S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **INDIANA MICHIGAN POWER COMPANY** for reconciliation of its power supply cost recovery revenues and expenses for the 12-month period ended December 31, 1996.	))))))	Case No. U-10971-R

At the February 25, 1998 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. John G. Strand, Chairman
Hon. John C. Shea, Commissioner
Hon. David A. Svanda, Commissioner

OPINION AND ORDER

I.

HISTORY OF PROCEEDINGS

On March 31, 1997, Indiana Michigan Power Company (I&M) filed an application, pursuant to 1982 PA 304, as amended, MCL 460.6h et seq.; MSA 22.13(6h) et seq., (Act 304) requesting a reconciliation of its power supply cost recovery (PSCR) revenues and expenses for the 12-month period ended December 31, 1996.

Pursuant to due notice, a prehearing conference was conducted on May 14, 1997 before Administrative Law Judge Frank V. Strother (ALJ). At that time, the ALJ granted the petition to intervene filed by the Michigan Community Action Agency Association (MCAAA). The Commis-

sion Staff (Staff) also entered its appearance and participated in the proceedings. To ensure that disputes regarding discovery did not unnecessarily delay resolution of this case, the ALJ conducted additional prehearing conferences on June 17, July 1, and July 9, 1997. Finally, evidentiary hearings were conducted on July 15 and 16, September 30, and October 21, 1997. The record consists of 495 pages of transcript and 27 exhibits, 26 of which were received into evidence.

The parties filed briefs on November 3, 1997. I&M and MCAAA filed reply briefs on November 12, 1997. On November 20, 1997, the ALJ issued his Proposal for Decision (PFD). I&M and MCAAA filed exceptions to the PFD on December 4, 1997. On December 11, 1997, I&M and the Staff filed replies to exceptions.

II.

POSITIONS OF THE PARTIES

I&M

I&M's service territory in Michigan[1] is divided into two parts, which are referred to as the St. Joseph and Three Rivers rate areas, respectively. Consistent with past practice, I&M proposed reconciling separately each area's PSCR revenues and expenses.

With regard to the St. Joseph rate area, David L. Hille, the Manager of I&M's Rates and Regulations Department, testified that the Commission should (1) begin with the $334,579 overrecovery incurred during the 1996 PSCR plan year, (2) reduce that figure to reflect unrecovered amounts and associated interest arising from I&M's 1994 and 1995 PSCR reconciliations, and (3) increase that figure to account for this rate area's proportional share of the conservation

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[1] I&M also provides retail electric service in northern and eastern Indiana.

program overrecovery established in Case No. U-10300-R. 5 Tr. 151. He went on to state that I&M should then return the net overrecovery of $194,157 (including interest) to customers in the St. Joseph rate area by applying a credit of negative 1.31 mills per kilowatt-hour (kWh) to those customers' October 1997 bills.

With regard to the Three Rivers rate area, Mr. Hille testified that the Commission should (1) start with the $114,662 underrecovery incurred during 1996, (2) reduce that figure to reflect

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[2]AEP is the parent company of I&M and six other electric utilities. The generation resources of the AEP companies are operated as an integrated system to serve the combined loads of the operating utilities. Mr. Symansic's direct employer, the American Electric Power Service Corporation, serves as the agent for each of these utilities with regard to the purchase and delivery of coal.

overall coal deliveries for 1996 were 14.3% lower than forecasted. 5 Tr. 203. He went on to state that these reduced requirements, when coupled with language establishing minimum purchase levels for coal obtained through I&M's long-term contracts, resulted in the purchase of slightly less spot market coal during 1996 than anticipated in the PSCR plan. Mr. Symansic went on to note that, notwithstanding that fact, I&M's per unit coal cost during the plan year was the third lowest of Michigan's 11 electric utilities and was at least 10¢ per million British thermal units (MMBtu) less than the statewide average. 5 Tr. 204.

Based on this testimony, I&M asserted that its fuel management practices and the resulting overall fuel costs for 1996 were reasonable and prudent, and should be approved.

MCAAA

Jerry E. Mendl, President of MSB Energy Associates, Inc., provided testimony on behalf of MCAAA. Based on a comparison of the relative prices paid for spot market and contract coal by utilities in Michigan and its neighboring states, he concluded that I&M could have reduced its coal costs throughout the plan year by placing more reliance on the spot market.

In support of his conclusion, Mr. Mendl noted that although I&M's contract coal purchases averaged 116.16¢ per MMBtu during 1996, the utility's average cost for spot market coal was 97.57¢ per MMBtu. Exhibit I-19. He went on to note that although one of AEP's other operating companies, Central Operating Company (Central), purchased 48% of its coal on the spot market during the PSCR plan year, only 16% of I&M's coal came from the spot market. Exhibit I-20. According to Mr. Mendl, if I&M had taken 48% of its coal from the spot market as Central did, "it would have reduced its fuel costs by $11 million in 1996." 8 Tr. 318. Based on Mr. Mendl's testimony, MCAAA argued that the Commission should disallow Michigan's jurisdictional share of

this $11 million, which MCAAA estimated to be approximately $1.7 million. MCAAA's initial brief, p. 8.

Staff

The Staff presented no witnesses in this case. Rather, after reviewing the documents and testimony submitted by the other parties, the Staff concluded that I&M's 1996 PSCR costs were reasonable and that no adjustments to the utility's reconciliation proposal are needed. The Staff therefore concluded that the Commission should reject MCAAA's proposed disallowance.

III.

DISCUSSION

In his PFD, the ALJ rejected MCAAA's arguments regarding the need for I&M to include a larger percentage of spot market coal in its overall fuel mix for 1996. He therefore recommended that the Commission approve the refund and surcharge factors set forth by I&M in its application. MCAAA and I&M filed a total of seven exceptions to the PFD.

The Availability of Additional Spot Market Coal

MCAAA's proposed $1.7 million disallowance was based on its assertion that spot market coal appropriate for burning in I&M's generating plants was available to the utility at an average price of 97.57¢ per MMBtu and in greater quantities than I&M chose to purchase during 1996. In recommending rejection of the proposed disallowance, the ALJ concluded that the mere availability of additional spot market coal was immaterial. This was particularly true, the ALJ stated, where "in following the coal procurement plan approved by the Commission in its 1996 plan proceeding, [I&M] did not need to make any further spot market purchases." PFD, p. 9.

MCAAA excepts to that conclusion. It argues, among other things, that the ALJ failed to recognize that Act 304 requires utilities to implement a least cost strategy when purchasing fuel and that strict adherence to a previously-approved PSCR plan does not preclude the possibility of a disallowance. MCAAA further asserts the ALJ's conclusion ignores important testimony elicited from one of I&M's witnesses. In support of this assertion, MCAAA cites statements from Mr. Symansic to the effect that additional spot market coal was available for purchase during 1996 and that I&M could have obtained spot market coal from the same mines that supply its contract coal (meaning that the coal would have equivalent levels of sulfur, ash, and heat content). MCAAA therefore argues that the ALJ's conclusion regarding this issue should be rejected.

The Commission disagrees with MCAAA's proposed application of Act 304. MCAAA is correct in arguing that strict adherence to a previously-approved fuel purchase plan does not serve as an absolute shield to disallowances under Act 304. Specifically, it is possible that deviating from a Commission-approved plan could be the most reasonable and prudent course of action given certain circumstances. Nevertheless, the ALJ properly concluded that no such circumstances were shown to exist in this case. This is based on the following three factors.

First, MCAAA's claim that I&M could have obtained additional spot market coal for 97.57¢ per MMBtu was speculative. Nowhere in the record did MCAAA establish the existence of offers from producers to provide spot market coal at that price. Second, even if it had been shown that some coal could be obtained for 97.57¢ per MMBtu, there was no proof that it would be available in sufficient quantities to bring I&M's spot market purchases to the 48% level suggested by MCAAA in computing its proposed disallowance. This is particularly true in light of the fact that

I&M regularly purchases over 10 million tons of coal annually.[3] Exhibit I-22, Schedule 4. Third, the utility had no need for additional coal from the spot market regardless of the price. Specifically, reduced fuel consumption during 1996 meant that I&M needed 14.3% less coal than anticipated. 5 Tr. 203. Thus, because the utility was already anticipating taking the minimum level of coal allowed under each of its long-term contracts, there was no room for more spot coal in I&M's fuel mix for 1996.

For all of these reasons, the Commission finds that it should reject MCAAA's exception and adopt the ALJ's conclusion that "the mere availability of spot market coal appropriate for burning in [I&M's] generating facilities is immaterial." PFD, p. 10.

Reasonableness of the 48% Benchmark

MCAAA also excepts to the ALJ's rejection of its proposal to use the percentage of spot market coal purchased by Central during 1996 as a measure of the reasonableness of I&M's coal purchases. Such a comparison is compelling, MCAAA contends, due to the fact that Central and I&M are both AEP subsidiaries, and that each of them had been purchasing an equal proportion of their coal (33%) on the spot market as recently as 1994. Accordingly, MCAAA continues, I&M's decision to reduce the percentage of spot market coal in its fuel mix to 16% during 1996 (while Central increased its proportion of spot market purchases to 48%) supports Mr. Mendl's claim that a $1.7 million disallowance is warranted.

MCAAA's arguments are not well taken. As noted by the ALJ, Central is so different from I&M that a comparison of the percentage of spot market coal in their respective fuel mixes for

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[3]As noted by the ALJ, the sheer volume of spot market coal that I&M would need in order to satisfy MCAAA's 48% benchmark could, by itself, place significant upward pressure on the price of that coal. PFD, p. 11.

1996 is largely irrelevant. Unlike I&M, Central (1) consists of a single, coal-fired generating station, (2) is a joint venture operated by two other AEP affiliates, the Ohio Power Company and the Appalachian Power Company, (3) has no retail customers, (4) provides all of its output at wholesale to Ohio Power and Appalachian Power, and (5) purchases much less coal each year than I&M.[4]

Moreover, Central's relatively heavy reliance on spot market coal may simply stem from the fact that the difference in price between its contract and spot market coal supplies in 1996 (38.91¢ per MMBtu) is more than twice I&M's spread (18.59¢ per MMBtu). See, Exhibit I-22, Schedule 4. Finally, as noted by Mr. Symansic, the percentage of spot market coal purchased by a utility is not an accurate indicator of its total per unit cost of coal. This is shown by the fact that "although [Central had] a higher percentage of spot market coal purchases than I&M did in both 1995 and 1996, and an equal percentage in 1994, I&M had lower delivered coal costs in each year." 9 Tr. 414. The Commission therefore concludes that the ALJ was correct in rejecting MCAAA's request to apply the 48% spot market coal benchmark proposed by Mr. Mendl.

Renegotiation of I&M's Coal Contracts

MCAAA argued that I&M should have renegotiated its long-term coal supply contracts to reduce the minimum takes required during 1996, the price of the coal, or both. This way, MCAAA continued, the utility either would be free to purchase a higher percentage of spot market coal or would be allowed to pay a price for contract coal that was more in line with spot market prices. The ALJ rejected this argument, concluding that "a further flaw in MCAAA's reasoning is its

[4]For example, Central's contract and spot market coal purchases totaled approximately 2.4 million tons during 1996. In contrast, I&M's coal purchases totaled about 11.8 million tons over the same period. Exhibit I-22, Schedule 4.

underlying assumption that I&M's long-term contracts would not prohibit it from making [spot market coal purchases] in substitution for its minimum contract takes." PFD, p. 12.

MCAAA excepts to that conclusion. According to MCAAA, the ALJ mistook "as an 'underlying assumption' the evidentiary fact that I&M can renegotiate its long-term coal contracts' minimum take and price terms." MCAAA's exceptions, p. 4. Specifically, MCAAA contends, Mr. Symansic revealed during cross examination that I&M has, since 1987, reduced the nominal coal volumes, minimum takes, and the price per MMBtu in several of its long-term contracts. 9 Tr. 482-485. With that established, MCAAA continues, and because spot market coal was less expensive than contract coal for at least two years prior to the start of 1996, I&M had an obligation to renegotiate the long-term contracts that would be in effect during the 1996 PSCR plan year. MCAAA therefore argues that the utility's failure to satisfy that obligation justifies the disallowance sought in this case.

The Commission disagrees and finds that MCAAA's arguments on this point must be rejected. Although MCAAA faults I&M's long-term contracts as being too restrictive, it offers no specific criticism of particular contract provisions and presents no evidence of missed opportunities that were available to the utility either when the agreements were signed or during the 1996 plan year. The Commission is thus left with a record in which the only evidence on this issue indicates that I&M entered into its long-term contracts to assure adequate deliveries of coal and to reduce the volatility of its fuel supply costs, and that it signed those contracts only after taking numerous steps to ensure that the delivered price of that coal was minimized. 5 Tr. 198-204. In light of this evidence, MCAAA's request for a disallowance due to I&M's failure to further renegotiate its long-term contracts should be denied.

Timeliness of the Proposed Disallowance

In addition to recommending that the Commission reject MCAAA's proposed disallowance, the ALJ questioned the timeliness of that proposal. He indicated that concerns regarding a utility's coal procurement policy and the language contained in its long-term coal contracts are more appropriate for consideration in the context of a PSCR plan case than during reconciliation. Moreover, he noted that although MCAAA was a party to I&M's 1996 plan case, it voiced no objection in that proceeding to the utility's proposed coal procurement strategy, supply contract terms, and projected coal costs. According to the ALJ, the fact that there was "sufficient opportunity for MCAAA to raise the issue" in the plan case provided additional support for rejecting the proposed disallowance. PFD, p. 13.

MCAAA excepts, claiming that the ALJ erred in suggesting that its proposal for a $1.7 million disallowance was untimely. In reaching his conclusion, MCAAA argues, the ALJ "wrongfully assumed that minimizing the cost of fuel is relevant only to a PSCR plan case." MCAAA's exceptions, p. 5 [Emphasis added]. Moreover, MCAAA asserts, Mr. Mendl's claim that I&M's coal costs for 1996 were excessive due to an overreliance on contract coal was based strictly on the record developed in this reconciliation case. MCAAA therefore contends that the ALJ's comments regarding the lack of timeliness should be rejected.

Again, the Commission disagrees. As noted by the Commission in its October 29, 1997 order in Case No. U-11449, the goal of a reconciliation proceeding like this is to review the utility's "compliance with the previously approved PSCR plan and to consider the reasonableness and prudence of any activities of the utility that were not previously considered in the PSCR plan proceeding." Order, p. 9. During I&M's 1996 PSCR plan case, the utility described all of its major coal supply contracts and discussed its coal procurement strategy for 1996, all as required by MCL

460.6j(3); MSA 22.13(6j)(3). The Commission approved I&M's plan, without amendment, in its June 26, 1996 order on Case No. U-10971. Thus, I&M's fuel procurement strategy and its long-term coal purchase contracts were deemed reasonable and prudent, at least as of that date.

In light of the PSCR plan's approval, the proper focus of the present proceeding is to determine whether I&M's management decisions during 1996 were likewise reasonable and prudent, or whether unanticipated circumstances arising during the plan year necessitated some particular deviation from the plan. Nevertheless, MCAAA cites no evidence showing a change in conditions from those anticipated by the Commission when issuing its order in the plan case. Instead, it offers arguments regarding I&M's coal procurement strategy, supply contract terms, and projected coal costs that could have been raised in the plan case proceeding. The Commission therefore concludes that the ALJ was correct in stating that these arguments were untimely.

The ALJ found this comparison "unconvincing." PFD, p. 15. He reached that conclusion because (1) the eight utilities selected for purposes of comparison were not a statistically relevant random sample, (2) Mr. Mendl provided no sound rationale for their selection, (3) no evidence was offered to show that the type of coal purchased by those utilities would have been suitable for use by I&M's generating plants at the times and quantities required, and (4) data indicated that I&M's average delivered cost of coal during 1996 was lower than that for nearly all members of Mr. Mendl's comparison group.

MCAAA excepts to that conclusion. According to it, because a "statistically relevant random sample" is unnecessary to establish that I&M purchases less spot market coal than other regional utilities, Mr. Mendl's analysis should suffice. Moreover, MCAAA argues, Mr. Mendl testified that he did not know the spot market coal percentages of the utilities before he selected his sample. Thus, while the sample may not have been random, MCAAA continues, it certainly was not biased. For these reasons, it asserts, the ALJ could safely rely on the comparison as proof that I&M should have purchased more spot market coal in 1996 than it did.

Notwithstanding MCAAA's arguments to the contrary, the Commission agrees with the ALJ and finds that Mr. Mendl's comparison does not justify a disallowance in this case. Even assuming that the lack of a random sample is insufficient reason to reject his comparison in its entirety, the results themselves are far from conclusive. For example, Exhibit I-22, Schedule 4 shows that Mr. Mendl calculated I&M's weighted average cost of coal for 1996 (including both spot market and contract coal) to be 113.15¢ per MMBtu. However, the next section of that exhibit shows that I&M's figure is less than the weighted average cost of coal for seven of the eight utilities contained in Mr. Mendl's analysis. Exhibit I-22, Schedule 5. The data assembled by MCAAA's witness further indicates that I&M's average cost of contract coal (116.16¢ per MMBtu) is less than the

weighted average cost of coal for six of the eight utilities examined by Mr. Mendl, and is even lower than the average cost of spot market coal for four of those utilities. 8 Tr. 327-328; Exhibit I-22, Schedules 4 and 5.

These results indicate that the percentage of spot market coal included in a utility's fuel mix may not, by itself, indicate unreasonableness and imprudence. This is particularly true where, as in the case of I&M, the utility's contract coal prices are relatively low. The Commission therefore concludes, as did the ALJ, that the comparison presented by Mr. Mendl was not adequate to support MCAAA's proposed disallowance.

Allegations Regarding the Lack of Empirical Evidence

In its final exception, MCAAA argues that the ALJ ignored the fact that I&M offered no study, data, or analysis to corroborate Mr. Symansic's claim that excessive reliance on spot market purchases would be a costly and undesirable long-term strategy. It further contends that although I&M asserted that it was doing everything possible to lower its fuel costs, the utility failed to "quantify the benefits of its actions, explain how these actions minimize fuel costs, or demonstrate why [it] could not purchase a higher fraction of spot market coal during 1996 than it did." MCAAA's exceptions, p. 8. According to MCAAA, this alleged lack of empirical evidence supporting the reasonableness of I&M's coal purchase strategy necessitates imposing the $1.7 million disallowance suggested by Mr. Mendl.

The Commission concludes that these arguments should be rejected for two reasons. First, as noted by the ALJ, MCAAA's arguments "ignore ample evidence in the record regarding [I&M's] coal procurement practices." PFD, p. 16. For example, Mr. Symansic testified that

(1) it "is not wise to purchase coal on the basis of price alone" because factors like boiler design, emissions standards, and other operational requirements affect the cost of coal per unit of electricity produced, (2) in an effort to determine whether less expensive coal could be burned at its Tanners Creek Generating Unit No. 4, I&M conducted a "test burn," which ultimately indicated that significant emissions problems would occur if the less expensive fuel mix was used, (3) AEP's coal procurement division monitors I&M's "coal consumption, scheduled deliveries, transportation constraints, forced outages, changes to scheduled outages, and other pertinent information on a daily basis," and produces an updated annual coal use forecast at least once a month, and (4) on at least eight occasions during 1996, I&M solicited bids for additional spot market coal. 5 Tr. 198-200; 6 Tr. 214; 9 Tr. 406 and 445. Second, the issue raised by MCAAA is better suited for analysis in the context of a PSCR plan case.

<u>Computation of the Over- and Underrecovery Balances</u>

As noted earlier in this order, the ALJ concluded that I&M's PSCR expenses for 1996 were reasonably and prudently incurred. He therefore recommended refunding an overrecovery balance of $194,157 to I&M's St. Joseph area ratepayers through use of a bill credit, as well as surcharging the utility's Three Rivers area ratepayers to collect a net underrecovery of $69,307, as initially proposed by Mr. Hille.

I&M excepts to that recommendation on the grounds that the figures cited by the ALJ no longer accurately reflect accumulated interest. Specifically, the utility notes that the figures provided by Mr. Hille were based on the assumption that I&M would issue credits and impose surcharges during the October 1997 billing month. Thus, I&M points out, those figures reflect interest only through the middle of October 1997. The utility therefore asserts that, pursuant to

MCL 460.6j(16); MSA 22.13(6j)(16), the Commission must provide for additional interest through the midpoint of the month in which I&M is directed to implement the credit and surcharge approved in this order. Finally, I&M contends that the computation of this additional interest should adhere to the methodology discussed by Mr. Hille on pages 160 and 166 of the transcript.

The Staff concurs with I&M's proposal, and MCAAA expresses no objection to that request.

The Commission concludes that the utility's exception is well taken and that the adjustments proposed by I&M should be approved. It therefore finds that the St. Joseph rate area's overrecovery balance of $194,157 and the Three Rivers rate area's underrecovery balance of $69,307 should be adjusted to reflect interest accrued between October 1997 and the midpoint of the billing month in which the bill credit and surcharge, respectively, are implemented.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 106, as amended, MCL 460.551 et seq.; MSA 22.151 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; MSA 22.1 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; MSA 22.13(1) et seq.; 1982 PA 304, as amended, MCL 460.6h et seq.; MSA 22.13(6h) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACS, R 460.17101 et seq.

b. MCAAA's proposed disallowance should be rejected.

c. I&M's PSCR expenses for calendar year 1996 were reasonably and prudently incurred.

d. A net overrecovery balance of $194,157 (plus interest accrued since the midpoint of October 1997) should be returned to customers in the St. Joseph rate area by way of a uniform bill credit, and a net underrecovery balance of $69,307 (likewise adjusted for interest accrued from the

midpoint of October 1997) should be collected from customers in the Three Rivers rate area through application of a uniform surcharge. The bill credit and the surcharge should be implemented during the April 1998 billing month.

THEREFORE, IT IS ORDERED that:

A. The disallowance recommended by the Michigan Community Action Agency Association is rejected.

B. Indiana Michigan Power Company shall refund to customers in its St. Joseph rate area, through use of a uniform bill credit applied during the April 1998 billing month, the net overrecovery balance of $194,157 (adjusted for interest from the midpoint of October 1997).

C. Indiana Michigan Power Company is authorized to collect from customers in its Three Rivers rate area, through application of a uniform surcharge during the April 1998 billing month, the net underrecovery balance of $69,307 (adjusted for interest from the midpoint of October 1997).

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ John G. Strand

Chairman

(S E A L)

/s/ John C. Shea

Commissioner

/s/ David A. Svanda

Commissioner

By its action of February 25, 1998.

/s/ Dorothy Wideman
Its Executive Secretary

B. Indiana Michigan Power Company shall refund to customers in its St. Joseph rate area, through use of a uniform bill credit applied during the April 1998 billing month, the net overrecovery balance of $194,157 (adjusted for interest from the midpoint of October 1997).

C. Indiana Michigan Power Company is authorized to collect from customers in its Three Rivers rate area, through application of a uniform surcharge during the April 1998 billing month, the net underrecovery balance of $69,307 (adjusted for interest from the midpoint of October 1997).

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

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Chairman

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Commissioner

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Commissioner

By its action of February 25, 1998.

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Its Executive Secretary

In the matter of the application of **INDIANA MICHIGAN POWER COMPANY** for reconciliation of its power supply cost recovery revenues and expenses for the 12-month period ended December 31, 1996.	))))))	Case No. U-10971-R

Suggested Minute:

> "Adopt and issue order dated February 25, 1998 reconciling Indiana Michigan Power Company's power supply cost recovery revenues and expenses for calendar year 1996, ordering application of a bill credit for customers in the St. Joseph rate area, and authorizing implementation of a surcharge for customers in the Three Rivers rate area, as set forth in the order."