upon testimony from another proceeding was improper. For the ALJ to go even further, and offer her own unsupported interpretation of this testimony that expanded the meaning beyond what was actually stated is especially improper.

proceeding, issue annually an order approving for each electric utility a true-up adjustment to reconcile any overcollections or undercollections of the preceding 12 months *to ensure the recovery of all amounts of net stranded costs.*” The method that has been “determined by the Commission” to be used in implementing these statutory sections is the U-12639 method. That method very plainly requires consideration of all production plant investment and power supply contract capacity costs in a revenue requirement calculation that is conducted on an annual basis. The ALJ’s recommendation to modify this method for 2004 would effectively deny recovery of stranded costs, in violation of the PA 141 provisions that guarantee recovery of net stranded costs, and would be blatantly unlawful. Indeed, if the argument was accepted by the Commission, it would be the equivalent of concluding that the original adoption of the U-12639 method was unlawful, and that the Commission is not in compliance with the provision of PA 141 requiring the Commission to issue an order no later than January 1, 2002 that “provide[s] for full recovery of a utility’s net stranded costs.” [MCL 460.10a(1).]

If the Commission concludes that some further evidence is required beyond the application of the revenue requirement calculation, then it should reopen the record to allow the introduction of such evidence. It would be unlawful and a violation of due process to deny Consumers Energy’s application without affording it an opportunity to present evidence regarding some heretofore unstated test.

2. The ALJ Properly Recognized that Third Party Sales Revenues Cannot be Double-Counted, But Failed to Make a Recommendation on How Such Revenues Should Be Allocated

The ALJ addressed the issue concerning the allocation of third party sales, and simply noted that the Commission should ensure consistency between this 2004 stranded cost proceeding and the 2004 PSCR reconciliation. Consumers Energy agrees that consistency in

these two cases is essential to a fair resolution of this issue. These revenues cannot be allocated twice, and thus double-counted.

The ALJ declined, however, to make a recommendation concerning the appropriate allocation of third party sales revenues between PSCR customers and ROA customers. As Consumers Energy noted in its brief, while the allocation of these revenues is essentially a policy judgment, the Company believes that its position more fairly balances the competing considerations. Consumers Energy's position, consistent with past Commission practice, allocates a sufficient amount of third party revenues to reduce stranded costs to zero, which in this case, results in approximately a 50-50 split of these revenues between ROA customers and full service customers. See Exhibit A-7. The MPSC Staff approach develops an allocation percentage that is based upon the percentage of fixed generation costs that are assumed to be recovered from full service customers, which in this case, results in an allocation of 96.78% of these revenues to full service customers, and 3.22 % to ROA customers. 2 TR 67. Energy Michigan effectively argues that 100% of third party revenues should be allocated for the benefit of ROA customers. Consumers Energy believes that its proposal is reasonable and balanced and should be adopted.

Respectfully submitted,

CONSUMERS ENERGY COMPANY

Dated: June 20, 2006

By:

 Digitally signed by Jon R. Robinson
Date: 2006.06.20 14:21:07 -04'00'

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STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
for determination of net stranded costs for)
the year 2004)
_____)

Case No. U-14526

PROOF OF SERVICE

STATE OF MICHIGAN)
) SS
COUNTY OF JACKSON)

Sammie B. Dalton, being first duly sworn, deposes and says that she is employed in the Legal Department of Consumers Energy Company; that on June 20, 2006 she served an electronic copy of the **Exceptions of Consumers Energy Company** upon the persons listed in Attachment 1 hereto, at the e-mail addresses listed therein.

Sammie B Dalton

Digitally signed by Sammie B. Dalton
Date: 2006.06.20 14:21:59 -04'00'

Sammie B. Dalton

Subscribed and sworn to before me this 20th day of June, 2006.

Margaret Hillman

Digitally signed by Margaret Hillman
Date: 2006.06.20 14:22:46 -04'00'

Margaret Hillman, Notary Public
State of Michigan, County of Jackson
My Commission Expires: 06/14/10
Acting in the County of Jackson

ATTACHMENT 1 TO CASE NO. U-14526 – E-Mail Service List

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