

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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

At the October 14, 2004 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. Robert B. Nelson, Commissioner
Hon. Laura Chappelle, Commissioner

ORDER AFTER REMAND

History of Proceedings

On December 18, 2003, the Commission granted the July 1, 2003 petition for rehearing and clarification filed by Consumers Energy Company (Consumers) regarding the Commission’s June 2, 2003 order (the June 2 order) in this proceeding that authorized Consumers to issue up to \$554,323,000 of securitization bonds pursuant to the Customer Choice and Electricity Reliability Act¹, which, among other things, allows certain utilities² the option of reducing their costs through

¹2000 PA 141 (Act 141) and 2000 PA 142 (Act 142), which amended 1939 PA 3, MCL 460.1 et seq.

²As 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.

the use of securitization.³ In so doing, the Commission remanded the proceedings to the Administrative Law Judges Division for additional proceedings. Although the Commission did not limit the scope of the investigation to be conducted on remand, the Commission specifically delineated two issues of concern. First, the Commission stated that it was concerned by challenges to its June 2 order with regard to the issue of nonbypassability. Second, the Commission expressed concern over allegations of unfairness on the part of retail open access (ROA) customers with regard to the extent to which they could be “double-charged” for Clean Air Act (CAA) compliance costs.

On January 13, 2004, Administrative Law Judge James N. Rigas (ALJ) conducted a prehearing conference and established a schedule for the remand proceedings. The prehearing conference was attended by Consumers, Attorney General Michael A. Cox (Attorney General), the Commission Staff (Staff), the Association of Businesses Advocating Tariff Equity (ABATE), Energy Michigan, and the Midland Cogeneration Venture Limited Partnership (MCV).

On March 30, 2004, the ALJ conducted an evidentiary hearing at which 8 witnesses testified and 13 exhibits were received into evidence.

On April 16 and 26, 2004, respectively, Consumers, the Attorney General, Energy Michigan, ABATE, and the Staff filed briefs and reply briefs. Because the Commission had indicated its intention to read the record, a Proposal for Decision was not prepared.

Positions of the Parties

Consumers contends that securitization charges in a financing order must be nonbypassable within the meaning of Section 10h(f) of Act 142, MCL 460.10h(f). According to Consumers, the

³Securitization 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.

approach followed by the Commission in its June 2 order uses an asymmetrical allocation of securitization charges between bundled and unbundled customers that will increase the financial risks that rating agencies must take into account in the bond rating process. Because of the possibility of migration of bundled customers to unbundled service to avoid paying a greater share of the securitization charges, Consumers insists that the customer base responsible for paying the securitization surcharge “could shrink to zero.” Consumers’ brief, p. 4. Consumers insists that the whole point of the securitization process was to generate savings associated with AAA bond ratings. Consumers maintains that its logic illustrates the Legislature’s intent in passing Act 142. Based on the statutory definition of a “nonbypassable charge” and its concerns over the financial stability of the revenue stream for servicing the securitization bonds, Consumers urges the Commission to approve revised securitization charges and securitization tax charges that will apply to customers whether they are taking ROA or bundled service. According to Consumers, the Commission should approve a uniform securitization charge per kilowatt-hour (kWh) and a uniform securitization tax charge per kWh.

Next, Consumers contends that its proposal for the securitization of its CAA costs does not result in “double-charging” its ROA customers because those customers receive the benefit of cleaner air and the company’s ability to serve all customers. Consumers also maintains that ROA customers benefit from the voltage support and stability of the electric transmission grid provided by its generation facilities. Additionally, Consumers notes that some ROA customers, such as The Kroger Company, have chosen to return to bundled service.

Consumers argues that the asymmetrical rate design in the June 2 order is inconsistent with the uniform nature of the securitization charges approved in the Commission’s financing order in

Case No. U-12505. According to Consumers, in that case, the Commission approved the securitization of Consumers' generation-related qualified costs and imposed a uniform securitization charge on all customers subject to certain limited offsets for ROA customers.

Consumers also urges the Commission to rescind its determination concerning the appropriate interest rate to be used in analyzing the statutory standard set forth in MCL 460.10i(2)(d). In so doing, Consumers reiterates its position that the appropriate interest rate for use in making the MCL 460.10i(2)(d) determination is the expected securitization bond interest rate rather than its pre-tax overall authorized rate of return of 10.63%. Consumers insists that reversal of the Commission's prior rulings on this issue is critical to the administration of Act 142.

Additionally, Consumers contends that the Commission should rethink imposition of a dividend restriction on the company. Consumers insists that the dividend restriction is poor public policy because the company has already committed to a dividend restriction in Case No. U-13730 and because having multiple dividend restrictions cause confusion.

In conclusion, Consumers asserts that it could save up to \$39 million during the first year following issuance of securitization bonds, which could improve the company's credit picture. Accordingly, Consumers requests that the Commission approve its revised securitization proposal.⁴

The Staff urges the Commission to consider all of the evidence presented on the remand issues before granting the Consumers' requests. According to the Staff, Consumers' savings from issuing securitization bonds may be minimal when compared to issuing conventional long-term debt. Citing evidence that the current cost for new 10-year long-term debt is 5.25% to

⁴On May 7, 2004, Consumers filed documentation indicating that it was withdrawing its request to recover its implementation costs in this proceeding.

5.50%, the Staff maintains that “there are very little interest related savings from the issuance of securitization bonds for the Clean Air Act Assets.” Staff brief, p. 16. The Staff concedes that credit improvement for Consumers is reasonable, but contends that the issuance of securitization bonds may not be the best method for Consumers to improve its credit. According to the Staff, if Consumers uses the proceeds of the securitization bonds to retire existing debt, the result will be to lower the total amount of debt in the ratemaking capital structure, which then increases the amount of equity in the capital structure. The Staff maintains that this change in the debt/equity ratio will most likely increase the cost to ratepayers. Also, the Staff points out that the securitization bonds are not included as debt by rating agencies, and could lead to the issuance of additional debt by the utility in lieu of an infusion of equity into the utility by its corporate parent, CMS Energy Corporation (CMS). On the other hand, the Staff believes that the issuance of conventional debt for its CAA investments would necessitate an equity infusion by CMS in order to maintain a favorable equity ratio.

The Attorney General agrees with Consumers’ interpretation of MCL 460.10h(f). He reasons that although charging ROA customers securitization charges related to CAA costs will have anticompetitive effects, the wisdom of that policy is a matter of legislative policy. Citing State Farm Fire & Casualty v Old Republic Ins, 466 Mich 142, 146; 644 NW2d 715 (2002), and Koontz v Ameritech Services, Inc, 466 Mich 304, 312; 645 NW2d 34 (2002), he also maintains that the Commission’s interpretation of MCL 460.10h(f) fails to give effect to every word, phrase, and clause in the statute, and renders a part of the statute surplusage or nugatory. The Attorney General argues that pages 54-61 in the June 2 order authorize securitization charges that include CAA costs, but exempt ROA customers from that portion of the securitization charges because CAA costs are generation-related. According to the Attorney General, such action falls within the

scope of the definitions in Sections 10h(f) and 10h(i) and effectively nullifies statutorily-imposed nonbypassability.

With regard to the issue of the ROA customers being charged twice for CAA costs—once by their suppliers and again by Consumers—the Attorney General argues that the issue is irrelevant, because Act 142 mandates imposition of resulting securitization charges upon all customers even if ROA customers’ claims of double charging are valid.

On the topic of dividend restrictions, the Attorney General maintains that the Commission should not revisit its prior rulings at this time. According to the Attorney General, acceptance of Consumers’ position would open the door to payment of dividends that could merely transfer cash from Consumers to its parent without consideration of Consumers’ own need for cash.

As for Consumers’ proposal to realign its securitization assets in this case (Exhibit A-92), the Attorney General contends that this proposal simply repackages an issue previously rejected by the Commission in the remand order. The Attorney General insists that the Commission’s prior determination should remain unchanged. The Attorney General insists that Consumers’ position on the MCL 460.10i(2)(d) test is flawed and should be rejected again.

The Attorney General also states that Energy Michigan’s proposal to change the return-to-service provisions in Consumers’ ROA tariff is completely outside the scope of the remand order and should be rejected.⁵

ABATE maintains that if the Commission determines that securitization charges must be nonbypassable such that it chooses to apply securitization charges to ROA customers, then the Commission should provide that ROA customers will receive an offsetting credit that negates the

⁵Arguments regarding Energy Michigan’s and ABATE’s proposals to exclude all implementation costs from the securitization proceeding are not discussed because of Consumers’ withdrawal of that issue.

price effect of the securitization charge on ROA customers. ABATE also contends that the Commission should reject use of a uniform per kWh surcharge. According to ABATE, a uniform surcharge is inconsistent with Commission policy and penalizes high load factor customers regardless of whether they are taking service as a bundled or ROA customer.

Energy Michigan maintains that the sources of power supply used by ROA customers include CAA costs. Energy Michigan also contends that Consumers' fossil fuel plants subject to CAA modifications are competitive in the market and, therefore, do not have stranded costs. Energy Michigan states that nonbypassable generation costs should not be imposed on ROA customers, and that to do so would constitute a subsidy of Consumers' bundled customers by Consumers' ROA customers.

Energy Michigan states that there are two alternative solutions to the problems of nonbypassability. First, Energy Michigan suggests that in lieu of paying for CAA costs, Consumers' return to service requirements could be revised to provide a 12-month notice period and a mandate to remain on bundled service rates for 12 months subsequent to that 12-month notice. According to Energy Michigan, if less than a 12-month notice is given, the ROA customer would be charged at market rates, which would fully compensate Consumers for all costs of serving returning customers regardless of market prices. Second, as a remedy for Consumers' contention that the securitization bonds will fall short of AAA bond-rating status, Energy Michigan proposed a mechanism whereby ROA customers would begin to pay for CAA securitization bonds once ROA migration off the Consumers system resulted in a loss of sales volume that caused a doubling of the securitization charges necessary to fund CAA securitization bonds. According to Energy Michigan, use of such a "circuit breaker" would ensure investors that funds would be available to

retire CAA securitization bonds under all circumstances including large customer migrations to ROA service.

Discussion

In the December 18 order, the Commission expressed concerns over its prior rulings in the June 2 order on the issues of nonbypassability and the anticompetitive effect of requiring ROA customers to bear any of the burden of generation-related expenses, such as Consumers' CAA costs.

Qualified costs are defined in Section 10h(g) of Act 142 as follows:

“Qualified costs” means an electric utility’s regulatory assets *as determined by the commission*, adjusted by the applicable portion of related investment tax credits, plus any costs that the commission determines that the electric utility would be unlikely to collect in a competitive market, including, but not limited to, retail open access implementation costs and the costs of a commission approved restructuring, buyout or buy-down of a power purchase contract, together with the costs of issuing, supporting, and servicing securitization bonds and any costs of retiring and refunding the electric utility’s existing debt and equity securities in connection with the issuance of securitization bonds. Qualified costs include taxes related to the recovery of securitization charges. (Emphasis added).

In the June 2 order, the Commission approved Consumers’ request to securitize its pre-2003 CAA costs. The Commission is now persuaded that its prior determination should be vacated.

Consumers maintained that its CAA costs should be considered a regulatory asset and qualified costs pursuant to MCL 460.10h(g). According to Consumers, the record in this proceeding fully supported such a determination. Moreover, arguing that securitization is the least expensive means of accomplishing recovery of its CAA expenditures, Consumers urged the Commission to authorize inclusion of these costs in the financing order.

All other parties opposed Consumers on this issue. The Staff had urged the Commission to exclude Consumers’ projected 2003 CAA expenditures and the 1999-2003 return on investment

for the CAA expenditures from the financing order. The Staff argued that the Commission had already made such a determination in its July 10, 2002 order in Case No. U-13380 when it granted the Staff's motion to strike testimony about Consumers' CAA costs from its 2001 and 2002 stranded cost case.

ABATE also opposed Consumers' efforts to securitize its CAA costs. According to ABATE, such costs should be recovered in a competitive market because all suppliers will have to build these costs into the price of their power. Further, ABATE stressed that the Commission has yet to view any costs related to a fossil fuel plant as being a potential stranded cost.

The Attorney General argued that the CAA costs are not appropriate for inclusion in a financing order because they were attributable to enforcement of federal law, not electric restructuring. Moreover, he asserted that if such costs were reasonable and prudent expenditures, they should be recoverable in a competitive market.

Energy Michigan also opposed Consumers' position because the installation of CAA equipment resulted in the utility's ability to use less expensive fuels. Energy Michigan insisted that Consumers should be required to use the anticipated fuel savings to offset the cost of the capital improvements. Energy Michigan also contended that the costs of complying with the CAA should be recoverable in a competitive market because Consumers' fossil fuel plants remained competitive.

The Michigan Environmental Council and the Public Interest Research Group in Michigan (collectively, MEC) asserted that Consumers' CAA costs were covered by its current rates or reviewable in the company's next rate case. The MEC also maintained that authorizing Consumers to recover these costs through use of a financing order would be anticompetitive because other suppliers do not have access to a similar cost recovery mechanism.

Kroger contended that an examination of Consumers' CAA projects revealed that many of the expenses related to boiler modifications that allow Consumers' coal plants to burn less expensive coal. Kroger insisted that the Commission should deny Consumers' request to include its CAA projects in the financing order.

In analyzing the arguments regarding approval of Consumers' request to securitize its CAA costs, the Commission focused most of its attention on the issue of whether the CAA costs could be considered to be a regulatory asset. In retrospect, the Commission should have devoted more attention to the issue of whether a regulatory asset comprised entirely of generation-related assets should be "determined by the commission" to be an appropriate "qualified cost." The arguments raised on rehearing and during the course of the remand proceeding now persuade the Commission that the underlying objectives of Acts 141 and 142 will be thwarted if an asset comprised entirely of generation-related costs that have not been shown to be stranded were to be securitized as proposed by Consumers. Accordingly, the Commission vacates those findings and orders that Consumers' application for authority to issue securitization bonds should be denied.

The denial of this application should in no way preclude Consumers from pursuing recovery of CAA costs pursuant to Section 10d(4) of Act 141.

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. Consumers' application for authority to issue securitization bonds should be denied.

THEREFORE, IT IS ORDERED that Consumers Energy Company's application for authority to issue securitization bonds is 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, abstaining.

(S E A L)

/s/ Robert B. Nelson
Commissioner

/s/ Laura Chappelle
Commissioner

By its action of October 14, 2004.

/s/ Mary Jo Kunkle
Its Executive Secretary

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