STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **CONSUMERS POWER COMPANY** for approval of a power supply cost recovery plan and for authorization of monthly power supply cost recovery factors for calendar year 1997.	)	Case No. U-11180

At the July 24, 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

History of Proceedings

On September 30, 1996, Consumers Energy Company[1] (Consumers) filed an application requesting approval of its power supply cost recovery (PSCR) plan and factor for 1997. A prehearing conference was held on November 5, 1996 before Administrative Law Judge Frank V. Strother (ALJ). He granted petitions for leave to intervene filed by Attorney General Frank J. Kelley (Attorney General), the Michigan Power Limited Partnership, the Midland Cogeneration Venture Limited Partnership (MCV), the Association of Businesses Advocating Tariff Equity

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[1]Effective March 11, 1997, Consumers Power Company became Consumers Energy Company.

(ABATE), and the Residential Ratepayer Consortium (RRC). The Commission Staff (Staff) also participated in the case.

The ALJ conducted evidentiary hearings from December 16, 1996 to March 21, 1997. The record consists of 777 pages and 42 exhibits. Consumers, ABATE, the RRC, the MCV, and the Attorney General filed briefs on April 4, 1997. Consumers, ABATE, and the RRC filed reply briefs on April 22, 1997. The ALJ issued a Proposal for Decision on July 24, 1997. The RRC, ABATE, and Consumers filed exceptions on August 7, 1997.[2] The RRC, Consumers, the Attorney General, and ABATE filed replies to exceptions on August 19, 1997.

Only three contested issues remain: the treatment of sulfur dioxide (SO_2) allowances, the coal burned at the Cobb plant, and the jurisdictional allocation of 325 megawatts (MW) of capacity from the MCV.

Sulfur Dioxide Allowances

The RRC's witness, Eileen Pitchford, proposed that the revenues that Consumers receives from the auction of SO_2 allowances by the United States Environmental Protection Agency (EPA) and the value of surplus allowances held by the company for future use or sale be accounted for in PSCR proceedings through a reduction in projected coal costs. The RRC made the same proposals in the 1995 reconciliation, Case No. U-10710-R. The ALJ, who also presided over that case, recommended again that the Commission reject those proposals.

The RRC excepts and requests that the Commission adopt its position on both issues. It also excepts to the ALJ's failure to address a closely related issue: its recommendation that the

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[2]ABATE's sole exception is to the ALJ's failure to reconsider his February 10, 1997 ruling that struck the testimony of its three witnesses. The Commission's April 24, 1997 order reviewed and upheld that ruling.

Commission require Consumers to manage its SO_2 allowances in a manner that maximizes their value to ratepayers. The RRC says that Consumers has acknowledged that if the Commission rejects these proposals, there will be no mechanism to account for the higher costs that customers would pay for the low sulfur coal that would yield more surplus allowances to be sold or held by Consumers. It says that in evaluating whether Consumers has produced electricity at the lowest reasonable cost, it will be necessary to account for the market value of SO_2 allowances.

The Commission rejected the RRC's position on the first two issues in its September 12, 1997 order in Case No. U-10710-R.

> The Commission agrees with the ALJ that the revenues and costs addressed in the parties' proposals for SO_2 allowances should be excluded from this case. As stated by the ALJ, crediting PSCR costs with the proceeds from auctions and other sales of allowances or the value of banked allowances would stretch the definition of the "booked costs . . . of fuel burned by the utility for electric generation." [MCL 460.6j(1)(a); MSA 22.13(6j)(1)(a).] The allowances are a regulatory authorization issued by the EPA and are necessary to comply with federal law. They are not the same as fuel, and the costs and revenues derived from them are not power supply costs within the meaning of [the statute]. Any relationship between the allowances and Consumers' decisions regarding the type of coal to burn in a power plant does not change the fact that the allowances are not included in the power supply costs described in the statute. If, as the RRC contends, the allowance program creates incentives that may affect coal purchasing decisions and thereby increase the costs paid by PSCR customers, review of the coal purchases under [1982] PA 304 will be available to redress any claim of unreasonable or imprudent actions.

September 12, 1997 order, Case No. U-10710-R, p. 12 (citation omitted). Those conclusions apply equally to the third issue. Consequently, the Commission concludes, notwithstanding the RRC's arguments, that Act 304 does not provide for the coordinated consideration in PSCR cases of the relationship between SO_2 allowances and the cost of coal burned. Rather, the value of the

allowances must be accounted for in rate cases and the cost of coal burned must be accounted for in PSCR cases.[3]

Coal Burned at the Cobb Plant

Consumers' PSCR plan called for it to burn a blend of approximately 70% low sulfur western coal and 30% low sulfur eastern coal at the Cobb plant in 1997. RRC witness Pitchford contended that by now Consumers should have developed a means to blend less costly mid-sulfur eastern coal with the western coal. This blending, she contended, would reduce coal costs without causing Consumers to violate applicable emission standards. She testified that, in 1996, only 30% of the eastern coal for the Cobb plant came from the region from which Consumers projects it will buy all of its eastern coal in 1997 and the remaining 70% was purchased from other regions at significantly lower delivered prices. 6 Tr. 495. To estimate the potential savings, Ms. Pitchford compared the cost of low sulfur eastern coal with the cost of mid-sulfur coal from the same area, which would presumably have comparable transportation costs. Because Consumers planned to purchase and burn 250,000 tons of low sulfur eastern coal and because she concluded that mid-sulfur coal would be available at approximately $2 per ton less than the low sulfur coal, the savings would be approximately $500,000.

The ALJ said that he could not conclude, based on the record, either that Consumers should have done more testing of mid-sulfur coal or that if such testing had taken place, it would have

[3]This conclusion does not prevent parties from arguing in PSCR cases that Consumers should have pursued a different coal procurement strategy because of the effect on SO_2 allowances. On the other hand, since the RRC first raised these issues, the Commission has granted Consumers' request to suspend the operation of its PSCR clause through December 31, 2001. February 11, 1998 order, Case No. U-11290 et al.

shown the proposed substitution to be feasible. He therefore recommended that the Commission reject the proposed reduction in coal costs.

The RRC excepts and argues that it did not recommend that Consumers do more testing or that the company should have concluded that the proposed substitution is feasible. The RRC says that the evidence shows that Consumers has already solicited bids for mid-sulfur coal from various regions to burn at the Cobb plant, that in 1996 Consumers purchased only 30% of its eastern coal from the higher priced low sulfur sources that it used to project costs for 1997, that Consumers already experiences slagging and fouling difficulties at the plant, and that mid-sulfur coal would not be expected to worsen the slagging problems. The RRC says that, for 1997 at least, the emission limits for the plant are governed by state law and that Consumers can comply with those limits by mixing mid-sulfur coal with low sulfur coal. The RRC concludes that it is unreasonable, based on this record, to assume that all of the eastern coal burned at the Cobb plant will come from higher priced low sulfur sources. Therefore, it recommends that Consumers' coal costs be reduced by $500,000, although the company remains free to use the coal of its choice.

The Commission concludes that Consumers' plan is unreasonable in failing to project that the company will burn at least some less expensive mid-sulfur eastern coal at the Cobb plant. The company has tested and burned mid-sulfur coal at the plant, 7 Tr. 561-3; Exhibit I-31, and additional testing was possible, 7 Tr. 664. It solicited bids for such coal in January 1997. 7 Tr. 560; 8 Tr. 697. It already has slagging and fouling problems at the plant, but has dealt successfully with those problems. 8 Tr. 739, 742. There is no reason to conclude from the record that environmental standards require that Consumers burn no eastern mid-sulfur coal at the plant. 6 Tr. 496, 498; 8 Tr. 755; Exhibit I-31. In short, it is unreasonable to project coal costs for the Cobb plant on the

assumption that only higher priced low sulfur eastern coal will be burned.[4] What is less clear on the record is the appropriate projections for the quantity and price of the mid-sulfur coal. See 6 Tr. 529; 7 Tr. 559-61. The Commission does not find it necessary to resolve those questions at this time. The plan year is over, and the reconciliation case has begun. The parties should address the issues in that forum.

Jurisdictional Allocation of MCV Capacity

Consumers proposed to allocate all of the costs associated with the purchase of 325 MW of capacity from the MCV to retail customers without an allocation to wholesale sales. This proposed treatment of the MCV capacity increases PSCR costs by $3.5 million.

Traditionally, the Commission has allocated all purchased power costs (and rate base generation costs) between jurisdictional (retail) and nonjurisdictional (wholesale) customers. Consumers sought a departure from that policy for the first 915 MW of the MCV capacity, which it purchases pursuant to the Commission's March 31, 1993 order in Case No. U-10127 et al. (which approved a settlement agreement). The Commission rejected the company's position in the 1993 PSCR reconciliation:

> [T]he costs associated with delivered power from the MCV should be treated the same as other purchased power costs, which requires removing the non-PSCR portion before the balance is recovered through the PSCR process. Before the March 31, 1993 order, these expenses were jurisdictionalized. In the settlement, Consumers did not seek to change that practice, and in modifying the settlement, the Commission did not intend to change that practice.

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[4]The Commission is not directing Consumers to burn any particular coal and does not understand the RRC's witness to be recommending any particular coal. It appears from the record that Consumers has tested several, and the proper choice will depend upon the price. In any event, Consumers remains free to burn the coal of its choice at the plant. It is not free to pass on the higher costs of an unreasonable choice. As the RRC argues, Consumers has had sufficient time to develop a routine for blending lower cost coal.

February 23, 1995 order, Case No. U-10155-R, p. 36. That decision has been affirmed by the Court of Appeals. ABATE v Public Service Commission, 219 Mich App 653; 557 NW2d 918 (1996).

The issue arose again with respect to the remaining 325 MW of the MCV capacity, which was the subject of a settlement agreement in Cases Nos. U-10685, U-10754, and U-10787. The company's position was that the settlement required the cost of the additional 325 MW to be allocated only to PSCR customers. The Commission did not adopt that position when it approved the settlement with modifications:

> [The company's proposal for] the MCV charges is a departure from ordinary ratemaking treatment, as discussed in the order in Case No. U-10155-R, supra, p. 36. In the Commission's view, the settlement fails to address the issue as clearly as [the] testimony because it merely states that "cost recovery for the full 325 MW block would be permitted." Exhibit A-4, p. 7. In the Commission's view, this language is ambiguous at best, even if construed in a light favorable to Consumers. It does not expressly state that the 325 MW would be exempted from the normal practice of allocating the cost of purchased power between jurisdictional and non-jurisdictional customers. Therefore, the Commission will leave the methodology for determining the percentage to be recovered from PSCR customers to be decided in Act 304 proceedings.

November 14, 1996 order, Cases Nos. U-10685, U-10754, and U-10787, p. 46.

Subsequently, the Commission addressed the issue in the 1996 PSCR plan case, where it accepted the recommendation of the ALJ, who also presided over that case, that the MCV costs should be jurisdictionalized:

> The Commission's November 14, 1996 order in Cases Nos. U-10685, U-10754, and U-10787 pointed out that Consumers' proposal to assign the entire cost of this 325 MW to its PSCR customers (1) represents a significant departure from ordinary ratemaking treatment, (2) directly conflicts with the cost allocation implemented for the initial 915 MW of MCV capacity, and (3) is based on language from the settlement agreement that "is ambiguous at best, even if construed in a light favorable to Consumers." Order [dated November 14, 1996 in Cases Nos. U-10685, U-10754, and U-10787], p. 46. The issue was therefore left open for a subsequent decision in an Act 304 proceeding. Id. Moreover, as correctly noted by the ALJ, Consumers

> offered no testimony in support of its proposal to assign 100% of the costs associated with this 325 MW of MCV capacity to its PSCR customers while continuing to jurisdictionalize all other power costs (including those from the first 915 MW). The Commission therefore concludes that the ALJ's recommendation should be adopted and that all costs for the remaining 325 MW of MCV capacity should be assigned to the utility's PSCR and non-PSCR customers through application of Consumers' standard jurisdictionalization factor.

May 7, 1997 order, Case No. U-10973, pp. 14-15 (footnote omitted). Consumers filed a petition for rehearing of that decision, which the Commission denies in another order issued today.

In this 1997 plan case, Consumers offered the testimony of Michael G. Morris, then its President and Chief Executive Officer, to resolve any question about the intent of the settlement agreement.[5] Mr. Morris testified that he was aware of the dispute about whether the first 915 MW should be jurisdictionalized, that the settlement agreement was drafted to avoid that dispute with regard to the 325 MW, and that the cost recovery provisions for the 325 MW were negotiated with the expectation that Consumers would recover all of those costs from retail customers. 8 Tr. 686-7.

The ALJ concluded that the May 7, 1997 order in Case No. U-10973 resolved the issue. He therefore recommended that the cost of the 325 MW of capacity be assigned to all customers through use of the standard jurisdictional factor.

Consumers excepts and argues that it presented new and additional unrebutted testimony demonstrating unambiguously that the intent of the settlement agreement was that Consumers would recover the cost of the 325 MW entirely from PSCR customers. It asserts that the Commission should approve the requested recovery for that reason. Consumers acknowledges that its proposal differs from the ordinary ratemaking treatment, but says that is not a reason to reject the

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[5]The ALJ had denied Consumers' motion to present the testimony. In its January 28, 1997 order, the Commission overruled the ALJ, concluding that the testimony was relevant and necessary for a full development of the issue.

proposal. It points out that the Court of Appeals has noted that well-established practice does not preclude the Commission from creating an exception for the MCV capacity. ABATE, supra at 665.[6] Similarly, it acknowledges that the proposed treatment of the 325 MW differs from the treatment of the first 915 MW, but says that is not a reason to reject the proposal. It asserts that the analysis for both blocks of capacity should properly focus on the intent of the parties who signed the settlement agreements. Consumers says that, contrary to the ALJ's conclusion, the November 11, 1996 order in Case No. U-10685 et al. did not reject the company's position, but merely deferred a resolution to a later PSCR case. It also says that the Commission's rejection of its position in the May 7, 1997 order in Case No. U-10973 was not based on a full and complete record such as is now before the Commission.

The Commission concludes that the remaining 325 MW of MCV capacity should be jurisdictionalized, as are all other generating and purchased power resources of the company. The Commission has previously rejected Consumers' position that the cost of the first 915 MW should be recovered only from PSCR customers. In considering the treatment of the remaining 325 MW, the Commission deferred the resolution of the issue to a PSCR case, but expressed skepticism that the cost should not be jurisdictionalized. With that background, the company presented evidence that establishes the intent of the company's chief negotiator that the cost of the 325 MW should not be treated the same as the 915 MW but rather should not be jurisdictionalized and his belief that the settlement was drafted to allocate the cost of the 325 MW entirely to retail customers.

Notwithstanding that testimony, the language of the settlement agreement is less than explicit, which remains troubling because there were a number of obvious ways to state unambiguously that

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[6]On the other hand, that court opinion also upheld the Commission's decision to require jurisdictionalization of the first 915 MW of MCV capacity.

the cost of the 325 MW, unlike all other similar costs, would be recovered only from PSCR customers. Nevertheless, even if it is true that the settlement language simply fails to state clearly the agreement of the parties, the Commission is unpersuaded that Consumers' intent is reason enough to depart from well-established practice. The Commission sees no policy reason for such a departure, and Consumers has not offered one. In the context of the settlement as a whole, the Commission does not find the departure to be reasonable, prudent, or in the public interest. The Commission is particularly concerned about creating a new precedent, just as greater competition is being introduced, that permits a utility to begin allocating particular resources to customer classes. The Commission also expects that there would be disputes about how to implement the company's proposal, which would require disparate treatment of capacity provided under a single power purchase agreement.[7] The Commission therefore concludes that jurisdictionalization should be required, even if the company views that as a modification of the settlement agreement.[8]

Calculation of Factor

Note 5 to Exhibit A-17 indicates that if the 325 MW of MCV capacity is allocated to all customers, the PSCR factor should be $0.00214 per kilowatt-hour. The ALJ therefore recommended that the Commission authorize that factor for 1997. The Commission adopts that recommendation.

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[7]The Commission is not concerned that adopting the company's position would result in the double recovery of some of the MCV costs. The potential recovery of a portion of the costs from both retail and wholesale customers could be avoided.

[8]In light of this conclusion, it is unnecessary to address whether the Commission may take official notice, as Consumers requests, of testimony from another case of the Staff negotiator's intent.

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. Consumers' 1997 PSCR plan should be approved as modified by this order.

THEREFORE, IT IS ORDERED that:

A. Consumers Energy Company's power supply cost recovery plan is approved as modified by this order.

B. Consumer Energy Company is authorized to implement a power supply cost recovery factor of up to $0.00214 per kilowatt-hour during 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 July 24, 1998.

/s/ Dorothy Wideman
Its Executive Secretary

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 July 24, 1998.

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Its Executive Secretary

In the matter of the application of	)	
CONSUMERS POWER COMPANY	)	
for approval of a power supply cost recovery	)	Case No. U-11180
plan and for authorization of monthly power	)	
supply cost recovery factors for calendar year 1997.	)	
	)	

Case No. U-11180

Suggested Minute:

> "Adopt and issue order dated July 24, 1998 approving Consumers Energy Company's power supply cost recovery plan for 1997 and authorizing the implementation of a power supply cost recovery factor, as set forth in the order."