

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of	)	
<b>CONSUMERS ENERGY COMPANY</b> for a	)	
financing order approving the securitization of	)	Case No. U-13715
certain of its qualified costs.	)	
_____	)	

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 REMANDING PROCEEDING FOR ADDITIONAL TESTIMONY**

On July 1, 2003, Consumers Energy Company (Consumers) filed a petition for rehearing and clarification of certain portions of the Commission’s June 2, 2003 order, which authorized Consumers to issue up to \$554,323,000 of securitization bonds pursuant to the Customer Choice and Electricity Reliability Act, 2000 PA 141 (Act 141) and 2000 PA 142 (Act 142), which amended 1939 PA 3, MCL 460.1 et seq., and which, among other things, allows certain utilities<sup>1</sup> the option of reducing their costs through the use of securitization.<sup>2</sup>

<sup>1</sup>As noted in Section 10h(c) of Act 142, the only entities eligible for securitization are those falling within the definition of “electric utility” in Section 2(d) of the Electric Transmission Line Certification Act, 1995 PA 30, MCL 460.562(d). Consumers satisfies that definition.

<sup>2</sup>Securitization is the process by which a utility--following the issuance of a financing order by the Commission--replaces relatively high-cost debt and equity with lower-cost debt in the form of securitization bonds.

Attorney General Michael A. Cox (Attorney General), the Association of Businesses Advocating Tariff Equity (ABATE), Energy Michigan, and The Kroger Company (Kroger) filed responses to the petition for rehearing.

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 a rehearing.

After reviewing the record, the Commission concludes that Consumers' petition should be granted, in part, and rejected, in part. Consumers' petition for rehearing raises a concern regarding unintended consequences that the Commission finds should be the subject of further scrutiny and reevaluation by the Commission. In so doing, the Commission will consider the merits of all five issues raised by Consumers' filing.

#### MCL 460.10i(2)(d) Securitization Cap

At pages 46-49 of the June 2 order, the Commission discussed the statutory standard set forth at MCL 460.10i(2)(d). The Commission interpreted this standard as a cap that reduced the total amount of qualified costs that could be securitized from \$644,389,000 to \$554,323,000.

Although arguing that the Commission committed errors of law and logic in its interpretation of MCL 460.10i(2)(d), Consumers indicates in its petition for rehearing that it would voluntarily accept the limitation and only securitize \$554,323,000 of qualified costs to avoid the uncertainty created by the Commission's interpretation of MCL 460.10i(2)(d). However, Consumers requests

that the Commission refrain from a final interpretation of MCL 460.10i(2)(d), and clarify that the difference between the total amount of qualified costs and the amount of costs authorized to be securitized can be accounted for as a regulatory asset, can continue to accrue a return at the company's overall rate of return through the date of recovery, and is subject to recovery in future electric rate proceedings.

The Attorney General is the only party to respond to Consumers' securitization cap exception. According to the Attorney General, the Commission did not err in rejecting Consumers' interpretation of MCL 460.10i(2)(d). The Attorney General insists that Consumers' securitization request must be determined to comply with all of the statutory tests and that the Commission should not find that the issue is moot merely because Consumers has agreed not to contest the issue at this time.

The Commission finds that its June 2, 2003 determination that MCL 460.10i(2)(d) requires use of the Commission Staff's methodology, which focuses on a 10.63% pre-tax rate of return as the discount rate in the statutory equation, is not only appropriate, but also required by Act 142. Therefore, the Commission declines to withdraw or otherwise undermine its prior determinations with regard to MCL 460.10i(2)(d), as proposed by Consumers.

#### Carrying Costs

Consumers' March 4, 2003 financing order application sought authority to include certain electric restructuring implementation costs through December 31, 2003 totaling \$96,791,000. The Commission found that Consumers could securitize \$64,108,000 of its 1998-2000 retail open access (ROA) implementation costs, which included implementation costs that were approved by the Commission's final orders in Cases Nos. U-11955, U-12358, and U-12891, wherein the Commission approved deferred recovery of Consumers' non-incremental implementation costs

incurred from 1998 to 2000. The Commission approved \$15,376,000 for 1998, \$25,156,000 for 1999, and \$19,587,000 for 2000. With carrying costs at 7% for the years 1998, 1999, and 2000, the total amount approved for securitization reached \$64,108,000.

In its petition, Consumers maintains that the amount it was authorized to securitize needs to be increased to reflect \$14,427,000 in additional carrying costs recorded in 2001, 2002, and 2003. According to Consumers, exclusion of the 2001-2003 carrying costs from the category of qualified costs eligible to be securitized is inconsistent with the Commission's past orders, inconsistent with the statutory definition of "qualified costs," and inconsistent with the statutory direction that "full recovery" of these costs be authorized. Furthermore, the Commission's exclusion of the \$14,427,000 of carrying costs creates uncertainty for accounting and financial reporting purposes about the Commission's intentions regarding the mechanism for recovery of this legitimate implementation cost.

In the alternative, Consumers suggests that if the Commission denies Consumers' request to include the \$14,427,000 of carrying costs in the amount to be securitized, the Commission should clarify that it did not mean to deny future recovery of this amount, that these additional carrying costs on the 1998-2000 implementation costs can continue to be accounted for as a regulatory asset, that the non-securitized implementation costs can continue to accrue carrying costs at 7% through the date of recovery, and that all such costs are subject to recovery in future electric rate proceedings.

The Attorney General agrees with Consumers that the Commission's arithmetical calculation of interest on the amount approved for securitization was flawed. However, the Attorney General maintains that the statutory cap on the amount that Consumers can be authorized to securitize set forth in Section 10i(2)(d) of Act 142, MCL 460.10i(2)(d), cannot be increased and must remain

fixed at \$554,323,000. According to the Attorney General, deferred recovery of any amount in error would subvert the statutory cap. For that reason, the Attorney General insists that while the amount of the carrying costs should be clarified, the amount to be securitized must remain unchanged.

ABATE states that it does not oppose Consumers' requests with regard to the carrying costs.

The Commission concludes that the calculation of interest on the 1998-2000 implementation costs should have included an additional \$14,427,000 of carrying costs for 2001-2003. However, the Commission finds that, due to the overall cap required by MCL 460.10i(2)(d) and Consumers' decision not to securitize more than the amount authorized by the June 2 order, the error pointed out by Consumers does not necessitate revision of the Commission's finding that the amount to be securitized is capped at \$554,323,000.

#### Dividend Limitation

The Commission placed the following limitations on Consumers' ability to issue securitization bonds:

Consistent with the terms of this financing order, Consumers Energy Company shall first use the actual cost savings arising from securitization for general electric utility purposes and shall refrain from paying any extraordinary dividends to CMS until further order of the Commission. The Commission anticipates making determinations in a general rate case proceeding involving all electric rate classes regarding the appropriate use of such savings.

June 2 order, p. 80.

The limitation applicable to the payment of dividends was discussed on page 46 of the June 2 order, where the Commission stated that Consumers' proposal will produce quantifiable and tangible benefits only if the Commission required Consumers to use the actual cost savings arising from securitization for electric utility purposes only and to refrain from paying any extraordinary

dividends to its parent, CMS Energy Corporation (CMS). Moreover, in footnote 21 on page 46, the Commission indicated that, “[f]or the purposes of this order, an extraordinary dividend shall be considered to be any amount over and above Consumers’ earnings.”

Consumers seeks clarification of this limitation. According to Consumers, the limitation on the payment of any extraordinary dividends to its parent creates significant ambiguity. Consumers does not quarrel with the general notion that dividends to its parent cannot be paid out of a capital account. Citing Section 305 of the Federal Power Act, 16 USC 825d, and Section 12 of the Natural Gas Act, 15 USC 717k, Consumers acknowledges the impropriety of such action. However, Consumers stresses that the lack of any firm definition of the term “earnings” causes a significant ambiguity because there are many ways to interpret that term. According to Consumers, the lack of clarity in the use of this term will create significant uncertainty in the minds of investors, which will harm CMS, Consumers, and the utility’s customers.

Consumers points out that it currently has loan agreements with various financial institutions that limit the amount of dividends that it can pay to CMS to no more than \$300,000,000 of aggregate dividends in a calendar year. According to Consumers, the restrictions in the loan agreements are not tied to its earnings.

Consumers argues that the Commission should clarify that it intended the June 2 order to state that Consumers should not pay dividends in excess of the amount of retained earnings recorded on its balance sheet. Consumers insists that, under the present loan agreements, its proposed interpretation would effectively restrict annual dividends to the lower of retained earnings or \$300,000,000.

In response, the Attorney General argues that the June 2 order adequately defines extraordinary dividends as those over and above Consumers’ earnings. The Attorney General

insists that Consumers' effort to persuade the Commission to revise its definition goes beyond the scope of the record. Moreover, the Attorney General contends that acceptance of Consumers' position that the payment of extraordinary dividends should be gauged through reference to the company's retained earnings would effectively eliminate the protection of the securitization savings intended by the Commission. According to the Attorney General, retained earnings is a balance sheet concept that includes income booked during prior years and would not be limited to amounts booked as net operating income during the period in which securitization savings will be recognized.

ABATE also opposes Consumers' effort to persuade the Commission to revise its definition of earnings. According to ABATE, Consumers' proposal is so broad that it would enable Consumers to dividend all of its earnings to CMS.

ABATE argues that Consumers would be better off if it simply stopped paying dividends to CMS until the utility's financial condition improves. In the alternative, ABATE contends that the Commission should redefine extraordinary dividends as any dividend in excess of the average payout ratio for combination electric and gas utilities in the United States. Based on June 2003 data, ABATE states that this payout ratio is 60% of net income, which it contends would strike an appropriate balance between the dividend support owed to CMS and the need of the utility to retain money for reinvestment in Consumers' electric operations.

The Commission finds that Consumers' proposal to define the term "earnings" used in footnote 21 of the June 2 order as "retained earnings" should be rejected. Consumers' proposal subverts the intent of the limitation. As pointed out by the Attorney General, retained earnings is a balance sheet concept that includes income booked during prior years.

## Issuance Costs

In the June 2 order, the Commission expressly conditioned Consumers' authority to issue securitization bonds by requiring the company to "adhere to the ratio of pre-2003 Clean Air Act compliance costs to 1998-2000 ROA implementation costs" established by the order to thwart any attempt by Consumers to structure the issuance of securitization bonds to achieve a different ratio of contributions from the customer groups than that inherent in the order. June 2 order, p. 66.

Consumers is concerned that the combination of the Commission's ratio requirement and the MCL 460.10i(2)(d) limitation fails to recognize that certain issuance costs are not "scalable," i.e., they do not decline proportionately with the reduction in the amount of securitization bonds. For example, Consumers contends that the call premiums on debt issuances that are to be retired with the proceeds from the securitization bonds differ among debt issuances. According to Consumers, the higher cost debt issuances that will be retired first will likely have higher call premiums, which means that issuance costs will not decline proportionately as the amount of the securitization bonds decline. Indeed, Consumers asserts that, in order to maintain the securitization of a sufficient amount of qualified costs to cover the call premiums, this category of issuance costs will need to be \$24,052,000, not the \$14,211,006 amount produced by simply reducing all costs by the ratio of \$554,323,000 divided by \$644,389,000, or 86%.

As a solution to this problem, Consumers suggests that the Commission authorize it to reduce the Clean Air Act principal investment by \$9,840,995 and to add that amount to the \$14,211,006 of non-scalable issuance costs. Consumers insists that this adjustment only slightly changes the

relationship between Clean Air Act costs and implementation costs from what was present in the original \$644,389,000 qualified cost total.<sup>3</sup>

ABATE and the Attorney General oppose Consumers' proposal to increase the amount of implementation costs to be securitized by \$9,840,995 while making an offsetting reduction to the amount of Clean Air Act costs to be securitized. ABATE maintains that its due process rights will be violated if the Commission were to amend the June 2 order based upon the extra record representations made by Consumers on rehearing. The Attorney General shares ABATE's concern over the use of extra record representations and adds that the June 2 order is sufficiently generous in providing \$35,853,000 to Consumers to cover its securitization bond issuance costs.

The Commission finds that Consumers' proposal to reduce the Clean Air Act principal investment by \$9,840,995 and to add that amount to the \$14,211,006 of non-scalable issuance costs should be rejected. The reason for conditioning Consumers' authority to issue securitization bonds by requiring the company to adhere to the ratio of pre-2003 Clean Air Act compliance costs to 1998-2000 ROA implementation costs was to avoid a situation whereby Consumers could achieve a different ratio of contributions from the customer groups than that inherent in the June 2 order. Consumers' proposed solution changes that ratio, albeit ever so slightly. However, Consumers should not interpret the denial of its proposal to mean that a more appropriate adjustment would be unacceptable. For example, Consumers could add \$9,840,995 to its issuance costs by reducing the securitized amount of Clean Air Act costs by \$8,804,246 and by also reducing the amount of securitized implementation costs by \$1,036,749 without violating the ratio limitation.

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<sup>3</sup>Under Consumers' proposed modification, the percentage that implementation costs represent of the total of Clean Air Act and implementation costs would increase from 10.5% to 10.7%.

### Cost Responsibility Allocation

In the June 2 order, the Commission determined that all customers, including ROA customers, should bear responsibility for the portion of the total securitized costs represented by implementation costs and associated issuance costs, but that only full service customers should bear responsibility for the Clean Air Act costs and associated issuance costs. This means that ROA customers will pay a securitization charge that is computed based upon only 10.5% of the total securitized costs, which creates a differential between the full service securitization charge and the ROA securitization charge.

Consumers is concerned that the freedom of customers to move between full service and ROA service could result in a reduction in the revenue stream that is necessary to support the securitization bonds. According to Consumers, the insecurity of the revenue stream is a significant concern to its financial advisers, the ratings agencies that must evaluate the financing order and bond structure, and prospective bond purchasers. Consumers asserts that to the extent there is movement of customers to ROA service, the securitization charge for the remaining full service customers must increase to make up the difference. Consumers stresses that, at the extreme, the last remaining full service customer could be left responsible for approximately 90% of the required bond payments.

To bolster its argument on this issue, Consumers attached an affidavit from Jack Kattan, who served as Consumers' chief financial adviser concerning the issuance of the proposed securitization bonds. Consumers also represents that Mr. Kattan's opinion is that the terms of the June 2 order do not support a AAA bond rating and will not allow the bonds to be priced on the same basis as other utility securitization bond issuances.

According to Consumers, the specific portion of the June 2 order that creates the problem is the allocation of cost responsibility between full service bundled (including special contract) and ROA customers in a manner that creates a significant differential between the securitization charges (and related tax charges) for these two customer groups. Consumers suggests that one solution to its concerns would be for the Commission to amend the order to provide for a uniform charge applicable to all customers (including ROA) as was done in the first securitization approved in Case No. U-12505. Consumers argues that this solution would not harm ROA customers or the ROA program because of the full offset for the securitization charge through December 31, 2005, which means that until January 1, 2006, there would no incremental effect on any customers, including ROA customers. Thereafter, Consumers states that the Commission will be able to design full service bundled and ROA customer rates, based upon an examination of all elements of the cost of service, and in whatever manner is supported by the record in future rate proceedings.

Consumers also notes that Mr. Kattan identified an alternative, albeit more complicated, solution in his affidavit, that would still allow the bonds to be sold on reasonable terms. According to Consumers, this alternative approach would preserve the Commission's desire to have the ROA customers initially pay securitization and tax charges that are based upon approximately 10.5% of the total costs securitized. Consumers explains that it calls for modification of the true-up process to incorporate a mechanism that would increase the securitization charge (and related tax charge) paid by ROA customers as the percentage of total load switching to ROA service increases. As customers switch to ROA, the ROA securitization and tax charges would be recalculated and increased to produce the same amount of revenue as would have been produced had the customer not switched to ROA. Full service bundled customer rates would be capped at

stated percentages of the uniform charge. These adjustments would be implemented automatically as part of the annual true-up process. If significant load migration to ROA service occurred in between annual true-ups, there would similarly be the ability to adjust the ROA charges in the same manner. Consumers asserts that the alternative approach balances the desire to minimize the effect on ROA customers with the need to make some modifications that will allow the bonds to be sold on reasonable terms.

Consumers' cost responsibility allocation exception is opposed by Kroger, ABATE, Energy Michigan, and the Attorney General. Kroger argues that Consumers' new proposal is flawed because it allows ROA customers to be double-charged for generation assets. According to Kroger, although Consumers' new proposal does not start out charging ROA customers for generation assets, as full service customers switch to ROA service, Consumers' true-up mechanism quickly and steeply shifts generation costs to ROA customers.

ABATE is concerned that Consumers' new proposal is not supported by a shred of record evidence. According to ABATE, the Commission should offer Consumers an opportunity to participate in additional evidentiary hearings. ABATE insists that the Commission would violate its due process rights by approving Consumers' petition for rehearing without giving ABATE an opportunity to cross-examine Mr. Kattan.

Energy Michigan argues that Consumers' contention that relieving ROA customers from the obligation to contribute to the Clean Air Act costs was considered by the Commission and rejected in the June 2 order. Accordingly, Energy Michigan insists that this argument cannot form the basis for granting Consumers' petition for rehearing. Energy Michigan also asserts that Mr. Kattan's new surcharge proposal cannot be considered because it is extra record evidence. If

the Commission intends to consider Mr. Kattan's proposal, Energy Michigan maintains that the Commission must allow Energy Michigan to present rebuttal testimony.

Although the Attorney General states that he is aligned with Consumers with regard to the need for uniform securitization surcharges for all customer classes, the Attorney General opposes Consumers' petition for rehearing because it is based on a new rate design that has no record support. In so doing, the Attorney General joins the other parties in insisting that additional hearings are necessary before the Commission can approve the scheme described in Mr. Kattan's affidavit. Moreover, the Attorney General contends that the new proposal is legally flawed. According to the Attorney General, the Commission cannot approve any approach that creates different securitization charges based on the identity of the generation supplier. Likewise, the Attorney General contends that the Legislature has not conferred on the Commission any authority to authorize either contingent or conditional securitization charges. Finally, the Attorney General argues that adoption of a sliding scale of securitization charges as proposed by Consumers is a poor policy determination because it creates uncertainty regarding rates, depends on unproven assumptions regarding future circumstances, and calls into question Consumers' ability to satisfy the requirements imposed by MCL 460.10i(1) through MCL 460.10i(2)(d).

The Commission finds Consumers' proposal to modify the allocation of cost responsibility cannot be acted on at this time. The Commission has examined Consumers' proposal and concludes that it would be unfair to the other parties to this proceeding to rule upon the proposal without additional evidentiary hearings. Consumers' proposal is based, in part, on an affidavit submitted by Mr. Kattan, which is not part of the record. ABATE and Energy Michigan insist that it would violate their due process rights for the Commission to consider Mr. Kattan's affidavit without affording the intervenors an opportunity to cross-examine Mr. Kattan and to present

rebuttal testimony. The Commission agrees. Accordingly, the Commission directs that this matter be remanded to the Administrative Law Judge Division for further proceedings consistent with this order.

Of significant concern to the Commission is the allegation in the affidavit that the Commission's June 2 order may not result in the highest possible rating for Consumers' securitization bonds. Obtaining the highest possible bond rating is crucial to the concept of securitization and is necessary to ensure that ratepayers receive the most benefit of the savings derived through securitization. To the extent that the June 2 order is flawed in this regard, it is in the public interest for the Commission to repair it. Indeed, pursuant to MCL 460.10i(1) and (2), the failure of the structure and pricing of the securitization bonds to result in the lowest possible securitization charges constitutes justification to reject Consumers' application.

While the Commission does not intend to limit the scope of the investigation conducted on remand, the Commission will take the unusual step of specifically delineating two issues that the Commission intends to focus on. First, the Commission is concerned by challenges to its June 2 order with regard to the issue of nonbypassability. Second, the Commission is concerned by the allegations of unfairness on the part of ROA customers with regard to the extent to which they could be "double-charged" for Clean Air Act compliance costs. The Commission recognizes that the arguments of the parties on these issues may have a great deal of merit. The Commission has struggled to resolve these perhaps legally irreconcilable issues on the current record and finds that it should provide the parties with an additional opportunity to present evidence and argument.

Finally, the Commission will read the record, which will obviate the preparation of a Proposal for Decision.

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. This case should be remanded to Administrative Law Judge James N. Rigas for additional proceedings consistent with this order.

THEREFORE, IT IS ORDERED that:

A. This case is remanded to Administrative Law Judge James N. Rigas for additional proceedings consistent with this order.

B. A prehearing conference before Administrative Law Judge James N. Rigas shall be conducted at 9:00 a.m. on January 13, 2004.

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, abstaining.

( 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

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MICHIGAN PUBLIC SERVICE COMMISSION

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Chair

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Commissioner

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Commissioner

By its action of December 18, 2003.

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Its Executive Secretary

In the matter of the application of )  
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certain of its qualified costs. )  
\_\_\_\_\_ )

Case No. U-13715

Suggested Minute:

“Adopt and issue order dated December 18, 2003 remanding this case to Administrative Law Judge James N. Rigas for additional proceedings, as set forth in the order.”