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

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of **CONSUMERS ENERGY COMPANY** for a determination of net stranded costs and for approval of net stranded cost recovery charges.	)))))	Case No. U-13380

At the December 18, 2003 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. J. Peter Lark, Chair
Hon. Robert B. Nelson, Commissioner
Hon. Laura Chappelle, Commissioner

ORDER DENYING REHEARING

On December 20, 2002, the Commission issued an order that required Consumers Energy Company (Consumers) to maintain its existing retail open access transition charge of zero during 2003. The basis for this determination was the finding that Consumers had not incurred net stranded costs during 2000 and 2001. The order further required Consumers to offset the securitization and tax surcharges on its retail open access customers' bills with credits funded by excess securitization savings.

On January 21, 2003, Consumers, the Association of Businesses Advocating Tariff Equity (ABATE), Energy Michigan, Inc., and The Michigan Association of Broadcasters and the Michigan Petroleum Association/Michigan Association of Convenience Stores (collectively, MAB et al.) filed petitions for rehearing. On February 11, 2003, Consumers, ABATE, Energy Michigan, Attorney General Michael A. Cox (Attorney General), and Adrian Energy Associates

LLC, Cadillac Renewable Energy LLC, Genesee Power Station Limited Partnership, Granger Electric Company, Grayling Generating Station Limited Partnership, Hillman Power Company LLC, Michigan Cogeneration Systems Inc., Riverview Energy Systems, Sumpter Energy Associates Limited Partnership, Viking Energy of Lincoln Inc., and Viking Energy of McBain Inc. (collectively, Adrian Energy et al.) filed answers.

Rule 403 of the Commission's Rules of Practice and Procedure, 1999 AC, R 460.17403, provides that a petition for rehearing may be based on claims of error, newly discovered evidence, facts or circumstances arising after the hearing, or unintended consequences resulting from compliance with the order. A petition for rehearing is not merely another opportunity for a party to argue a position or to express disagreement with the Commission's decision. Unless a party can show the decision to be incorrect or improper because of errors, newly discovered evidence, or unintended consequences of the decision, the Commission will not grant rehearing.

Special Contracts

Consumers opposes the stranded cost adjustment that imputes revenues for the rate discounts it gives to special contract customers. The discounts are the difference between the rates those customers would pay if they were to take service under Consumers' full service tariffs and the rates they actually pay under their special contracts. Consumers argues that it justified the discounts on the basis of the reduced cost of serving special contract customers. It claims that most of the discounts can be attributed to the relatively low cost of serving larger industrial customers, who would otherwise pay the full tariff rates that subsidize other customer classes as a result of rate skewing.

To identify the amount of the discounts that it attributes to rate skewing, Consumers proposed to use the regulatory adjustment from the rate unbundling analysis approved in the May 16, 2002

order in Case No. U-12970. Consumers says that the regulatory adjustment accounts for "the difference between the costs allocated to a rate class and the costs recovered through the rates charged for that class." Order, Case No. U-12970, at 2. Consumers claims using this approach to eliminate the effects of rate skewing would reduce the imputed revenue adjustment from $33.8 million to $3.1 million in 2000 and from $31.5 million to $5.6 million in 2001.

Consumers argues that the determinations issued in Case No. U-12970 are binding on the Commission. Consumers claims that, if anything, the adjustment for rate skewing underestimates the actual cost of service under the special contracts, given that those customers generally have higher load factors and are less expensive to serve than others within their tariff rate class. Consumers says that the basis for the analysis it performed in Case No. U-12970 was the cost of service study used to set its existing base rates in Case No. U-10685. It argues that the Commission erred by stating that the cost of service study "predates most or all of Consumers' current special contracts and did not account for them." December 20, 2002 order at 12. Instead, Consumers claims, the order in Case No. U-10685 made reference to several of the special contracts, and the cost of service study included the loads of the customers now being served under those contracts.

Consumers argues that the benefits of the special contracts for customers that continue to pay full tariff rates outweigh the revenues it foregoes through the discounts. Consumers claims that, but for the inducement of the special contracts, those customers would have left its system and stranded even more costs to be recovered from remaining customers.

In reply, Energy Michigan, the Attorney General, and ABATE contend that Consumers failed to meet its substantial burden to justify rate recovery of the special contract discounts. Energy Michigan argues that the May 16, 2002 order in Case No. U-12970 did not purport to approve a

cost allocation. It further claims that the cost of service studies prepared in Case No. U-10685 could not have accounted for the special contracts because the record in Case No. U-10685 closed in May 1995, some five months before Consumers filed its application in Case No. U-10961 for approval of the first of its special contracts.

Energy Michigan claims that service Consumers provides under special contracts can be more costly than its tariff service in some respects. Energy Michigan notes that the special contract with General Motors Corporation in Case No. U-10961 requires Consumers to pay liquidated damages for service interruptions and commits Consumers to assign 17 of its full-time employees to support General Motors' energy conservation programs.

For the most part, Consumers is repeating arguments already made in this case, and the Commission is persuaded that it should reaffirm the determinations regarding the special contracts in the December 20, 2002 order. The Commission's orders approving the special contracts made it abundantly clear that Consumers was at risk of absorbing the cost effects of the discounts and that its only means of avoiding that outcome was to make a "compelling showing" that would meet the "substantial burden" of providing "a clear, convincing, and unequivocal demonstration either (1) that the contract prices and terms are justified on the basis of the cost of service, or (2) that the benefits for other (non-participating) ratepayers are substantial and have a value that outweighs the costs that are not recovered from the contract customers." Order dated October 25, 1995, Case No. U-10961, at 4-5 (quoting order dated March 23, 1995, Case No. U-10646, at 21.) The Commission also made clear that the required showing must include a "cost-of-service study that identifies and quantifies all costs incurred under the contracts." Id. at 5. The purpose of these conditions was to hold other ratepayers harmless from the cost effects of decisions that Consumers may have been induced to make primarily for the benefit of its shareholders. By voluntarily

accepting these conditions, Consumers understood that it would not be obtaining any regulatory endorsement of the prudence of its contracting decisions and that it was not receiving assurances that would secure any expectations of future rate recovery. In short, Consumers assumed all risks of adverse consequences of its decisions to enter into special contracts.

While the Commission did not foreclose rate recovery of the discounts altogether, it did impose conditions that Consumers has not met. Consumers has not attempted to justify the discounts by submitting cost of service studies in this case. It is not adequate for Consumers to rely on the unbundling percentages approved in Case No. U-12970. Although it claims that the unbundling analysis was based on the cost of service study used in Case No. U-10685, the study was submitted in 1995 on the basis of a projected 1996 test year. The determinations made in Case No. U-12970 may have complied with the unbundling requirement introduced in 2000 as Section 10b(2) of the Customer Choice and Electricity Reliability Act (Act), MCL 460.10b(2). However, they did not alter the existing tariff rate structure, which was frozen by Section 10d of the same act, or affect Consumers' actual cost of providing service. They had no effect on special contracts that Consumers negotiated after the cost of service study prepared in Case No. U-10685. The regulatory adjustment percentage derived in Case No. U-12970 does not provide a basis for disaggregating the costs of serving the special contract customers from the utility's overall cost of service.

Purchased Power Capacity Costs

Consumers says that it modified its stranded cost computation by voluntarily removing capacity costs of $23.3 million in 2000 and $55.5 million in 2001 that it had incurred for power purchases. It says that it made this concession to simplify the proceeding, eliminate controversy, and lower the transition charge. It says that it would not have made this concession if it had

known that the Commission would alter the computational methodology approved in the December 20, 2001 order in Case No. U-12639 by imputing special contract revenues. It claims that it lacked notice of this change. It characterizes the Commission's treatment of stranded costs as a series of arbitrary changes in methodology. It claims that the Commission should reopen the record to admit evidence of all of its purchased power costs.

Energy Michigan, ABATE, and the Attorney General oppose Consumers' request to reopen the record. They claim that Consumers was well aware of the issues that could be raised in this proceeding. Energy Michigan says that Consumers itself requested several changes to the Case No. U-12639 methodology. Energy Michigan says that Consumers' wish to reconsider its tactical decision as to the capacity costs it would claim is not a basis for rehearing under Rule 403. Energy Michigan suggests that the real reason that Consumers excluded those costs was that they related to the replacement power it purchased as a result of outages of the Palisades nuclear plant. Thus, Energy Michigan says, including those costs in the stranded cost computation would have raised issues regarding the prudence of Consumers' management of the plant and its outages and the propriety of asking retail open access customers to pay for the outage.

The Commission finds that Consumers' request to revise one of its positions in this case is not a basis for granting rehearing under Rule 403. Neither the Commission's findings regarding the special contract revenues nor Consumers' second thoughts about its position on purchased power qualify as claims of error, newly discovered evidence, facts or circumstances arising after the hearing, or unintended consequences resulting from compliance with an order.

The findings in the December 20, 2002 order did not violate Consumers' procedural rights. The special contract issue was within the scope of Consumers' application to recover stranded costs. In Case No. U-12639, the Commission placed all parties on notice that it would consider

future revisions to the stranded cost computation. December 20, 2001 order at 14; May 16, 2002 order at 2-3 (on rehearing). As noted, in the October 25, 1995 order in Case No. U-10961 and subsequent orders approving special contracts, the Commission reiterated that Consumers was voluntarily accepting the risk of unfavorable rate treatment of the special contract discounts.

Consumers states that in 2001 it paid $15 million more in capacity charges than it paid in 1997 for purchased power under contracts with Ada Cogeneration Partnership, the Michigan Power Limited Partnership, and the Midland Cogeneration Venture. It claims that the additional charges are stranded costs and that denying their recovery is inconsistent with state and federal law pertaining to qualifying facilities.

In reply, Energy Michigan says that Consumers did not specifically raise an issue regarding those three contracts during its direct case. ABATE says that no provision for cost recovery is appropriate as long as Consumers has a negative balance of net stranded costs. The Attorney General says that purchased power is recoverable under the power supply cost recovery clause, which is subject to the rate freeze imposed by MCL 460.10d.

Adrian Energy et al. say that the finding that Consumers had a negative balance of net stranded costs in 2000 and 2001 forecloses an argument that the right to full recovery of the capacity charges paid to qualifying facilities has been impaired. They add that the guarantee of full recovery in state and federal law would have come into play if Consumers had in fact incurred stranded costs.

The capacity charges are not recoverable on a basis independent of the methodology used to compute net stranded costs in this case. The Commission's finding that Consumers had negative net stranded costs makes it unnecessary to address this issue further.

Clean Air Act

Consumers argues that the Commission erred when it issued the July 10, 2002 interlocutory order that struck evidence of capital costs incurred by Consumers to comply with the Clean Air Act, 42 USC 7401 et seq. ABATE substantially agrees with Consumers on this point.

The rate treatment of this issue was addressed through the authorization granted in the June 2, 2003 financing order in Case No. U-13715, at 21-25. The Commission reaffirms that the cost recovery implications of Clean Air Act compliance will not be addressed as part of the stranded cost computation in this case.

Stranded Cost Computation

Consumers says that the Commission is subject to a statutory obligation to issue orders that "provide for full recovery of a utility's net stranded costs" by January 1, 2002. MCL 460.10a(1). Consumers argues that the Commission's decision to find a negative balance in an indeterminate amount and not to address the other computational and methodological issues is a failure to define the stranded cost methodology and puts the Commission in violation of its statutory obligations. Consumers says that the resulting uncertainty makes the stranded cost process unpredictable going forward and could destabilize retail open access's future prospects. Consumers requests the Commission to reopen the record for the purpose of resolving all outstanding issues and to adopt one of the methodologies proposed to eliminate the lag in time between stranded costs and their collection.

The Attorney General opposes rehearing on this ground. The Attorney General says that Consumers is not prejudiced by unpredictability.

In effect, Energy Michigan, ABATE, and MAB et al. agree with Consumers that the Commission's order should have contained more precise findings and that the absence of a

computation creates uncertainty. They argue that the Commission should calculate the dollar amounts of negative net stranded costs or stranded benefits for 2000 and 2001 and make provision to return those amounts as a future credit or benefit to customers.

Energy Michigan argues that the negative balances represent excess revenues that should be available to pay for Consumers' Clean Air Act costs during 2000 and 2001. Energy Michigan also urges the Commission to find that the balances may be carried forward as reserves against future obligations to pay for Clean Air Act costs, securitization charges, or any other stranded costs or deferred charges. Otherwise, it claims, the possibility that those costs might affect future rates could provide an opportunity for Consumers to suppress retail open access.

ABATE argues that a carryforward of stranded benefits is implicit in the concept of a stranded cost reconciliation in MCL 460.10a(10).[1] Together with the MAB et al., ABATE argues that the Commission is ignoring its statutory duty to set just and reasonable rates. ABATE further contends that the Commission is acting arbitrarily and capriciously by shifting its stranded cost policies from order to order. ABATE and the MAB et al. observe that the December 20, 2001 and May 16, 2002 orders in Case No. U-12639 had promised a final resolution of the computational issues in this docket. They argue that the failure to compute a carryforward balance in the December 20, 2002 order violates the statutory duty imposed by MCL 24.285 to make adequate findings of fact and to issue conclusions of law supported by authority or reasoned opinion. ABATE says that silence on the stranded cost balances could foreclose retail open access customers from receiving any of the stranded benefits attributable to Consumers' plants that produce power at a cost below the market price. ABATE further claims that Consumers will have

[1] Citations to subsections in MCL 460.10a conform to the statute as recently amended by 2003 PA 214.

an incentive to securitize as many of those plants as possible in order to shield ratepayers from the profits from sales produced at a below-market cost.

ABATE requests that a carryforward be instituted to recover future stranded costs or securitization charges. The MAB et al. say that MCL 460.10d does not foreclose an immediate rate reduction for Consumers' customers, but that it imposes only a ceiling on existing rates. The MAB et al. alternatively suggest a carryforward that would defer the negative stranded cost balances, with interest, to be applied against future stranded costs, implementation costs, or general rate increases.

In the December 20, 2002 order, the Commission made findings that established that the stranded cost computations would be negative. It therefore authorized a continuation of the zero transition charge set in Case No. U-12639 and declined to address the potential effects of the negative balances in future years. These determinations effectively disposed of Consumers' application to make findings regarding its stranded costs (of less than zero in both 2000 and 2001) and to set a transition charge (at zero), and the Commission is required to go no further.[2] Quantifying negative balances would not affect the determinations that there will not be a positive transition charge for 2003 and that no other action is necessary to give effect to negative balances. None of the arguments advanced on rehearing persuade the Commission that the order's findings and conclusions were in error or that rehearing is otherwise appropriate under the standard set forth in Rule 403. The Commission is not aware of any duty on its part to make further findings if they do not affect the actions it is implementing in this case. Such findings would be dicta. The parties generally contend that more findings might create more guidance for future stranded cost

[2] The Commission also rejects the MAB et al.'s claim for immediate rate reductions as a misreading of MCL 460.10d(1), which imposes a rate freeze until December 31, 2003. The rate cap provisions appear in MCL 460.10d(2) and do not become effective until after December 31, 2003.

determinations. Whether or not that is true, the Commission will not engage in further computational precision in this case, as it has expressed its lack of confidence in the reliability of the methodologies, data, and estimates on the record for purposes of making determinations with long-term consequences.

Securitization Offset

In the December 20, 2002 order, the Commission required Consumers to maintain an offset on the bills of retail open access customers that would be equal to their securitization charges. The order used 50% of Consumers' excess securitization savings as the funding source for the securitization offsets.

Consumers states that it supported using the excess securitization savings to fund reductions to the transition charge, but that this became unnecessary once the Commission determined that there were no stranded costs in 2000 and 2001, and hence no transition charge in 2003. Consumers argues that using excess securitization savings to cancel out the securitization charges violates Section 10d(6) of the Act, MCL 460.10d(6), which provides that the Commission shall allocate the savings either for "further rate reductions" or "to reduce the level of any charges authorized by the commission to recover an electric utility's stranded costs." Consumers interprets Section 10d(6) to preclude the use of the savings for any purpose that does not either reduce all of its customers' rates (as opposed to retail open access customers only) or reduce the transition charge that recovers stranded costs. Citing the definition of "qualified costs" in MCL 460.10h(g), Consumers says that the qualified costs that are eligible for securitization encompass some costs that do not fit within the definition of stranded costs, so that creating an offset to the securitization charge is not permissible under Section 10d(6) as a reduction of stranded cost charges.

Consumers also contends that the securitization offsets are contrary to the requirement in MCL 460.10k(2) that securitization charges shall be "nonbypassable." It notes that, by definition, a nonbypassable charge is "a charge in a financing order payable by a customer to an electric utility or its assignees or successors regardless of the identity of the customer's electric generation supplier." MCL 460.10h(f).

Energy Michigan says that Consumers' argument is flawed due in part to a failure to read the provisions of Section 10d in their entirety. According to Energy Michigan, Section 10d(6) authorizes the funding of "further rate reductions" with the securitization savings remaining after the utility has funded the 5% rate reduction provided for residential customers in Section 10d(1). Energy Michigan further construes the reference in Section 10d(7) to the funding of 5% rate reductions for all customers (including non-residential customers) as a threshold to be reached before diverting any remaining savings to the Low-Income and Energy Efficiency (LIEE) Fund. As Energy Michigan explains it, Consumers has attained sufficient savings to fund its 5% rate reduction for residential customers, but not enough to fund or implement a further 5% reduction for other, non-residential customers or to provide any funding to the LIEE Fund. In Energy Michigan's view, Section 10d(6) is fully applicable under these circumstances and authorizes the use of Consumers' excess securitization savings on hand (after funding the 5% residential rate reduction) to fund "any further rate reductions," including securitization offsets for retail open access customers.

Energy Michigan also argues that the securitization offsets are permissible under Section 10d(6) as a means of reducing stranded cost charges. It says that Consumers is attempting to draw an artificial distinction between stranded costs and qualified costs, but that both terms address the common concept that certain costs may not be recoverable in a competitive market.

Energy Michigan thus suggests that both the securitization charge and the transition charge qualify as "any charges authorized by the commission to recover an electric utility's stranded costs" under Section 10d(6). It further argues that both bundled and retail open access customers pay securitization charges that are subject to the same offsets, and that the charges they pay remain in place as a nonbypassable means of securing the funding necessary to discharge the financial obligations of securitization.

Energy Michigan objects to the premise of Consumers' argument that a stranded cost computation can never be negative. Energy Michigan claims that the negative balance of net stranded costs in this case is more than adequate to fund the securitization offsets that Consumers is disputing.

The Commission rejects Consumers' contention that the securitization offsets are contrary to Section 10d(6). In the first place, as Energy Michigan points out, Section 10d(6) does not state that the Commission must allocate excess securitization savings to proportional rate reductions for all customers.

Second, Consumers' Section 10d(6)-based argument regarding a distinction between costs that can be stranded and those that can be securitized is not persuasive. Stranded costs and qualified costs are similar in meaning and function under the regulatory framework established by the Act. Both concepts address the potential financial hardships that a utility may incur in making the transition between traditional regulation and a market-driven environment. The primary difference between the two terms is the distinct statutory mechanisms provided for their cost recovery. The stranded cost mechanism grants the Commission considerable discretion both to determine stranded costs and to provide for their recovery via the transition charge. See MCL 460.10a. Securitization, on the other hand, is a specialized financing mechanism for

qualified costs, which may include regulatory assets as well as "costs . . . that the electric utility would be unlikely to collect in a competitive market." MCL 460.10h(g).

Notwithstanding the difference in cost recovery mechanisms, the costs themselves are closely related, if not always the same, and the provision made in this case for securitization offsets to recover some of those costs is consistent with Section 10d(6)'s provision permitting excess securitization savings to be used "to reduce the level of any charges authorized by the commission to recover an electric utility's stranded costs." The treatment of the savings is also consistent with Section 10d(6)'s immediately following sentence, which prohibits securitization and stranded cost charges and credits from resulting in a reallocation of cost responsibility among the different customer classes. The import of this sentence is that the Commission must consider the cumulative effect of all of the "approved securitization, transition, stranded, and other related charges and credits" and may do so even before Section 10d(7) is implicated

The Commission rejects Consumers' argument that the offsets violate the securitization concept of making the charges nonbypassable. The treatment provided for retail open access customers is the same as the treatment of the charges in full service customers' existing rates. Securitization charges are being collected in the bills of both types of customer and are nonbypassable, notwithstanding the offsets that both types of customer receive. Moreover, the Court of Appeals recently affirmed the order in Case No. U-12639 on this point in Consumers Energy Co v Michigan Public Service Comm, unpublished opinion per curiam of the Court of Appeals, decided November 18, 2003 (Docket Nos. 241990, 241991), sl op at 4-5.

Energy Michigan requests the Commission to issue a determination that securitization offsets may be funded in the future from negative stranded cost balances as well as excess securitization savings. Energy Michigan says that the 50% share of excess securitization savings that is

designated for offsetting retail open access customers' transition and securitization charges amounts to only $6.1 million per year, which will not be sufficient to continue funding the offsets once the aggregate retail open access load on Consumers' system exceeds 600 megawatts.

It is not necessary in this case to issue an opinion on the point raised by Energy Michigan. The issue may be raised in subsequent stranded cost proceedings.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 106, as amended, MCL 460.551 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1999 AC, R 460.17101 et seq.

b. The petitions for rehearing should be denied.

THEREFORE, IT IS ORDERED that the petitions for rehearing are denied.

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.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ J. Peter Lark
Chair

(S E A L)

/s/ Robert B. Nelson
Commissioner

/s/ Laura Chappelle
Commissioner

By its action of December 18, 2003.

/s/ Mary Jo Kunkle
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.

MICHIGAN PUBLIC SERVICE COMMISSION

_____
Chair

_____
Commissioner

_____
Commissioner

By its action of December 18, 2003.

_____
Its Executive Secretary

In the matter of the application of **CONSUMERS ENERGY COMPANY** for a determination of net stranded costs and for approval of net stranded cost recovery charges.	)))))	Case No. U-13380

Suggested Minute:

> "Adopt and issue order dated December 18, 2003 denying the petitions for rehearing of the December 20, 2002 order that approved a zero transition charge for Consumers Energy Company in 2003, as set forth in the order."