

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of )  
CONSUMERS ENERGY COMPANY for )  
determination of net stranded costs for the year 2004. )  
\_\_\_\_\_ )

Case No. U-14526

At the September 26, 2006 meeting of the Michigan Public Service Commission in Lansing,  
Michigan.

PRESENT: Hon. J. Peter Lark, Chairman  
Hon. Laura Chappelle, Commissioner  
Hon. Monica Martinez, Commissioner

**OPINION AND ORDER**

In this order, the Commission declines to adopt the recommendations of the Proposal for Decision (PFD) submitted by Administrative Law Judge Sharon L. Feldman (ALJ), that Consumers Energy Company (Consumers) “does not have stranded costs for 2004 because it has not shown it has any unrecovered costs due to competition.” PFD, June 6, 2006, p. 29. Rather, the Commission concludes this case by adopting the stranded cost figure recommended by Consumers and the Commission Staff (Staff), while repeating the caveat that Consumers has now recovered all stranded costs arising from the utility restructuring imposed by 2000 PA 141 (Act 141).

**Introduction**

On November 21, 2005, Consumers filed this case to seek Commission approval for a determination that it “incurred zero stranded costs in 2004” after \$24.126 million in revenue from wholesale power sales is “allocated to stranded costs in the same manner as . . . in prior stranded

cost cases.” Application, pp. 2-3.<sup>1</sup> Consumers also proposed that, “[t]o the extent a greater amount of these [wholesale power sale] revenues are allocated to PSCR [power supply cost recovery] costs in Consumers Energy’s 2004 PSCR reconciliation proceeding (Case No. U-13917-R), the amount of 2004 stranded costs could be increased as much as \$24.1 million.” *Id.*, p. 2.

The ALJ approved intervention by a number of parties, two of whom have filed exceptions and replies to the PFD, Energy Michigan, and Attorney General Michael A. Cox (Attorney General).<sup>2</sup> The Staff also filed exceptions.

The record contains testimony offered on behalf of Consumers, Energy Michigan, and the Attorney General, and briefs and replies by those same parties, ABATE, and the Staff. After considering the testimony and briefs, the ALJ made five recommendations to the Commission:

First, the ALJ recommended that the Commission adopt the Attorney General’s position that “Consumers did not have stranded costs for 2004 because it failed to establish that any of its unrecovered production fixed costs are costs that would have been recovered under regulation but cannot be recovered under competition.” PFD, p. 7.

Second, the ALJ recommended “that the Commission allocate net revenues from third-party sales in this case in accordance with its decision in Case No. U-13917-R [Consumers’ 2004 PSCR reconciliation case].” *Id.*, p. 19.

Third, the ALJ recommended rejecting Energy Michigan’s proposed alternative calculation of stranded costs because Energy Michigan failed to show that its proposed method of calculating those costs was sound. *Id.*, p. 25.

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<sup>1</sup>Referring to Case Nos. U-12639, U-13380, U-13720, and U-14098.

<sup>2</sup>Other intervenors were Association of Businesses Advocating Tariff Equity (ABATE), National Energy Marketers Association, and Midland Cogeneration Venture Limited Partnership; none filed exceptions to the PFD or replies to the exceptions of others.

Fourth, the ALJ recommended eliminating PSCR costs from the revenue requirements calculation and adopting “the reasonable presumption . . . that all reasonably and prudently incurred PSCR costs will be recovered through the PSCR process and . . . not . . . considered stranded.” *Id.*, p. 27.

Finally, the ALJ recommended rejection of Energy Michigan’s proposal to require Consumers to supply retail open access (ROA) customers with electric power equal in cost to the amount that these customers pay for securitization bond and nuclear decommissioning charges. *Id.*, p 28-29.

#### Exceptions to the PFD and Replies

Consumers, Energy Michigan, and the Attorney General filed both exceptions and replies. The Staff filed exceptions only.

In its exceptions, Consumers first argues that ALJ erred by requiring Consumers to show, as a threshold requirement, that its unrecovered costs could have been recovered under regulation but cannot be recovered under competition. Consumers argues “that this ‘threshold test’ is not part of the Commission-approved stranded costs calculation method,” and also that this amounts to a novel test that the Commission has explicitly rejected in prior orders. Nonetheless, Consumers continues, the evidence in the case still meets the threshold test and “demonstrates that the revenue deficiency identified by the previously-accepted calculation method represents” previously recoverable costs that it could no longer recover after competition. Finally, Consumers argues that, “before the application of this test in this case could be considered lawful, the record must be reopened to allow evidence to be presented concerning this new test.” Consumers’ exceptions, June 20, 2006, pp. 1-2.

Consumers further argues that the actual deficiency in its generation revenue exceeded \$50 million, based on a claim that its actual stranded costs included \$21.13 million in 2004 Clean Air

Act expenses and \$5.08 million in seasonal capacity costs on top of the \$24.13 million contested here. “Thus, the fixed costs that were not recovered in 2003 due to ROA competition were approximately \$67 million. The total actual generation fixed costs revenue deficiency in 2004 (if all generation-related costs are included) was \$50,314,616. All of these costs would have been recoverable under regulation.” *Id.*, p. 8.

Consumers next objects to the ALJ’s refusal to recommend a way to divide the revenue from wholesale power sales between its retail customers, referred to as PSCR or full-service customers, and those served by an alternative electric supplier (AES), known as ROA customers. *Id.*, p. 11. Consumers argues that “past Commission practice” was to “allocate[] a sufficient amount of third party revenues to reduce stranded costs to zero” and it proposes the same here, arguing that doing so here “results in approximately a 50-50 split of these revenues between ROA customers and full service customers.” *Id.*

Energy Michigan argues that the monies paid by ROA customers for securitization bonds and taxes and for nuclear decommissioning charges amounts to a forced subsidy by those customers to the Palisades nuclear plant and that the Commission should direct “Consumers to provide ROA customers with an amount of power” based on those amounts. Energy Michigan’s exceptions, June 20, 2006, p. 8. Energy Michigan further takes exception to the ALJ’s recommendation to remove all PSCR costs and revenues from future stranded cost calculations. Energy Michigan argues that the ALJ based this recommendation on an exhibit that was unsupported by any witness. Energy Michigan argues that, therefore, the Staff calculation method lacks record support and, further, escaped critical scrutiny through cross-examination precisely because there was no direct testimony in support of that method offered. *Id.*, pp. 9-11.

The Attorney General argues that, if the Commission does not adopt the ALJ's recommended finding that Consumers failed to show that it had any stranded costs, then it should adopt the Attorney General's position that none of the third party sales revenue should be used to offset any stranded costs because "Consumers Energy did not present any testimony satisfying the standard for determining mitigation of stranded costs." Attorney General's exceptions, June 20, 2006, p. 2 (quoting the Attorney General's initial brief, April 26, 2006, p. 7).

The Staff does not squarely take exception to the PFD. Rather, the Staff notes that its proposed "interpretation of stranded costs . . . has never been previously adopted nor implemented by the Commission" and also that it differs from the method the Commission adopted in Case No. U-12639, which is the method that "the Staff . . . has relied on . . . to present their calculations of stranded costs." Staff's exceptions, June 20, 2006, pp 1-2.

In its reply, Consumers addresses the Staff's exceptions by reiterating its strenuous objections to the PFD, adoption of which would be an "unlawful, unreasonable . . . denial of due process." Consumers' replies, June 27, 2006, p. 1. Consumers argues that its "loss of load to retail open access . . . in 2004 was 4,151,167 MWh. . . . This corresponds to an enormous revenue loss. . . . If that load had remained full service, the revenue deficiency indicated by the U-12639 method would obviously have been much less." *Id.*, p. 3. Consumers argues that "the generation fixed cost revenue deficiency indicated by application of that method must be offset (mitigated) through the use of available third party revenues. This results in approximately a 50-50 split of those revenues between ROA customers and full service customers." *Id.*, pp. 3-4.

Consumers' reply to the Attorney General emphasizes that it relied on the Case No. U-12639 method of calculating the stranded costs when deciding to make wholesale power sales to third parties "to mitigate the impact of ROA load loss," and it asserts that "adoption of the ALJ's

recommendation regarding the ‘threshold/second step’ would clearly be unlawful and unreasonable.” *Id.*, p 4.

Consumers replies to Energy Michigan’s exceptions by asserting that they are “merely the latest effort to have the Commission retract its early rulings that apply decommissioning and securitization charges to ROA customers,” citing Case Nos. U-12505 (authorizing securitization of the Palisades nuclear plant and approving securitization charges for all customers) and U-14150 (approving pass through of nuclear decommissioning charges to all customers). Consumers also cites from the Commission’s order in its recent rate case, Case No. U-14347, where the Commission affirmed denial of a bypass that would allow ROA customers to bypass the securitization and nuclear decommissioning charges. *Id.*, p. 5.

Energy Michigan replies to the Staff by arguing that, if the Commission does not adopt the ALJ’s conclusion that stranded costs are zero, then it must follow the precedent set in prior stranded cost cases, which have not only all used the revenue requirement method specified in Case No. U-12639 but also applied all excess wholesale power sales revenues above the amounts assumed in the PSCR base to offset stranded costs. Energy Michigan’s replies, June 27, 2006, p. 3. Energy Michigan further argues that all of Consumers’ 2004 wholesale power sales revenue resulted from “the ROA program which freed up literally all the Mwh used for third party sales.” *Id.*

Energy Michigan replies to the Attorney General by arguing that he ignores record evidence in this case and also in the Consumers’ 2004 PSCR reconciliation proceeding, Case No. U-13917-R, “proving that available third party sales revenue were caused by the sale of Mwh freed up by the ROA program.” *Id.*, p. 5. Energy Michigan cites ROA sales of approximately 4 million MWh and wholesale power sales of 2.48 million MWh “as basis for the Energy Michigan witness conclusion

that all third party sales resulted from Mwh freed up by the ROA program.” *Id.*, p. 5. Energy Michigan argues that its witness’s testimony was never rebutted and, therefore, the “record evidence demonstrates beyond all reasonable doubt that the vast majority if not all of third party sales resulted from Mwh freed up by over 4 million Mwh of system sales departing for the ROA program.” *Id.* Thus, Energy Michigan concludes, “[i]f the Commission does not adopt the theory of the AG that there is zero stranded cost, the Administrative Procedures Act requires that the Commission use the U-12639 method to both calculate stranded costs and offset those costs with available third party sales revenue because that is the only ‘traditional U-12639’ outcome that is supported by record evidence.” *Id.*, p. 6 (emphasis in original).

Energy Michigan replies to Consumers by, first, arguing that Consumers’ exceptions did not go far enough because they failed to note that the precedents that Consumers cites also require that all wholesale power sales revenue be used to offset stranded costs. *Id.*, p. 7. Second, Energy Michigan argues that Consumers and the Staff fail to recognize that it was the ROA program that made the wholesale power sales possible and allowed “Consumers to avoid significant PSCR increases due to purchase of additional power. . . . [T]he Mwh freed up were sold into the market and provided revenues more than sufficient to offset the stranded costs.” *Id.* Therefore, Energy Michigan argues, the “‘traditional U-12639’ method of calculated and offsetting stranded costs must be embraced in its entirety as regards the cost and use of third party sales revenue to mitigate those costs.” *Id.*, p. 8. Energy Michigan then argues that Consumers is improperly attempting to reargue the Commission’s decision to exclude Clean Air Act expense from stranded cost cases. *Id.* Finally, Energy Michigan notes that the same Act 141 that Consumers cites also gives the Commission “wide latitude to set the actual formula used to determine stranded costs.” *Id.* (citing MCL 460.10a(17)(c)). Energy Michigan concludes as follows:

Use of the “traditional U-12639” method[] requires application of that formula to both calculation of revenue deficiency and use of available third party sales revenue to mitigate or offset that deficiency. Loss of retail sales to ROA service clearly produces retail revenue reductions but just as clearly avoids some PSCR costs and produces additional revenue from the sale of power not needed by retail customers. The Commission should reaffirm this fact and order the complete application of the U-12639 theory and precedent to both calculating stranded costs and using third party sales revenues to mitigate those costs. The parties and participants in the ROA market have relied upon this framework and are entitled to consistent application of that framework at least through termination of the PA 141 rate freeze on December 31, 2005. [*Id.*, pp. 8-9.]

The Attorney General replies to Consumers by arguing that Consumers’ attack on the “threshold test” is weak because, in her PFD, the ALJ did not create a new test or definition of stranded costs but, rather, simply referred to the existing definition of stranded costs from Case No. U-12639 and its progeny: “The ALJ never creates a new test; never creates a new interpretation, and never changes the Commission[’s] existing definition of stranded costs.” Attorney General’s replies, June 27, 2006, p. 1. The Attorney General further argues that Consumers attempts to mislead the Commission by misstating the definition of stranded costs as costs “that *were* not recovered under competition” rather than the proper definition of “costs . . . that *cannot be* recovered under competition.” *Id.*, p. 3. Further, the Attorney General argues that Consumers, having failed to show the stranded costs in its direct case or in rebuttal, is now attempting to enlarge the record to support its claims. *Id.*, p. 4. The Attorney General also argues that the ALJ was correct to rule out recovery for losses suffered due to the rate freeze imposed with Act 141; the Attorney General argues that, although this was not the basis for the PFD’s finding of zero stranded costs, it was required in any event by the rate freeze provision of the act. *Id.*, pp. 4-5 (citing MCL 460.10d(1)). Finally, the Attorney General replies that reopening the record to permit Consumers to submit additional evidence would violate the other parties’ due process rights and that Consumers “had the opportunity to rebut the Attorney General’s arguments . . . but failed to do so.” *Id.*, p. 6.

## Discussion

In Act 141, the Legislature required the Commission to issue orders that “shall provide for full recovery of a utility’s net stranded costs and implementation costs as determined by the commission.” MCL 460.10a(1). However, the Legislature did not define stranded costs, leaving the Commission with the task of defining stranded costs and of conducting annual contested case proceedings to ensure that each utility recovered any net stranded costs.

The Commission conducted a contested case proceeding and issued an order adopting the Staff’s proposed method for calculating stranded costs, describing it as “the most direct approach to determining net stranded costs, i.e., costs that would have been recovered under regulation that cannot be recovered under competition, offset by mitigation (such as market sales of capacity and energy that are freed up when customers choose alternative suppliers) and stranded benefits . . . .” Case No. U-12639, December 20, 2001, p. 10, *aff’d Consumers Energy Co v Pub Service Comm*, unpublished opinion *per curiam* of the Court of Appeals, decided November 18, 2003 (Docket No. 241990). The order described the Staff’s method in greater detail as follows:

The Staff proposed that the Commission annually compute net stranded costs on a historical basis. Stranded costs would be the difference between each year’s revenue requirement associated with fixed generation assets, generation-related regulatory assets, and capacity payments associated with PPAs [power purchase agreements] and that year’s revenues available to cover those costs. In calculating the revenue requirement, it excluded variable costs because those can be avoided when customers take service from alternative electric suppliers. In calculating revenues available to cover fixed generation costs, it included the generation component of current rates and net revenues from third-party sales. The Staff used cost of service studies from Consumers’ and Detroit Edison’s most recent rate cases . . . to estimate the portion of rates that covers fixed generation costs. When the revenue requirement for a specific year exceeds the revenues available to cover those costs, the utility has stranded costs for that year. . . . The Staff recognized that there would be a delay in the recovery of stranded costs due to the historical nature of its methodology, although it did not intend for the delay to inhibit the utilities’ ability to recover any costs that could be shown to be stranded. [*Id.*, pp. 4-5.]

In this case, witnesses for Consumers, the Attorney General, and Energy Michigan presented evidence regarding the determination of stranded costs.

Consumers' witness, Charles F. Belknap, Jr., originally filed testimony indicating that, using the method from Case No. U-12639, he had calculated that Consumers had a shortfall of \$24,126,000 in recovery of fixed costs relating to generation, but by including that same amount of contribution from third party sales, Consumers would have had net stranded costs of zero in 2004.<sup>3</sup> Mr. Belknap subsequently filed supplemental testimony indicating that, using the Staff's method, he calculated stranded costs of \$22,260,000 (\$23,775,000 of total stranded costs, less \$1,515,000 of third party sales offsets).<sup>4</sup>

The Attorney General's witness, Charles W. King, testified that Consumers' calculated amount of \$24,126,000 is unrelated to the departure of customers to retail open access service and therefore does not represent stranded costs. According to King, the apparent shortfall is due to two factors: (1) the Act 141 residential rate cap still in force during 2004, and (2) Consumers' choice not to seek a commercial and industrial (C&I) rate increase after the freeze on those rates for the largest C&I customers was lifted at the end of 2003.

Energy Michigan's witness, Richard A. Polich, filed testimony with two basic criticisms of Consumers' calculation. First, Mr. Polich contends that Consumers' calculation did not properly differentiate PSCR costs and revenues. Mr. Polich calculates that \$48,795,000 of Consumers' claimed stranded cost calculation of \$24,126,000 is attributable to this mismatch, and Mr. Polich contends that Consumers actually enjoyed negative stranded costs (stranded benefits). Second, Mr. Polich testified that Consumers' calculation did not properly match the proportion of sales to

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<sup>3</sup>If the contribution from third party sales is not included, Consumers claims stranded costs of \$24,126,000.

<sup>4</sup>No witness for the Staff supported this calculation.

retail customers with the allocation of generation fixed costs to those customers. He notes that Consumers allocates 98.3662% of generating costs to retail customers who only account for 89.6143% of total sales. Mr. Polich calculates that this inflates the stranded costs by \$67.4 million. Mr. Polich combines these two factors and claims that Consumers actually enjoyed stranded benefits of \$85,610,000 in 2004.

In response, Consumers contends that the Attorney General failed to properly apply the definition of stranded costs and that Energy Michigan's calculation of stranded benefits incorrectly applies revenues to power supply costs. Thus, each witness claims to be the only one who properly applies the Commission's previously adopted definition and calculation of stranded costs, although their results vary from positive \$22 million to negative \$85 million.

After reviewing the evidence, the Commission concludes that the cause of this discrepancy is that the 2004 stranded cost calculation was confounded by an unusual feature, a "PSCR shortfall" caused by Act 141 rate caps. The parties make different assumptions about how to treat that shortfall in their stranded cost calculations.

Some background will be helpful. Before 2000, Consumers' rates included a PSCR factor under 1982 PA 304. Setting PSCR factors involves a prospective utility power procurement plan for the year and a retrospective reconciliation to match the utility's PSCR revenues with its reasonable and prudent fuel and purchased power supply costs. Act 141 froze all of Consumers' retail electric rates through 2003, and the Commission suspended the PSCR process during the rate freeze. The total retail rate freeze expired at year-end 2003, but Act 141 still imposed rate caps for residential and small (less than 15 kilowatts) C&I customers. Thus, in 2004, there were no rate caps for medium and large C&I customers. Under Act 141, the caps expired in series; the cap for

small C&I customers expired at year-end 2004 and the cap for residential rates expired at year-end 2005.

Thus, although the Commission reinstated the PSCR process in 2004, the rate caps limited the effect of the PSCR factors. The PSCR factors were fully effective only for medium and large C&I customers. The PSCR factors for residential and small C&I customers could operate only up to the point that the rate caps were reached. Cost increases that would have required raising the PSCR factors beyond the rate caps could not be reflected in the PSCR factors, a situation discussed in the record as a partially functioning PSCR process.

Because the PSCR process was suspended until 2004, this is the first stranded cost case in which the Commission must consider how to determine stranded costs with the PSCR process and rate caps in place. Theoretically, the PSCR process would have little effect on stranded costs because the PSCR system is designed to match revenues with reasonable and prudently-incurred costs. However, in this case, rate caps meant that PSCR revenues from residential and small C&I customers could not rise enough to reflect costs increases in 2004. Consumers includes the PSCR shortfall in its calculations, yielding the \$24 million stranded cost figure.<sup>5</sup> Energy Michigan argues that the PSCR shortfall should be removed from the stranded costs calculation entirely, which yields stranded benefits rather than stranded costs. Although expressed in somewhat different terms, the Attorney General's position is essentially the same as that of Energy Michigan: he argues that Consumers' calculation only indicates that there is a revenue shortfall, which was caused by the residential rate cap rather than to any stranded costs. Thus, the positions of Energy Michigan and the Attorney General are consistent in that neither would find any stranded costs.

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<sup>5</sup> In its rebuttal testimony, Consumers contends that if the fact of a partially functioning PSCR process is to be recognized, the Commission should adopt the Staff method that Consumers introduced in its supplemental testimony.

The parties differ strongly on whether Consumers had met its burden. After reviewing the record, the Commission concludes that the company followed the approved procedure and submitted the stranded costs data required by the Commission's prior cases. Hence, for this final stranded costs case, the Commission adopts the figure and the netting process proposed by Consumers, as modified by the Staff, resulting in \$23,775,000 in stranded costs, to be offset by proceeds from wholesale power sales to third parties to produce a net zero stranded costs figure.<sup>6</sup>

Further, the Commission reaffirms the finding expressed in Consumers' most recent rate case, which concluded in December 2005: "Consumers' production fixed costs that had been stranded when customers moved to choice service have now been reallocated to customers in the bundled service rate classes. This reallocation of production fixed costs in this rate case now allows Consumers full recovery of its production fixed costs on a going forward basis. Therefore, production fixed costs cease to be stranded."<sup>7</sup> Thus, the Commission expects that this order—and the corresponding order in The Detroit Edison Company's stranded costs case, Case No. U-13808-R—will conclude the series of stranded cost cases resulting from restructuring of the electric system.

The Commission need not address in this order Consumers' exception to the ALJ's refusal to recommend an allocation of Consumers' revenues from wholesale power sales to third parties. The Commission has addressed that issue in resolving Case No. U-13917-R, Consumers' 2004 PSCR reconciliation case.

The Commission also finds Energy Michigan's proposal—that Consumers be required to furnish ROA customers with an amount of power equal in cost to the amount those customers pay for securitization bonds and taxes and for nuclear decommissioning charges—is entirely without

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<sup>6</sup>With the offset to be addressed as part of Consumers' PSCR reconciliation case, U-13917-R.

<sup>7</sup>Note 3, *supra*.

merit. This proposal is not only outside the scope of this proceeding, as the ALJ suggested; it also attempts to reargue settled questions. PFD, pp. 28-29.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCL 462.2 *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 should be ordered to apply revenues from wholesale power sales to third parties as necessary to reduce its net 2004 stranded costs to zero.

THEREFORE, IT IS ORDERED that Consumers Energy Company apply revenues from wholesale power sales to third parties as necessary to reduce its net 2004 stranded costs to zero. The disposition of the remaining third-party sales revenues has been specified in the Consumers Energy Company 2004 power supply cost recovery rate case, Case No. U-13917-R.

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  
Chairman

( S E A L )

/s/ Laura Chappelle  
Commissioner

/s/ Monica Martinez  
Commissioner

By its action of September 26, 2006.

/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

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Chairman

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Commissioner

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Commissioner

By its action of September 26, 2006.

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Its Executive Secretary