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

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **CONSUMERS ENERGY COMPANY** for authority to increase its rates for the generation and distribution of electricity and for other relief.	)))))	Case No. U-15645

At the November 2, 2009 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. Orjiakor N. Isiogu, Chairman
Hon. Monica Martinez, Commissioner
Hon. Steven A. Transeth, Commissioner

OPINION AND ORDER

I.

HISTORY OF PROCEEDINGS

On November 14, 2008, Consumers Energy Company (Consumers) filed an application requesting a $215 million rate increase above the retail electric base rates established in the June 10 and 19, 2008 orders in Case No. U-15245. Consumers asserted that its request for rate relief is based on 2009 test year data that establishes a need for additional revenue due to (i) new investment in distribution facilities, generation plant, and new technology; (ii) ongoing investments in Clean Air Act and other electric utility assets in order to provide reliable service to the company's customers and comply with environmental and legal requirements; (iii) ongoing efforts to strengthen its capital structure and balance sheet in light of declining sales and the current Michigan economy; and (iv) increases in operation and maintenance (O&M) costs.

In addition, Consumers requested that the Commission establish health care, pension, and certain other benefit costs based on cost-specific analyses as described in the company's filing. Consumers also renewed its request for the recovery of costs associated with a non-officer incentive compensation program for certain company employees.

Among the specific programs proposed for funding is Consumers' Advanced Metering Infrastructure (AMI) pilot program. According to Consumers, AMI technology has the potential to allow the utility to gather customer energy consumption data using two-way wireless communication technology, which promises to (1) allow more accurate meter read and billing information, and (2) enable enhanced customer outage detection, load control, remote turn-on/turn-off, load profiling, and theft identification. Moreover, Consumers asserted that AMI will "facilitate the adoption of rate structures that send price signals to customers to allow them to better manage their energy costs." Application, p. 3.

Consumers requested that the Commission discontinue the forestry tracker mechanism approved in Case No. U-14347. However, citing the uncertainty of the Michigan economy, Consumers proposed adoption of other "ratemaking mechanisms that would adjust future rates based upon how actual sales levels compare to the sales level used to set rates in this case, and that would adjust future rates based upon how actual uncollectibles expense compares to the level of uncollectibles expense used to set rates in this case." Application, p. 4.

Consumers proposed that rates be established to reflect an overall rate of return on total rate base of 7.22% and an authorized rate of return on common equity of 11.0%. Consumers also noted that its filing addresses the issue of recovery of electric transmission expenses.[1] Consumers' annual transmission expenses for 2009 were projected to be $235 million.

Consumers also requested that the Commission confirm that the income tax policy authorized in Case No. U-10083 for ratemaking and accounting purposes will apply to the new Michigan Business Tax (MBT) that became effective January 1, 2008. Further, Consumers asserted that the final order should include the authorizations to use specified accounts consistent both with Case No. U-10083 and Statement of Financial Accounting Standard No. 109 (FAS 109).

With regard to rate design, tariff, and other such proposals, Consumers indicated that it was proposing various revisions to its electric rules, regulations, and tariffs. Among other things, Consumers is seeking to phase-out discounted tariffs for municipal pumping and metal melting in accordance with Section 11 of 2008 PA 286 (Act 286), MCL 460.11, which requires the Commission to realign all rates to cost of service by October 6, 2013. Consumers also proposed removal of the educational provision sunset clause and various retail open access (ROA or choice) billing changes.

Citing the fact that its rate structure is currently not based on cost of service principles because some customer classes are paying more than their cost of service while others are paying less than their cost of service, which is inconsistent with the Legislature's direction in Act 286, Consumers has asked the Commission to design rates in a manner that reduces the misalignment by approximately 20% per year over a five-year period. According to Consumers, the rate

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[1]This point was raised in Consumers' application because, at the time of the filing, the Michigan Supreme Court was in the process of reviewing the Commission's policy of including electric transmission expenses in the determination of a utility's annual power supply cost recovery factor. In *Attorney General v Public Service Comm*, 483 Mich 993; 764 NW2d 272 (2009), the Michigan Supreme Court affirmed the Commission's position on this issue.

realignment will send more accurate price signals to customers, which will promote the efficient use of energy.

Finally, Consumers stated that it was reserving the right set forth in Section 6a(1) of Act 286, MCL 460.6a(1), to implement up to the amount of the proposed annual rate request through equal percentage increases applied to all rates in the event that the Commission fails to issue an order within 180 days of the filing of its rate case application.[2]

On December 18, 2008, a prehearing conference was conducted by Administrative Law Judge Sharon L. Feldman (ALJ) at which she granted the petitions to intervene submitted by the Michigan Cable Television Association (MCTA); Attorney General Michael A. Cox (Attorney General); The Kroger Company (Kroger); the Association of Businesses Advocating Tariff Equity (ABATE); the Michigan Environmental Council and the Public Interest Research Group in Michigan (MEC/PIRGIM); the Midland Cogeneration Limited Partnership (MCV); Hemlock Semiconductor Corporation (Hemlock); Energy Michigan; the Michigan State Utility Workers Council, Utility Workers Union of America, AFL-CIO (Utility Workers Council); Constellation New Energy (CNE); Gerdau MacSteel; Metal Technologies, Inc., and Ravenna Castings Center, Inc., d/b/a Ravenna Ductile Iron Plant (MTI/RDI); the Michigan Municipal League, the Michigan

[2]On April 22, 2009, the Commission issued an order requiring Consumers to file proposed interim tariffs by April 29, 2009, allowing the parties to respond to the filed tariffs by May 1, 2009, and setting a hearing for May 5, 2009. On April 29, 2009, Consumers filed proposed tariffs reflecting a rate increase of $179 million to be collected beginning May 14, 2009, through an equal 7.1% increase applied to all base rates. On May 13, 2009, the Commission ordered that "[i]f Consumers Energy Company chooses to self-implement a rate increase on and after May 14, 2009, the increase shall be implemented by applying the rate design shown on the attached tariff sheet, which has been derived in accordance with the rate design included in its November 14, 2008 application." May 13, 2009 order, Case No. U-15645, p. 11. The Commission further ordered that "[d]uring the six-month period in which self-implemented rates are collected, Consumers Energy Company shall refund $36.04 million of the proceeds associated with the sale of the Palisades Nuclear Power Plant to residential customers." May 13, 2009 order, Case No. U-15645, p. 11.

Townships Association, the City of Wyoming, the City of Grand Rapids, and other municipalities (collectively, the Municipal Coalition); and Phillip Forner. The Commission Staff (Staff) also participated in the proceedings.

After approval of the interventions, the ALJ allowed David Shaltz to make a Rule 207 statement on behalf of the Area Agencies on Aging Association of Michigan and the Michigan League for Human Services. Next, Susan Kayser made a Rule 207 statement on behalf of the citizens of the City of Flint. Finally, the ALJ established a schedule for the remainder of the proceedings.

Evidentiary hearings on Consumers' request for rate relief were held on June 8, 9, 10, 11, 15 and 18, 2009. Witnesses appeared for cross-examination or their testimony was bound into the record by agreement of the parties. In all, 47 witnesses presented direct and/or rebuttal testimony. The complete record in this case consists of 1,872 pages of transcript in 12 volumes and 224 exhibits that were admitted into evidence.

On or before July 9, 2009, Consumers, the Staff, the Attorney General, ABATE, CNE, Energy Michigan, Kroger, Hemlock, MEC/PIRGIM, the Municipal Coalition, the Utility Workers Council, the MCTA, MTI/RDI, and Mr. Forner filed briefs regarding Consumers' request for rate relief. On July 23, 2009, Consumers, the Staff, the Attorney General, ABATE, Energy Michigan, Hemlock, MEC/PIRGIM, the Municipal Coalition, and Mr. Forner filed reply briefs.

On September 2, 2009, the ALJ issued her Proposal for Decision (PFD).[3]

Consumers, the Staff, the Attorney General, ABATE, Energy Michigan, MEC/PIRGIM, MCTA, Kroger, the Municipal Coalition, and Mr. Forner filed exceptions on September 17, 2009. On September 28, 2009, Consumers, the Staff, the Attorney General, ABATE, CNE, Energy

[3]The Commission finds that the ALJ did a thorough and comprehensive analysis of the record in this case in compiling the PFD, and declines Consumers' request to dispense with the PFD.

Michigan, the Municipal Coalition, the Utility Workers Council, Hemlock, and MEC/PIRGIM filed replies to exceptions.

II.

TEST YEAR

With the passage of 2008 PA 286, the Commission is required to adopt a new rate making model that challenges some of our traditional methods of determining the cost of service allocations, rate design, and revenue requirements. By allowing the utility to "use projected costs and revenues for a future consecutive 12-month period in developing its requested rates and charges" the dynamics of determining costs requires a certain degree of forward projections that is not solely dependent on historical data. The basis for using a forward test year is to address the problem of regulatory lag between past and future costs. While the advantage of historical data is its objective and verifiable nature, it lacks the necessary forward perspective required in a changing economic environment. An historical test year is by definition not timely and may fail to adequately consider future demands. Consequently, any time a State moves from a historical to a future test year the initial transitional year will naturally not follow the process used in those which preceded it, and will require a different standard of review. What is gained by dealing with data that is "known and measurable" can be lost in forcing a utility to operate with outdated numbers. Much of the discrepancy between the recommendations of the PFD and this order are due to the failure by the parties to recognize this distinction and adjust for the statutory mandate.

The selection of a test year is the starting point for establishing just and reasonable rates for both the regulated utility and its customers. The purpose of a test year is to determine the level of investment on which the shareholders of the utility are entitled the opportunity to earn a fair rate of return and the level of expenditures that the utility is entitled the opportunity to recover.

The selection of an appropriate test year has two components. First, a decision must be made regarding a future consecutive 12-month period to be used for setting the utility's rates. Second, a decision also must be made regarding how the Commission should establish values for the various revenue, expense, rate base, and capital structure components used in the rate-setting formula. Ordinarily, the former question is easily resolved, but the latter question often proves to be far more contentious.

In this case, Consumers proposed using calendar year 2009 as its future 12-month period to be used for setting the utility's rates. No party took issue with this proposal, which was adopted by the ALJ. The Commission agrees that a 2009 test year period is appropriate for setting Consumers' rates.

With regard to the matter of the method by which the Commission is to determine values to be assigned to the revenue, expense, rate base, and capital structure components of the rate-setting formula, the Commission notes that the parties are not in agreement. Although both the company and the Staff opted to use projected 2009 test years, their respective forecasting methods differ significantly due in large measure to the parties' interpretation of Act 286, which amended MCL 460.6a.

Citing MCL 460.6a(1), which provides that a utility "may use projected costs and revenues for a future consecutive 12-month period" to develop its requested rates and charges, Consumers asserts that the intent of the Legislature in amending MCL 460.6a(1) was to require the Commission to give fair consideration to utility projections for revenues and expenses and set rates accordingly. The Staff countered that although the language in MCL 460.6a(1) now permits a utility to file projected costs and sales, the overarching requirement that the Commission set just and reasonable rates has not been abrogated by the Legislature.

The ALJ agreed with the Staff's position regarding the interpretation of MCL 460.6a(1). In so doing, the ALJ added that "it is appropriate on this record to use the 2009 calendar year as the test year for setting rates, and the selection of this projected test year does not dictate any particular methodology to employ in setting rates for this projected test year." PFD, p. 19.

The Commission is aware that the exceptions and replies are replete with arguments by the parties regarding test year issues. The Commission is persuaded that in this case and in future rate cases it should direct its focus upon the strengths and weaknesses of the evidentiary presentations of the parties regarding specific expense and revenue projections. Pursuant to MCL 460.6a(1), as recently amended by Act 286, a utility has explicit authorization to rely on projections of its future costs and revenues. The new provisions thus recognize that using projected data as a basis for rates may optimally reflect the cost of service contemporaneously with the effective period of the rates. A projected test year may reduce rate lag by providing more accurate adjustments when capital expenditures are escalating or revenues and costs are in flux. Given all of the circumstances, the Commission finds that the starting point for its analysis of the record shall be Consumers' 2009 test year projections.

The reliance by the Staff and the ALJ on historical data as the determinant of just and reasonable renders the statutory mandate in Act 286 meaningless. While the Commission retains its authority and duty to determine and set rates that are just and reasonable, it must make that determination by giving due consideration to the projected costs of the utility on a forward looking basis. The debate regarding the proper test year was decided by the legislature and the Commission finds the use of a future test year to be the proper measure of projected costs and revenues.

For future guidance, the Commission's expectation is that the parties will fully document the basis for their test year projections by offering into evidence detailed supporting explanations and underlying assumptions rooted in expected business, financial, and economic circumstances. Rate applications may not rely on undocumented estimates of future ratemaking expenses and revenue criteria. When necessary, parties should provide competing projections, with a similar basis of support. The record thus created should lend itself to a comparative review of the reasonableness and prudence of the projections. Historical data may play a role, but ordinarily will not be the controlling factor except in circumstances that clearly demonstrate that it is a more fair and reasonable reflection of the utility's cost of service, relative to projected data.

III.

RATE BASE

A utility's rate base consists of the capital invested in used and useful plant, less accumulated depreciation, plus the utility's working capital requirements. In Consumers' case, rate base also includes liability to the U.S. Department of Energy (DOE) for pre-1983 disposal of spent nuclear fuel (SNF). The ALJ summarized the positions of the parties regarding total rate base as follows:

> Consumers Energy initially proposed a rate base of $6,292,682,000 on a total electric basis, consisting of $5,929,987,000 in net plant, $242,080,000 in working capital, and an additional amount of $120,615,000 for the interest portion of its DOE liability, and excluding certain energy efficiency and renewable energy plant covered by 2008 PA 295. Mr. Rasmussen's testimony acknowledges that the company's proposed rate base is approximately $700 million more than the rate base the Commission approved for test year 2008 in Case No. U-15245, which roughly translates to approximately half the company's requested revenue increase. Through modifications made in its briefs, as discussed below, Consumers Energy now proposes a slightly smaller rate base, reflecting minor reductions in net plant and the interest component of the DOE liability.
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> Staff initially proposed a rate base of $6,260,589,000 consisting of net utility plant of $5,900,552,000 on a total company basis, working capital of $241,567,000, and

> DOE Liability of $118,470,000. Note that Staff's rate base calculations are generally presented on a total electric basis, although final rates will be set on the basis of the company's jurisdictional revenue requirement. The company took issue with Staff in its rebuttal case for not translating its revenue requirements calculations from a total electric basis to a jurisdictional basis. In its briefs and the attached appendices, the company often presents Staff's total company numbers as appropriate to compare with the company's jurisdictional numbers, which is not correct. While Staff has not expressly addressed the company's rebuttal testimony on this issue or the presentation in its initial brief directly, Staff did develop jurisdictional factors consistent with its cost of service study, discussed in section IX. Nonetheless, for ease of comparison, the following discussion will focus on total electric amounts.

PFD, pp. 20-21 (footnotes omitted).

A. Net Plant

Net plant is comprised of total utility plant-in-service, plant held for future use, plus construction work in progress (CWIP), less depreciation. The positions of the parties are explained on pages 21-27 of the PFD and are not repeated here. The dispute over net plant amount again centers on the method that Consumers used in its test year projections compared to the method used by the Staff. In keeping with its utility budget approach, Consumers' witnesses testified to a number of proposed additions to both distribution and generation plant including its planned AMI program. Consumers calculated a net utility plant amount of $5,907,649,000. The Staff, on the other hand, began with 2007 historic test year plant in service and provided for growth in plant to determine the 2009 plant in service. This allowance was calculated by taking the five year average of plant additions net of retirements, adjusted for annual projected inflation. The allowance was then added to plant totals to calculate the projected plant in service for 2007, 2008, and 2009. The Staff calculated a net plant amount of $5.9 billion on a total electric basis.

The ALJ recommended that the Commission adopt the Staff's plant balances including amounts for plant-in-service, CWIP, and depreciation. The ALJ noted there was only a $29.4 million difference on a total company basis between the company's net plant amount and that proposed by the Staff. The ALJ added that both Consumers and the Staff had amended their positions on the amount that should be included in net plant for AMI and those modifications reduced the difference to about $5.6 million.[4] The ALJ observed that when using the company's actual expenditures for 2008, the company's budgets were overstated, thus calling into question the reliability of the company's projections.

Consumers takes exception to the ALJ's recommendations arguing that the difference between the Staff's and the company's net plant balances are not minimal. Consumers argues that the company's witnesses testified at length about planned production and distribution capital additions and that the ALJ erroneously rejected the company's evidence.

In reply, the Staff maintains that Consumers' evidence was not disregarded as the company claims; the ALJ simply found that the method used by the Staff in projecting plant balances was more reasonable and accurate. The Staff adds that Consumers failed to address the fact that under the time constraints of the case, the Staff and other parties were not able to analyze and verify the company's projections. The Staff reiterated that Consumers' estimates for production and distribution capital additions were presented in broad categories with testimonial support comprised of descriptions of certain projects. According to the Staff, this was insufficient information for other parties to undertake a thorough review, necessitated by the fact that these projects are regularly subject to modification in scope, cost, and timing. Further, the Staff asserts that Consumers' testimony failed to provide the information to adequately validate the company's projected production and distribution additions; while the Staff's position was based on historical data appropriately adjusted.

In light of the above determination regarding the appropriate test year, the Commission finds

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[4]The treatment of expenses for AMI is discussed in more detail, *infra*.

Consumers' method for estimating net utility plant to be the most reasonable. A key difference in method relates to their treatment of capital expenditures. In keeping with its forward-looking approach, Consumers' witnesses projected and justified capital expenditures that bridge the period between historical data and the projected test year. While others disputed Consumers' approach, they did not undermine the legitimacy of the projects that Consumers used as the basis for its capital expenditures or call into question the need for those projects.

B. Working Capital

The ALJ recommended a total company working capital requirement of $242,080,000. There were no exceptions filed. The Commission therefore adopts a working capital requirement of $239,806,000 on a jurisdictional basis.

C. Pre-1983 DOE Liability

As the ALJ explained, DOE liability represents Consumers' responsibility for the disposal costs of SNF associated with pre-1983 nuclear power generation at the Palisades Nuclear Power Plant (Palisades), which the utility has since sold.[5] Pursuant to the Nuclear Waste Policy Act of 1982, which gave the federal government responsibility for disposing of SNF, the DOE began collecting a fee of 1 mill per kilowatt-hour (kWh) of nuclear power generation, on a going-forward basis, with a one-time charge assessed for previous generation. The DOE gave utilities three options to pay the fee for pre-1983 nuclear generation. Consumers opted to defer payment up to the time of disposal, subject to the accumulation of interest at the 13-week Treasury bill rate, estimated by the Staff at 0.32% for 2009, and agreed to by the company in its brief.

Both Consumers and the Staff included pre-1983 DOE liability in the company's rate base with the principal amount of $44 million as an offset to the depreciation reserve, and $118 million

[5] *See*, the Commission's March 27, 2009 order in Case No. U-14992.

in accumulated interest since 1983, on a total company basis, included as a separate line item. The total amount of $162 million is also included in the company's capital structure as an element of long-term debt. Consumers noted that the purpose of the ratemaking treatment (i.e., including the pre-1983 DOE liability in rate base and capital structure) is to allow the company to recover the annual interest on the current liability, while benefiting the ratepayers by recognizing the amount of the liability as a source of low-cost capital.

MEC/PIRGIM argued that including the pre-1983 DOE liability in both rate base and capital structure is a ratemaking error that is contrary to what the Commission intended when it approved the utility's choice to defer payment to the DOE. According to MEC/PIRGIM, this treatment instead produces a significant overrecovery of interest costs. MEC/PIRGIM calculated the effect of excluding the pre-1983 DOE liability from rate base while giving the ratepayers the benefit of the low-cost DOE liability in the capital structure. According to MEC/PIRGIM, its analysis indicates that Consumers recovers an additional $12 million to $17 million over the necessary revenue requirement for DOE interest by also including the pre-1983 DOE liability in its rate base.

MEC/PIRGIM further argued that the pre-1983 DOE liability should be placed into a trust because that treatment would be consistent with the fact that ratepayers paid the principal amount years ago, it would save Consumers letter of credit fees, and it would protect ratepayer funds in the event that the DOE finally disposes of the SNF. Given the disarray in the DOE's disposal program and its failure to meet the 1998 deadline to begin accepting fuel for disposal, MEC/PIRGIM also contends that segregation of the funds into a trust would ensure the availability of the funds to provide for whatever disposal costs are ultimately required.

The Staff argued that the issue of ratemaking treatment of pre-1983 DOE liability should be deferred to a future rate case with Consumers required to provide a complete analysis of the effects of alternative treatments.

The ALJ found that the magnitude of the overrecovery demonstrated by MEC/PIRGIM was too large for the issue to be deferred to a future rate case. The ALJ reviewed Commission orders from 1978 forward in an attempt to determine the logic behind the ratemaking treatment but was unable to completely reconstruct the history associated with the Commission's decision to include DOE liability in rate base. According to the ALJ, it appeared that while the inclusion of pre-1983 DOE liability in rate base in 1991 was an effort to correct an accounting entry, it was not clear that the ratemaking treatment was expected to continue indefinitely. The ALJ added, "One key principle stands out, and has not been disputed or contradicted by any party in this proceeding: In its decision, the Commission accepted Consumers Energy's representation that the purpose of the two steps was only to allow the company to collect interest on the DOE liability on a going forward basis, and not to collect interest that had accrued on the DOE liability from April 7, 1983 forward. Indeed, Consumers Energy has continued to acknowledge this." PFD, p. 42. The ALJ further noted that MEC/PIRGIM raised this issue in Case No. U-15245 but it did not provide a detailed technical analysis as it did here.

The ALJ recommended that pre-1983 DOE liability should be removed from rate base and that future interest should be recovered by including the funds in capital structure. The ALJ also rejected MEC/PIRGIM's recommendation that the accrued funds be placed in a trust, in light of previous Commission orders finding that a trust was unnecessary.

Consumers takes exception to the ALJ's recommendation, arguing that there is no reason to change the longstanding treatment of pre-1983 DOE liability. Consumers adds that the ALJ attempted to reconstruct a record from 20 years ago and admitted that she did not understand the Commission's reasons for including pre-1983 DOE liability in rate base. Consumers also observes that the ALJ's recommendation to remove pre-1983 DOE liability from rate base, but leave it in capital structure, provides ratepayers with a benefit without an offsetting cost.

The Staff did not object to excluding pre-1983 DOE liability from rate base but observed that continuing to include it in capital structure would not accomplish the ALJ's objective. Instead, the Staff recommends removing DOE liability from rate base and including annual interest as an expense.

The Commission finds Consumers' arguments unpersuasive and agrees with the ALJ that the analysis performed by MEC/PIRGIM is compelling. The Commission adopts the ALJ's recommendation. The Commission agrees with the Staff that simply leaving the pre-1983 DOE liability in Consumers' capital structure will not accomplish the recovery of on-going interest costs and that therefore an expense item must be added to O&M to cover interest cost.

The Commission also agrees with MEC/PIRGIM that segregating pre-1983 DOE liability into a trust fund has become necessary because of the uncertainty surrounding future payment of the funds, and because the liability has grown quite large. The Commission therefore directs Consumers to present a proposal to establish a trust for pre-1983 DOE liability in the company's next rate case if filed on or before January 3, 2011. Otherwise, the company shall file the proposal to establish a trust for its pre-1983 DOE liability in a new docket on January 4, 2011. The proposal shall include a recommendation for the period, during which the accrued funds will be deposited into the trust and recommended guidelines for prudent management of the funds.

D. Rate Base Summary

In light of the preceding discussion, the Commission finds that Consumers' jurisdictional 2009 test year rate base is set at $6,146,847,000, comprised of net utility plant of $5,907,041,000 and a working capital allowance of $239,806,000.

IV.

RATE OF RETURN

The criteria for establishing a fair rate of return for public utilities is rooted in the language of the landmark United States Supreme Court cases *Bluefield Water Works Co v Public Service Comm of West Virginia*, 262 US 679; 43 S Ct 675; 67 L Ed 1176 (1923) and *Federal Power Comm v Hope Natural Gas Co*, 320 US 591; 64 S Ct 281; 88 L Ed 333 (1944). The Supreme Court has made clear that, in establishing a fair rate of return, consideration should be given to both investors and customers. The rate of return should not be so high as to place an unnecessary burden on ratepayers, yet should be high enough to ensure investor confidence in the financial soundness of the enterprise. Nevertheless, the determination of what is fair or reasonable, "is not subject to mathematical computation with scientific exactitude but depends upon a comprehensive examination of all factors involved, having in mind the objective sought to be attained in its use." *Meridian Twp v City of East Lansing*, 342 Mich 734, 749; 71 NW2d 234 (1955). With these principles in mind, the Commission turns to the factors that form the basis for determining the rate of return for Consumers.

A. Capital Structure

Consumers and the Staff followed the Commission's practice of estimating Consumers' actual capital structure for the test year. Consumers presented a capital structure comprised of 51.84% debt and 47.61% equity as percentages of permanent capital and 44.51% debt and 40.88% equity on a ratemaking basis. Subsequently, Consumers accepted the Staff's proposed ratemaking capital structure comprised of 44.80% debt, 0.48% preferred stock, and 40.51% common equity. In its brief, however, Consumers requested that the Commission recognize a $100 million equity infusion made June 17, 2009 rather than in October 2009, as originally assumed by the Staff in developing its capital structure.[6] According to Consumers, the effect of recognizing this timing difference would be to increase the Staff's common equity balance from $3.754 billion to $3.785 billion.

The Attorney General and ABATE recommended a capital structure designed to reflect more closely the capital structure of Consumers' parent company, CMS Energy Corporation (CMS Energy), by increasing the debt percentage to 58.92% and reducing the common equity percentage to 26.48%. The Attorney General and ABATE argued that although Consumers' rates have been based on a roughly balanced capital structure, CMS Energy, Consumers' parent company and equity investor, has a capital structure that is much more heavily weighted toward debt. As such, the Attorney General and ABATE argued that the equity return built into Consumers' rates at the higher common equity percentage overcompensates CMS Energy equity investors who have a smaller actual equity investment.

In addition, the Attorney General and ABATE claim that because debt is tax deductible and equity is not, rates are based on the inclusion of a tax multiplier to compensate Consumers for taxes attributable to the return on equity financing. According to the Attorney General and ABATE, the amount of taxes built into rates will not be fully paid because of the higher debt component of CMS Energy's capital structure, which allows it to deduct a greater amount of debt than provided for in Consumers' rate calculations. Therefore, the Attorney General also proposed that if his capital structure recommendation is rejected, the Commission should revise the tax multiplier. According to the Attorney General, this revision would reflect that CMS Energy does

[6]According to Consumers, both the Staff and the company agreed that the equity infusion should be reflected in the capital structure and agreed that the infusion would be delayed until after March 2009.

not pay taxes on equity at the level assumed in setting rates for Consumers based on Consumers' capital structure, because the interest costs on the debt CMS Energy uses to fund the equity investment in Consumers are tax-deductible.

The Attorney General urged the Commission to take into consideration, in both capital structure, and return on equity, that in the current economic climate Consumers should recover the minimum sufficient to attract capital and to maintain credit.

The ALJ recommended the rejection of the hypothetical capital structure proposed by the Attorney General and ABATE, noting that the Commission has treated Consumers as a stand-alone company and has established as a reasonable goal that Consumers maintain a capital structure roughly balanced between debt and equity. For the same reason, the ALJ recommended that the Commission reject the Attorney General's and ABATE's proposal to modify the revenue multiplier. The ALJ also rejected Consumers' proposal to include a $100 million equity infusion into the company's equity balance on grounds that the infusion occurred after the record closed.

Consumers took exception to the ALJ's recommendation that the Commission should not take official notice of the $100 million equity infusion that occurred in June 2009. Consumers argues that the 12-month limit for resolving rate cases does not provide sufficient rationale for the ALJ's determination that official notice should not be taken of extra-record evidence.

The Commission agrees with the ALJ that the capital structure proposed by the Staff, and agreed to by Consumers, should be adopted. The Commission also agrees that the June 2009 equity infusion should not be included in Consumers' capital structure. As the ALJ observed, although the Commission has considered information submitted after the close of the record in other cases, under the tight time constraints required by Act 286 the presentation of new information after the close of the record should be discouraged. If any party disputes the updated information, there is little time to address any concerns raised. The Commission also agrees that it is a reasonable presumption that a party will ordinarily only present information that advances its case and will therefore be selective in its updates. The Commission therefore adopts the ALJ's recommended ratemaking capital structure of 44.80% debt, 0.48% preferred stock, and 40.51% common equity.

B. Balances and Cost Rates

1. Short-term Debt

The Staff projected a short-term debt amount of $72 million at a cost rate of 1.68%, comprised of a projected 3-month London Interbank Offer Rate (LIBOR) of 1.33% and a revolver interest spread rate of 0.35%. Consumers accepted the Staff's short-term debt amount and its projected LIBOR rate of 1.33% and interest rate spread of 0.35% however, Consumers argued that the overall rate of 1.68% was understated because the Staff failed to include an adjustment to the short-term debt cost to provide for recovery of annual revolver fees and amortization of upfront revolver fees that the company incurs related to the short-term debt. Consumers claimed that these types of fees are normal in revolving credit agreements and are routinely included in such agreements. Moreover, these are costs that must be incurred by Consumers in order to have the revolving credit available for the financing needs of the company. Consumers added that the company has recently increased the amount it can borrow and is thus projecting revolver fees that are $400,000 higher than the $850,000 in fees it paid in 2007. Consumers calculated that including these revolver fees will increase the short-term debt interest rate to 3.41%.

The Attorney General and ABATE recommended a short-term debt balance of $72 million with a cost rate of 5.99% in both capital structure scenarios.

The ALJ observed that it was difficult to determine the reason for the Staff's exclusion of the supplementary revolver fees but found that in Consumers' previous rate case, Case No. U-15245, the LIBOR rate plus a 35 basis point spread was used in computing the company's short-term debt rate. The ALJ therefore recommended adopting the Staff's cost of short-term debt.

The Commission notes that there have been significant changes in the credit market since 2007, when Case No. U-15245 was in process, with higher fees being charged to customers across the board. The Commission further finds that the Staff failed to effectively rebut the inclusion of the additional 173 basis points for supplemental revolver fees. The Commission therefore adopts a short-term debt amount of $72 million at a cost of 3.41%.

2. Long-term Debt

Long-term debt is comprised of fixed rate issuances and variable rate issuances. The Staff calculated a long-term debt balance of $4,151,384,615 while Consumers initially used a long-term debt balance of $4,146,000,000. These differences were attributable to the Staff's use of more recent information about the timing of certain debt issuances. The Staff also used an updated interest calculation for pre-1983 DOE liability resulting in an approximately $2 million difference. The Staff calculated $162,346,000 for current DOE liability and Consumers estimated $164,901,000 for current DOE liability. Subsequently, Consumers accepted the Staff's updated estimate for DOE liability and included the total of principal and interest of $162,346,000 in the company's capital structure.

Consumers initially proposed a long-term debt cost of 5.85%, while the Staff proposed a cost of 5.55%. The difference was related to the treatment of the cost of Consumers' February 2009 debt issuance that was made part way into the calendar year and to a difference in the methods used by the parties. Subsequently, the Staff agreed with Consumers' calculation method. Use of

Consumers' method applied to the Staff's updated data produced the Staff's proposed long-term debt cost of 5.69%.

Consumers also proposed to include, as part of the interest, the fees it pays for the letter of credit it provides to Entergy for the pre-1983 DOE liability under the terms of the Palisades sale. Consumers argues that the $1.898 million annual cost of the $165 million letter of credit required by the Palisades sale transaction should be recovered from the ratepayers because it enables the company to continue to retain the pre-1983 DOE liability as a low cost source of funds in the capital structure for the benefit of customers. Including the fees would increase the cost of long-term debt from 5.69% to 5.74%.

The Staff and MEC/PIRGIM argued that the letter of credit fees should be rejected, relying on the Commission's decision in Case No. U-15245. MEC/PIRGIM added that the letter of credit fee should be considered an ancillary expense under the Palisades Power Purchase Agreement (PPA) rather than a debt-related cost in the company's rate case.

The ALJ reviewed the Commission's decision in Case No. U-15245 and noted that it was clear that the Commission had rejected the same arguments in that case that Consumers made here. Based on the Commission's determination in Case No. U-15245, the ALJ recommended that the letter of credit costs continue to be excluded from the cost of long-term debt calculation.

Consumers took exception to this recommendation, arguing that this issue should be decided on the basis of the record in this case and not with reference to Case No. U-15245. According to Consumers, the letter of credit allows the company to retain use of the pre-1983 DOE liability funds, a source of funding that costs less than alternative sources for a corresponding amount of long-term debt.

The Commission disagrees with Consumers and finds that the utility's justifications for requiring ratepayers to cover the letter of credit are the same as they were in Case No. U-15245, and circumstances have not rendered these justifications any more valid now than they were then. The Commission therefore adopts a long-term debt balance of $4,151,385,000 at a cost rate of 5.69% as proposed by the Staff and recommended by the ALJ.

3. Preferred Stock

Consumers, the Staff, the Attorney General, and ABATE recommended a preferred stock balance of $44 million for the 2009 projected test year at a cost rate of 4.46%. This was an uncontested issue; therefore the Commission adopts a preferred stock balance of $44 million at a cost of 4.46%.

4. Common Equity

The utility's cost of common equity is the return investors expect, or require, in order to provide the utility with capital. The cost of capital is an opportunity cost; in order to induce investors to purchase common stock or bonds, there must be the prospect of receiving earnings that are sufficient to make the investment attractive compared with other investment opportunities.

The positions of the parties and the different models used to estimate return on equity (ROE) are discussed extensively on pages 65-86 of the PFD and will not be repeated here. A summary of the results of the various analyses by the parties is set forth in the following table:

	DCF	CAPM	Risk Premium	Other Authorized ROE's
Consumers	11.87% average 11.03% median 11.81% CMS	10.36% average 10.19% median 11.24% CMS	10.52%-11.40%	
Staff	12.61% average 12.87% median	7.46%-8.65% median 8.55%-10.06% CMS	10.03%-11.38%	10.46% average 10.45% median
Attorney General /ABATE	<u>Classic DCF</u> 11.12% average 11.21 % median	8.36%		

	<u>FERC 2-step</u> 10.88% <u>Sustainable Growth</u> 10.32% average 10.30% median			

On the basis of the above analyses, Consumers recommended an ROE range of 10.75-11.25% and the Staff recommended a range of 10.5% to 11.00%. The Staff initially recommended that the Commission use the upper value of 11.00% due to uncertainties in the financial markets. The Staff revised this recommendation in its initial brief and recommended an ROE of 10.75% on the basis of new information. The Attorney General and ABATE recommended an ROE of 10.5% based on a weighted average of the results of the various analyses performed by the Attorney General's expert, and recommend a reduction of 45 basis points if the Commission adopts the sales and uncollectibles trackers.

The ALJ noted that Consumers was requesting an increase in its ROE and an increase in its revenue requirements at the same time that Michigan residents and businesses are experiencing the worst economic conditions in decades. The ALJ further found that Consumers had provided no substantial or compelling reason for an increase to the company's ROE and therefore recommended no change to Consumers' currently authorized ROE of 10.7%.

Consumers takes exception to the ALJ's recommendation and argues that the ALJ relied too heavily on "defective" analyses provided by other experts in the case and in some instances provided invalid critiques of evidence provided by Consumers.

The Attorney General and ABATE also take exception, arguing that it was inconsistent for the ALJ to find their expert's testimony most credible, yet fail to adopt the expert's recommendation that Consumers' ROE should be set at 10.5%. The Attorney General and ABATE also recommend a further reduction in the company's ROE if the Commission adopts a revenue decoupling proposal.

The Commission agrees with the ALJ that Consumers failed to provide a compelling reason for an increase in the company's currently authorized ROE. Furthermore, because the revenue decoupling proposal adopted in this order is a pilot program, the Commission finds that it would be imprudent to reduce the company's ROE at this time as recommended by the Attorney General and ABATE. The Commission therefore approves an ROE of 10.7% and an equity balance of $3,754,200,000 as discussed previously.

5. Other Cost Rates

As the ALJ noted, there are no disputes among the parties regarding the other cost elements. All parties used a cost rate of 0% for deferred federal income taxes. Costs associated with deferred JDITC are determined from the cost of long-term debt, preferred stock, and common equity.

C. Overall Rate of Return

Consumers' overall rate of return of 6.98% is calculated as shown on the following table:

Description	Amount	Ratio	Cost Rate	Weighted Cost
Short-Term Debt	$72,300,000	.78%	3.41%	0.03%
Long-Term Debt	$4,151,384,615	44.80%	5.69%	2.55%
Preferred Stock	$44,038,000	0.48%	4.46%	0.02%
Common Equity	$3,754,200,000	40.51%	10.70%	4.33%
Deferred FIT	$1,186,489,000	12.80%	0.00%	0.00%
JDITC				
Long-Term Debt	$30,409,422	0.33%	5.69%	0.02%
Preferred Stock	$322,584	0.00%	4.46%	0.000%
Common Equity	$27,499,994	0.30%	10.70%	0.03%
Total JDITC	$58,232,000			0.05%
TOTAL	$9,266,643,615	100.00%		6.98%

V.

REVENUES AND EXPENSES

To determine whether there is a revenue deficiency or excess, it is necessary to establish Consumers' adjusted net operating income (NOI) for the test year based on its current rates. Net operating income constitutes the difference between a company's operating revenue and its operating expenses including depreciation, taxes, and allowance for funds used during construction (AFUDC). Adjusted NOI includes the ratemaking adjustments to the recorded NOI test year for projections and disallowances.

A. Operating Revenues

1. Sales

The ALJ examined the record evidence and the arguments of the parties before recommending that the Commission adopt the sales forecast projected by the Staff. That forecast is shown in Exhibit S-5, Schedule E-1 and results in $11,811,187 in increased projected revenues over Consumers' sales forecast. 7 Tr 807. Both parties project a decline in sales from 2007. However, Consumers believes that sales will be 1.7% lower than the Staff projects.

Consumers excepts and argues that the ALJ erred when she determined that the Staff's projections were more accurate than Consumers. Consumers states that this finding is "mystifying" because the Staff merely averaged Consumers' forecasts for 2009 and 2010 with actual sales for the period ending November 2008. Consumers argues that the Staff's calculation method maximizes the effect of "stale 2008 data" and minimizes the effect of 2009 and 2010 data. Consumers asserts that the Staff did not provide a reasoned projection or consider the likelihood of future events that might affect the economic conditions in Consumers' service territory, which would affect electric sales.

In contrast, Consumers states that its witness "examined in great detail the economic conditions likely to be present during the test year and the effect that those conditions would have on [Consumers'] sales." Consumers' exceptions, p. 30. Consumers argues that this testimony detailed Michigan's economic outlook, referencing experts such as Global Insight and analyzing the automotive customers' economic outlook, housing starts in Michigan, and the state's population. It argues that "[d]espite the Company's exhaustive investigations and analysis, the PFD asserts that no 'greater accuracy' can be expected from Consumers' forecasts as compared to Staff's" and faults the company for not presenting an analysis of the accuracy of its position. *Id.*

Further, Consumers argues that the ALJ failed to recognize that the forecast that members of the Staff prepared for the Michigan energy appraisal report contradicts the Staff's position in this proceeding. Consumers argues that the PFD provides no reason that the appraisal report would be neither appropriate nor suitable for setting rates. Consumers states that the $11 million difference between the Staff's and Consumers' sales projections is significant to the company, and urges the Commission to reject the PFD and adopt the company's sales forecast.

The Commission finds that Consumers' sales projections should be adopted for purposes of this rate case. As noted in the PFD, sales were lower in 2008 than in 2007. Despite the Staff's argument that those sales reductions occurred before the severe economic downturn in 2008, the Commission notes that there is no record evidence that the economic conditions in Michigan have significantly improved.

2. Base Tariff and PSCR Revenues

Resolution of the sales issue dictates the resolution of this issue. Because the Commission adopted Consumers' proposed sales levels, those sales levels will be used to calculate the new base PSCR amount.

3. Miscellaneous Revenue Adjustment

The Staff proposed a $2,000 adjustment in miscellaneous revenues to reflect a difference with Consumers' proposal to increase its reconnection charges to $85. The Staff recommended permitting an increase to $80 per reconnection and projected more reconnections would occur. The ALJ recommended adopting the Staff's adjustment. No exceptions were filed to this issue. The Commission adopts the Staff's recommended adjustment.

B. Operating Expenses

1. PSCR Expense

As noted above regarding revenues, resolution of the sales issue dictates the resolution of the power supply cost recovery (PSCR) expense. Because the Commission adopted Consumers' proposed sales levels and calculated a new base PSCR amount, the Commission will use the company's sales projection to calculate the PSCR expense adjusted to be consistent with the PSCR base adopted in this order. As reflected in footnote 1 of this order, transmission costs remain recoverable through the PSCR process.

2. Other Operations and Maintenance (O&M) Expenses

Consumers projected $682 million in O&M expense for the 2009 test year, which reflects a $95 million (or 15%) increase from 2007. The proposed increase is due partly to inflation and partly to expected changes related to budgeted projects.

Consumers presented its projections by company division, including inflation adjustments, AMI and comprehensive enterprise application (CEA) projections, injuries and damages, and uncollectible accounts. Consumers offset these increased O&M expenses by $117 million to remove acknowledged disallowances and certain projected decreases. The disputed issues are addressed below.

a. Inflation Factor

Consumers excepts to the recommendation in the PFD that the Commission adopt a negative inflation index for 2009. Consumers argues that the testimony of its witness, Anne Rogus, supported the use of 4.3% for 2008 and 1.3% for 2009. The Staff presented inflation factors on Exhibit S-4, Schedule D1.1. It projected inflation would be 3.85% for 2008 and negative 1.23% for 2009. Consumers argues that there is no evidence that the company's other O&M expenses are expected to decrease in 2009. On the contrary, Consumers argues, its witnesses described numerous items that are expected to increase, not decrease, and several items that are expected to increase at a rate above general inflation rates. It argues that use of a negative inflation rate for 2009 would be unreasonable.

The Staff and ABATE generally reply that the ALJ's recommendation should be adopted.

The Commission finds that the Staff's proposed inflation factors more closely reflect the economy in Michigan and the general decline of prices. A negative inflation factor is appropriate in the current economic cilmate. There is no indication that Consumers will somehow be exempt from declining prices in this economy. Therefore, the Commission rejects Consumers' exception on this issue.

b. Production O&M

Consumers next argues that the PFD erroneously rejected Consumers' proposed production O&M expense. Consumers argues that it explained why the Staff's method of beginning with Form P-521 is not appropriate or consistent with traditional ratemaking practices in its reply brief pp. 16-21. Consumers further argues that although the ALJ recognized the company's evidence concerning production was extensive, she found it insufficient. Consumers argues that the PFD does not provide any standard against which the testimony could be measured. Rather, the company argues, the PFD criticizes the company's evidence as not adequately addressing the issue of ratepayer protection. Consumers argues that the PFD does not provide revenues "sufficient to allow the utility to provide utility service in a safe and efficient manner, and to provide a reasonable return to the investors who have supplied the capital necessary to operate the business." Consumers' exceptions, pp. 33-34. In sum, Consumers argues, the PFD fails to adequately analyze the testimony supporting the company's view on this issue.

ABATE responds that Consumers' proposed production O&M expense should be reduced by at least $17.1 million. ABATE states that although it did not specifically challenge Consumers' other O&M expense, ABATE did challenge the company's proposed increase in expense for outage and non-outage base maintenance. It states that same $17.1 million is excluded from the Staff's proposed production O&M expense, which the ALJ recommended adopting. Thus, ABATE did not except to the ALJ's conclusions. ABATE argues that Consumers projected that the utility would expense $17.1 million to achieve a $7 million benefit to ratepayers. With the cost exceeding the benefit, ABATE argues, this is not reasonable and prudent. Moreover, ABATE argues, there is no assurance that all ratepayers would see a benefit from the increase in maintenance expense, because any benefits would be realized in PSCR proceedings.

After reviewing the evidence presented by Consumers, the Staff, and ABATE, the ALJ determined that the Staff's evidence was more persuasive on this issue. The Staff used historical production O&M expense data from annual reports for 2003 to 2007, analyzing the expenses separately for steam generation, hydraulic generation, other power generation not including fuel, and fuel handling expenses. In the process, the Staff made certain adjustments, including the addition of $8.9 million for the Zeeland plant, removal of urea expenses, which are recovered through the PSCR process, and an inflation-based revision to the cost for fuel handling. The ALJ noted that the Staff's proposed treatment resulted in projected increases greater than the rate of inflation, although not as much as Consumers projected.

She noted that ABATE challenged the outage maintenance and non-outage base maintenance expense projections. For those categories, Consumers projected a 187% increase over 2007 levels, despite the fact that it had projected 2008 levels at less than 2007 expenditures. Its witness analyzed the company's support for this increase and determined that Consumers intended to increase spending by $10.5 million to obtain a savings of $7.6 million in net replacement power costs. With the benefit not nearly equal to the cost (and no guarantee that any benefit would actually be realized), ABATE recommended that the Commission limit the increase to the rate of inflation for these two items, resulting in a $16.58 million decrease in the 2009 projections.

The ALJ critiqued ABATE's contention that no linear trend exists in expenditures for historical steam generation. She found that this argument contradicted statements that as the company's plants age, maintenance expenses increase. She further found that the company had not adequately explained why, when certain expenses in 2008 were far below their 2007 levels, the company continues to seek increases well in excess of 100% for those items for 2009. The ALJ recommended that the Commission adopt the Staff's analysis of the appropriate 2009 test year increases attributable to production O&M costs.

The Commission is persuaded that it should adopt a middle ground between the PFD's recommendation and Consumers' projected production O&M expenses for purposes of this rate case. The Commission finds that Consumers' presentation on this issue demonstrates that there are costs for which historical expenditures are not representative of what is needed in 2009. For example, Consumers presented testimony that in 2009, the utility will be required by the Clean Air Interstate Rule[7] to operate the selective catalytic reduction equipment for the full year, although that had not been done previously. Consumers' witness, David B. Kehoe, Director of Staff – Electric Generation, testified that the best method to project costs for 2009 is to escalate those historic costs by inflation, then add costs that are unique to the test year and beyond. He also included costs related to high energy piping systems, flow accelerated corrosion, mercury monitors, and operation costs for the Zeeland plant that was purchased in 2007. Mr. Kehoe further

[7]A rule under the Clean Air Act, 42 USC 7651 *et seq.*

stated that many of these costs are required by federal law, and thus, not discretionary. *See*, 7 Tr 611-626. For the reasons stated above, the Commission finds that $155,860,000 is a reasonable projection for production O&M on a total company basis.

c. Electric and Gas Supply Department

Consumers next excepts to the PFD's conclusion that the Staff has included a known and measurable change in Consumers' Electric and Gas Supply Department, thus rejecting Consumers' argument that the Staff eliminated that cost. Further, Consumers argues, even if the ALJ correctly concluded that the Staff treated the inflation adjusted O&M for the department correctly, the known and measurable change projected was reduced by $361,000 in the PFD without explanation as to the justification for the reduction. It argues that no other party challenged the known and measureable changes to other O&M expenses proposed by the company.

The Commission finds that Consumers' projected expenses for the electric portion of its Electric and Gas Supply Department are likely too high, in light of historical expenditure levels and the lack of specific evidence to support its values. Nevertheless, Consumers reasonably explained the inclusion of cost increases for project-adjusted O&M increases that might not be picked up via inflation adjustments. Examples of such projects are the O&M expense associated with maintenance contracts for the merchant software installed "to accommodate the ancillary service market introduced by MISO" (7 Tr 575), staffing necessary to perform economic modeling and analysis for a major new project, and staffing expenditures associated with the utility's merchant software replacement project.

Based on the above, the Commission finds that the PFD's recommended O&M level for the Electric and Gas Supply Department is probably too low, because it ignores some of the evidence produced by Consumers. Therefore, the Commission concludes that $9,781,000, which is the middle point between the company and the PFD's recommendation, should be adopted as the amount for O&M expenses of the Electric and Gas Supply Department.

d. Distribution O&M Projections

Consumers identified $243,595,000 for distribution O&M in 2007 and projected that figure to increase to $293,406,000 for 2009. Again, the Staff analyzed the issue differently than Consumers by first reducing the included categories to exclude the CEA computer replacement program, the Low-income Energy Efficiency Fund (LIEEF), and the Electric Customer Operations Division expenses, projecting a base of $207,850,000 for comparison to Consumers' annual reports. Tree trimming costs were separately analyzed, as they are in this order. The non-tree trimming distribution O&M is $166,314,000.

The Staff took the position that Consumers' proposed increases were so great as to create doubt that the identified money would be spent as suggested. The Staff recommended inflationary increases of 3.85% and negative 1% in the base other distribution O&M expenses. The Staff proposed a $4.7 million adjustment to 2007 costs for 2009.

ABATE challenged the proposed reliability improvement project component of distribution O&M expense projection and recommended a $10 million reduction. ABATE argued that Consumers had failed to provide any compelling evidence concerning how the increase would provide significant benefits to ratepayers, and recommended that the increase be limited to inflation related costs only.

The ALJ recommended that the Commission adopt the Staff's position that adjusted 2007 other O&M expense includes inflation plus real growth allowance of $3.6 million is reasonable. She found that the company had failed to establish that its reliability improvement plan constitutes a 'known and measurable change' for which ratepayers should pay an additional $10 million.

The Commission finds that half of Consumers' proposed adjustment for its projected known and measurable distribution O&M expenses, as adjusted to reflect the Staff's inflation and growth allowances, should be adopted except as provided below for base labor increases and the employee incentive compensation plan (EICP). Among other things, the Commission is persuaded by Consumers' witness Richard J. Ford's (Vice-President, Energy Delivery) rebuttal testimony, which states that final year end distribution capital expenditures are available and should be used for purposes of this rate case. Mr. Ford also testified that distribution O&M expenses should include $10.5 million for the company's reliability improvement project. In his view, exclusion of those expenses would increase deterioration-related outages in length and in frequency. According to Mr. Ford, the miles to receive pole top rehabilitation represent just over 1% of the system miles. He explained that "[g]iven that deterioration is the second leading cause of outages and that 50-70% of our equipment is over 30 years old, the proposed additional O&M is considered the minimal amount to address deterioration of the aging infrastructure." 7 Tr 472.

The Commission rejects ABATE's argument that because the cost savings would be less than the expense, the Commission would be remiss in including any portion of the reliability improvement costs in rates. First, the Commission has included only about half of the electric reliability program costs. Second, the Commission recognizes that there are costs involved in outages that may not be reflected in calculations concerning replacement power costs. Particularly with distribution O&M, Consumers reasonably and prudently desires to prevent problems before they occur. For all these reasons, the Commission concludes that Consumers' projected distribution O&M expenses should be adopted except as provided below for forestry base labor increases, and the EICP.

For the above stated reasons, the Commission finds that $154,160,000, on a total company basis, should be included in rates for Consumers' distribution O&M.

e. Forestry O&M

Consumers projected that it would need $41.5 million, on a total company basis, for tree trimming in 2009, a nearly 100% increase over its 2007 actual expenditures of $22 million. It supported the requested increase by evidence that tree trimming increases the reliability of electricity delivery. The company also requested discontinuance of the tracker mechanism put in place by the Commission in Case No. U-14347.

The Staff reasoned that such a large increase was unlikely to be actually spent for the intended purposes. It recommended increasing the actual expenditures for 2007 by inflation plus an additional increase of 1% for 2007 and 1.23% for 2008 to recognize real growth. The Staff projected $22.8 million for tree trimming in 2009. The Staff supported eliminating the tree-trimming tracker, but retaining the requirement that the company annually report actual tree-trimming expenditures.

ABATE recommended that this expense category be closely monitored and evaluated, suggesting a 3-year average expense level be used as a reasonable amount for ratemaking purposes. ABATE did not propose a specific level of tree trimming expense.

The ALJ reviewed the evidence and arguments and noted that this category of expense has been addressed in numerous Commission orders. She stated that the tracker mechanism adopted by the Commission in Case No. U-14347 followed a long history of unsatisfactory performance by Consumers. Moreover, she noted that the Commission rejected the company's request to release it from the tracker in its most recent rate case, Case No. U-15245. The ALJ recommended that the

Commission authorize the company to continue spending at its estimated 2008 level, $30.3 million, on a total company basis, and that the tracker remain in place.

Consumers excepts and argues that, because no party objected to releasing Consumers from the tracker, the Commission should grant the company's request. Further, Consumers argues that the Commission should grant its request for $41.5 million in rates for use in tree trimming and line clearing. It points to its desire to address 6500 miles of line, 5500 of which are on the distribution system. It states that this represents about 10% of the electric system's area, which permits a 10-year cycle for tree trimming and line clearing. It claims that its request is at the low end of the industry average.

The Staff clarifies that it supports releasing Consumers from its tracker mechanism only if the Commission limits the company's tree trimming funds to its recommended level of $22,854,255. Further, the Staff indicates that it continues to believe that the annual reporting requirement for funds spent in this area is important.

The Commission is persuaded that it should adopt the ALJ's recommended level of $30.3 million for tree-trimming and line clearing for 2009 for purposes of this rate case. As found by the ALJ, Consumers proposed a nearly 100% increase over its 2007 tree trimming expenditures for expense in the test year. While the ALJ rejected the Staff's approach of using an inflation-adjusted amount of only $22.8 million, she was justifiably leery of recommending the approval of the entire amount Consumers proposed. The Commission finds that the ALJ's recommendation, which is based on allowing the company to continue spending at its estimated 2008 level of expenditures, $30.3 million, strikes a reasonable balance on this issue for the purposes of this rate case.

The Commission finds that Consumers should not be permitted to recover that amount without some assurance for the ratepayers that the company will actually do with the funds what it proposes. Therefore, the Commission finds that the tracker requirement approved in Case No. U-14347 and reaffirmed in Case No. U-15245 should remain in place.[8] The tracker allows the company to recover a reasonable amount of its tree trimming and line clearing activities, caps the total amount that the utility may recover from its customers for these costs, and ensures that the ratepayers will receive the benefit of these expenditures. Additionally, the Commission finds that, Consumers must account for these revenues on an annual basis. Therefore, the Commission orders that this funding is subject to an *annual* reporting requirement and subject to refund if not spent. Furthermore, the Commission's authorization of this amount for forestry expenses is conditioned upon a binding commitment from Consumers that the funds will be used solely for forestry and line clearing activities and an explicit waiver of its right to object to the refund provision on grounds of retroactive ratemaking.

The company shall file annual reports in this docket reflecting the amounts actually expended for tree trimming and brush clearing activities. The first of these reports reflecting calendar year operations is due on or before May 1, 2010, and annually thereafter. If the report shows that a refund is due, Consumers shall file an application for authorization to refund the amounts left unspent, plus interest with its annual report in this docket.

The Commission rejects Consumers' argument that because no party sought to extend the tracker on these funds that the Commission must relieve the company from that condition. In the

[8]In that order, the Commission required that Consumers agree to file an annual report, no later than 120 days after year-end, including for all distribution lines, at a minimum: (1) total line clearance expenditures in dollars; (2) length of line cleared to company specifications in miles; (3) number of line clearance crews used; (4) number of trees removed; (5) number of trees trimmed; and (6) average outage duration per customer in minutes. *See*, October 13, 2009 order, pp. 53-54.

Commission’s view, Consumers’ repeated failure to spend the amounts expressly provided for forestry require that a tracker be used, as described above to protect the ratepayers.

f. Electric Injuries and Damages

Consumers used a five-year average, adjusted for inflation, to project its 2009 electric injuries and damages expense, which resulted in adding $320,000 to the amount actually expended in 2007. The Staff used a three-year average and no inflation factor, resulting in a $227,000 adjustment to 2007 actual expense. The ALJ noted that the Commission has historically used multi-year averages to project the amount likely to be needed for this expense due to the unpredictable nature of this category and the many factors that may influence the amount. The ALJ further noted that in recent orders the Commission has used a five-year average but rejected use of inflation factors. Because she found the record lacked the appropriate data to calculate a five-year non-inflated average, the ALJ concluded that the Staff’s three-year average should be used.

Consumers excepts and argues that the Commission should employ the company’s proposed amount, increasing its 2007 injuries and damages expense by $320,000. It argues that its five-year escalated average is more appropriate than the Staff’s three-year non-escalated average.

The Commission is not persuaded that Consumers’ five-year average with inflationary factors used is more representative of injuries and damages than the Staff’s three-year average. Consumers’ failure to cite numbers capable of producing the simple five-year average, without the inflation factors, reflects that the ALJ correctly concluded that the record did not contain data to make the calculation. The Commission affirms its position that inflation is not an appropriate consideration in developing injuries and damages amounts. Therefore, the Commission concludes that the ALJ’s recommendation should be adopted on this issue.

g. Uncollectible Expense

Consumers used a regression model to project uncollectibles for 2009 of $17.87 million, based on historical data from the five-year period of 2003 through 2007. The Staff originally proposed an uncollectible expense for 2009 of $10.2 million based on a three-year average of data from 2005-2007, but later supported an uncollectible expense amount of $12.12 million based on data from 2006-2008.

The ALJ recommended adoption of the Staff's more recent projection, because the Commission has relied on a three-year average in the last two rate cases, and because the ALJ found that the parties had failed to properly identify the factors that influence the level of uncollectibles.

In its exceptions, the company cites the dismal state of the Michigan economy, and rising unemployment, energy prices, and consumer debt as reasons to guard against being overly optimistic about uncollectibles in 2009. The Commission agrees and adopts Consumers' projection. Actual uncollectibles in 2008 were $20.73 million, a 59% increase over 2007. The Commission sees no reason to think that 2009 will bring a significant improvement in this category. Consumers' projection of $17.87 million is based on a longer time period than the Staff's, and comes closer to the 2008 figure than the Staff's projection does.

h. Employee Compensation

In the June 10, 2008 order in Case No. U-15245, pp. 29-33, the Commission rejected Consumers' request for approximately $6.3 million in funding for its proposed employee incentive compensation program (EICP) for non-officer employees. The Commission gave a clear and detailed description of the shortcomings of the proposal and the elements of an acceptable program, including the importance of requiring employee performance that goes beyond the regulatory minimum requirements for the utility, and focusing on setting individual employee goals that could directly affect the individual employee's conduct at work. The Commission favors the use of financial incentives that are clearly and directly tied to improvements in customer service, safety, and system reliability, and looked forward to a more robust proposal in this rate case.

Consumers' revised proposal asks the Commission to approve a $3.6 million increase to base salaries – not tied to any incentive – and a $3.6 million bonus program that rewards "common goals, esprit and solidarity through the incentive structure." 8 Tr 871. "The Company emphasizes individual contributions through an individual's base compensation." *Id. See,* 8 Tr 857-895.

The Staff and the Attorney General opposed both parts of the proposed EICP, noting that it is not responsive to the Commission's directions, the pay increase does not constitute an incentive, several of the stated goals continue to require a job performance standard identical to what Commission regulations already require, individual performance standards were not set, the benefits of the program were not shown to outweigh the costs, the company offered no retention study to show that the pay increase is necessary to retain competent employees, and the utility's customers are facing the severest economic downturn in recent history.

The ALJ recommended rejection of the EICP proposal. The ALJ cited the concerns of the Staff and the Attorney General, as well as the fact that the company failed to show that its stated metric for determining competitive salary levels was appropriate, given that the company relied on studies including the unregulated energy sector, as well as the regulated energy sector.

Consumers takes exception to the ALJ's recommendations. Consumers argues that the base salary increase is necessary to bring the company to market-based levels of compensation that will allow it to attract and retain a competent workforce. The company argues that it has demonstrated that the pay increase is necessary to cover its reasonable costs of doing business, and that the Commission can require no more. Consumers contends that this choice is within management's discretion. Consumers points out that the Staff's witness acknowledged that he had not done any analysis of whether Consumers' proposed compensation levels were reasonable. Consumers posits that the ALJ's criticisms of the company's analysis are unfounded and speculative since the company's analysis was based on industry sources looking at comparable companies. Finally, Consumers argues that there was no reason to perform a retention analysis.

In reply, the Staff supports the PFD and repeats its concerns with the EICP proposal.

The Commission is disappointed with this EICP proposal, which utterly disregards the guidance provided in Case No. U-15245. It is disingenuous for Consumers to contend that the Commission must authorize an "incentive program" that consists of a pay increase tied to no incentive, and a bonus tied to goals that the Commission specifically disavowed in Consumers' last rate case. This is all the more obvious in the current economic climate. For ratepayers to be asked to pay for an incentive compensation program under existing economic conditions, that program must, more than ever, clearly demonstrate that its benefits outweigh its costs. The Commission can only advise Consumers to read, again, the June 10, 2008 order in Case No. U-15245, where the Commission spelled out the necessary elements of an acceptable program. Therefore, the Commission adopts the findings of the PFD and rejects the inclusion of the cost of the incentive compensation program proposed by Consumers.

3. Other Expenses and Taxes

a. Depreciation Expense

Basing its figure on 2009 average plant in service projections, Consumers' projected depreciation expense is $286 million. The Staff used the ratio of depreciation expense to average plant used to arrive at depreciation expense of $285.7 million. Consumers' witness testified that the Staff's calculation was incorrect because the average plant figure used by the Staff included land, which is not depreciable. Consumers then adjusted the Staff's figure to $289 million. The PFD recommended rejecting Consumers' adjustment in favor of the Staff's figure. In light of the foregoing conclusion regarding net utility plant, the Commission finds that depreciation expense should be $286 million, as Consumers originally projected.

b. Property Tax Expense

Consumers' projected a property tax expense of $129,121,000. The Staff examined and adopted Consumers' method for calculating property tax expense, arriving at a projected property tax expense of $128,866,000. The ALJ recommended adoption of the Staff's calculation. Consumers excepted to the Staff's figure, claiming the Staff miscalculated net utility plant. In light of the foregoing conclusion regarding net utility plant, the Commission approves $129,500,000, on a total company basis, for property tax expense.

c. Allowance for Funds Used During Construction

AFUDC is a function of the capital expenditure assumptions made by each party and the authorized rate of return. Consumers' projected AFUDC is $4,743,000. The Staff, using the same calculation, projected AFUDC to be $3,556,868. The ALJ adopted the Staff's calculation. In its exceptions to the PFD, Consumers states the difference in the amounts proposed by the parties is due to capital expenditure assumptions, and argues for acceptance of the company's AFUDC amount. Based on the Commission's determinations elsewhere in the order, the Commission agrees with Consumers, and calculates AFUDC to be $4,743,000, on a total company basis, for the 2009 test year.

d. General Taxes

The Staff accepted Consumers' adjustment to Palisades' payroll tax and payroll tax ratio and used these figures in calculating the adjustment to general taxes. The Staff made an additional adjustment to general taxes based on its earlier O&M adjustments and arrived at a total general tax adjustment of $259,000. Consumers does not dispute the calculation method used by the Staff, but does dispute the O&M adjustments made by the Staff. Consumers takes exception to the ALJ's recommendation to use the Staff's figure and reiterates its argument that the Staff incorrectly calculated overall O&M expenses. The Commission agrees with Consumers and calculates general taxes of $28,296,000, on a total company basis, for the 2009 test year.

e. Michigan Business Tax (MBT)

Consumers and the Staff used the same method of calculating the MBT, but arrived at different figures due to the different revenue and O&M expenses projections. Consumers calculated the current MBT amount to be $17,348,000. The Staff calculated a current MBT amount of $16,364,000, a reduction of $984,000 from Consumers' calculated amount, and a deferred MBT amount of $6,303,000. The PFD recommends using the same calculation method used by both Consumers and the Staff and approves the Staff's calculation. In its exceptions to the PFD, Consumers argues that the Staff's calculation was in error because incorrect projected revenue and O&M expense amounts were used in the calculation. The Commission agrees with the ALJ that Consumers' calculation method and the Staff's are the same. Using that method, with the changes determined in this order, results in an MBT of $29,116,000, on a total company basis.

f. Federal Income Tax (FIT)

The Staff made a $1,810,027 adjustment to Consumer's 2007 FIT levels. In its calculation, the Staff included an adjustment of a negative $1,590,973 for the "Domestic Production Activities

Deduction" (DPAD), arguing that Consumers should be considered a stand-alone company for ratemaking purposes and, as a stand-alone company, would qualify for the DPAD. Consumers disagrees with this argument. In its rebuttal case, Consumers insists that the income tax adjustment proposed by the Staff is not appropriate because (a) the deduction does not apply to Consumers as a stand-alone company, and (2) even if the DPAD were deemed to exist, there is significant uncertainty that the proposed calculation of the amount would be allowed by the IRS.

The PFD recommended the Commission adopt the Staff's FIT tax adjustment. The ALJ reasoned that the Commission has traditionally treated Consumers' electric operations as a stand-alone utility for ratemaking purposes. The ALJ stressed that her "PFD recommended rejection of [a] suggestion to recognize the different capital structures between CMS Energy and Consumers Energy, by crediting Consumers Energy and its ratepayers with some of the tax advantage enjoyed by CMS Energy as a result of its higher level of debt financing." PFD, p. 138. She found the approach proffered by the Staff on this issue "persuasive and consistent with the approach the Commission has taken in setting other components of Consumers Energy's rates." PFD, p. 138. The Commission agrees.

The ALJ is correct that, for the purposes of setting rates, the Commission has broad ratemaking authority to evaluate all of the circumstances that it deems relevant. For example, in setting Consumers' gas rates in the December 7, 1989 order in Case No. U-8678 *et al,* the Commission used a hypothetical capital structure that was remarkably different from the utility's actual capital structure because Consumers' then actual capital structure was severely distorted by the Midland Nuclear Plant circumstances. Here, the Commission notes that Consumers supports the ALJ's recommendation to set its rates based on a capital structure that treats the company's electric operations as a separate entity from CMS Energy giving the utility the benefit of a ratemaking capital structure with a 44.8% debt to 40.51% equity ratio rather than mirroring its corporate parent's ratemaking capital structure with a 58.9% debt to 26.5% equity ratio.

The Commission agrees with the Staff and the ALJ that, if a utility garners a significant benefit, on one hand, from being treated as a stand-alone company for one aspect of ratemaking (ratemaking capital structure), then, on the other hand, the utility's complaints about such treatment for a different aspect of ratemaking (determination of federal income tax expenses) ring hollow. In this case, it appears from the Staff's testimony that the reason given by Consumers to the Staff in response to an audit request regarding the inapplicability of the DPAD to CMS Energy was that "at the consolidated level, CMS, Consumers' parent company, did not have net operating income to qualify" for the deduction. 10 Tr 1237. The Staff's position is explained as follows:

> In essence, Consumers is alleging that it could not claim the DPAD for its 2007 Federal Income Tax return because the non-utility operation of CMS had a net operating loss. It is Staff's position that the tax benefits Consumers could have enjoyed should not be denied because of the Company's non-utility affiliates. The ratepayers should not bear the unnecessary costs because of the non-profitability of CMS' other subsidiaries.

10 Tr 1237.

The Commission finds this reasoning persuasive. Therefore, the Commission finds that the Staff's negative adjustment for DPAD should be included in the calculation of Consumers' FIT.

g. Pro Forma Interest

The pro forma interest adjustment calculates the projected change in the company's taxes due to the change in the projected interest expense and is dependent on the 2009 projected interest expense. Interest expense is tax deductible, so increasing interest expense reduces taxes. The Staff reduced Consumers' interest expense by $5,720,000. The ALJ recommended adopting the Staff's calculation.

In its exceptions, Consumers asserts that the Staff's calculation is incorrect because it is the result of an incorrect calculation of rate base and cost of capital. MEC/PIRGIM's exceptions assert that the corrected pro forma interest figure would decrease FIT expenses by $190,000, which should decrease the revenue deficiency by $310,000. Despite the differing figures used in the calculation, there is no dispute among the parties regarding the method of calculation for pro forma interest. The Commission agrees with the ALJ and adopts the calculation method for pro forma interest used by both Consumers and the Staff.

h. Interest Synchronization

Interest synchronization ensures that the utility has an opportunity to recover its pre-tax overall rate of return on rate base supported by its deferred JDITC balance. This calculation affects FIT and NOI. The Staff's interest synchronization adjustment was calculated to be a negative $399,000, which translates into a reduction in FIT of $399,000 and an increase in 2009 adjusted NOI by $399,000. The PFD recommends that the Commission include the Staff's interest synchronization figure in its findings.

Consumers excepts to this recommendation and asserts that the Commission should adopt its rate base and cost of capital and then reject the Staff's interest synchronization calculation.

The calculation method for interest synchronization is an arithmetic calculation that is not in dispute. The values used for interest synchronization that go into the determination of Consumers' rates depend on findings made elsewhere in this order. Accordingly, based on the findings embodied in this order, the Commission finds that the appropriate interest synchronization adjustment should be $399,000, on a total company basis.

i. DOE Liability Interest Expense

Due to the resolution of the issues concerning the DOE liability in the rate base portion of this order, the Commission finds that, based upon the record evidence, an adjustment needs to be made to subtract $519,510 from net operating income for pre-1983 DOE liability interest expense.

VI.

OTHER RATEMAKING ISSUES

A. Decoupling Proposals

As a means of decoupling, Consumers first proposed a sales tracker mechanism that compared actual annual sales, adjusted for normal weather, to the base levels established in this case. Stephen P. Stubleski, Consumers' Lead Principal Rate Analyst, explained his company's initial position as follows:

> If weather adjusted sales exceed or are below the base level amount for any customer class, the Company would calculate the associated incremental sales and calculate the net change in revenue associated with the incremental sales. If the aggregate net incremental revenue for all customer classes exceeds $5 million on an annual basis, a credit will be determined to refund 100 percent of the non-PSCR revenue in excess of the $5 million revenue deadband. On the other hand, if the aggregate net incremental revenue amount is less than the deadband on an annual basis, then the Company would, following notice and hearing, prospectively adjust rates upward through surcharges so that it is collecting 100 percent of the non-PSCR revenue related to the incremental amount outside of the deadband revenue deficiency on an annual basis. The surcharge adjustment would be allocated to each rate class based on an equal percent of revenue for each class as established in this case.

7 Tr 710-711.

The Staff did not oppose Consumers' deadband-based sales adjustment mechanism because it shifts less risk to Consumers' customers than a full decoupling mechanism. However, the Staff recommended an alternative to Consumers' sales tracker: an energy optimization (EO) lost revenue tracker. The EO lost revenue tracker removes any disincentive that Consumers may have to exceed the statutory minimum energy efficiency requirements. Lost sales would be estimated annually by reference to the Michigan Energy Measures Database and Energy Optimization program participation rates. The annual lost sales would also be calculated by customer class, and with regard to whether a customer is a bundled customer or an ROA customer. This calculation uses the rate case billing determinants and revenue requirements for each customer class, minus surcharges such as the PSCR surcharge. The EO lost revenues tracker does not include federal energy tax credits, federal compliance efficiency standards, or updated building codes. However, the mechanism could be amended in the future by the Commission to include similar items for which Consumers had direct involvement. The Staff's EO lost revenues tracker would not require a reduction in the return on equity.

Consumers later proposed a revised revenue decoupling mechanism (RDM), which would be applicable to all residential, secondary and primary customers. In his testimony, Mr. Stubleski described the RDM as follows:

> The RDM would establish a baseline average annual usage per customer for each customer rate class ('baseline average kWh') as approved by the Commission in the most recent general rate case. Annually thereafter, the company would determine the actual annual average consumption per customer class ('actual average kWh') and compare that to the baseline average for each rate class. If the actual average kWh per customer is below the baseline average kWh, then Consumers Energy would multiply the difference by the number of customers in that class as established in the most recent general rate case. The resulting volume would then be multiplied by the average non-PSCR rate for that class as approved by the Commission in the most recent general rate case, to derive the total amount of revenue to be collected from that rate class. Consumers Energy proposes to collect this amount through an equal per kWh surcharge applied to all customers in that class over the subsequent 12 months following Commission approval. At the end of the 12-month period, Consumers Energy would determine any over or under-collection of the RDM amount and roll that amount into the determination of the next period RDM adjustment.

7 Tr 732.

In his brief, the Attorney General discourages the Commission from adopting any decoupling mechanism on policy grounds. According to the Attorney General, a decoupling mechanism does not promote customer energy efficiency, burdens customers with additional costs between rate cases, provides a disincentive for Consumers to be efficient, and essentially eliminates business risk for Consumers with no benefit to customers. The Attorney General further argues that the Commission lacks explicit statutory authority to approve a revenue decoupling program.

ABATE contends that decoupling would eliminate Consumers' incentive to promote economic development and to control its own costs because its major non-fuel components would be subject to automatic rate increases irrespective of what other cost savings could be achieved by the utility. ABATE claims that there is little need for decoupling following the passage of Act 286, which incorporates a self-implementation provision. In the event that a tracker is approved, ABATE recommends modifying the tracker to include only a 50/50 sharing mechanism outside of the deadband.

Kroger argues that Consumers' sales tracker is an example of single-issue ratemaking, and should be rejected.

Energy Michigan requests that the Commission reject any sales tracking mechanism that bills ROA customers for generation related costs or sales losses that reflect generation related costs. If the Commission adopts a sales tracker mechanism, Energy Michigan states that the mechanism should charge or credit ROA customers only for sales charges related to distribution costs.

The ALJ noted that "[m]ultiple proposals and many competing legal and policy arguments were presented by the parties on the subject of revenue decoupling." PFD, p. 140. The ALJ found that, on its face, Section 97 of 2008 PA 295 (Act 295) does not prohibit the Commission from adopting a revenue decoupling mechanism. However, the ALJ found no evidence on the record of the potential rate effects on all classes of customers associated with any of the proposed decoupling mechanisms. In addition, she found no evidence as to whether any of the decoupling proposals will be cost effective or likely to reduce the overall consumption of fossil fuels in this state. The ALJ asserts that the Staff's mechanism is the most limited in scope and, therefore, the most preferable of the decoupling mechanisms. However, due to the economic climate in Michigan, the ALJ suggested that the Commission carefully evaluate the potential rate effects of any decoupling proposal so as to avoid any unintended consequences. Finally, the ALJ recommended that the Commission reject the proposed mechanisms until the Commission is presented with further evidence and detailed analysis of these issues.

In its exceptions, Consumers states that the ALJ's recommendations are in error. Consumers asserts that its RDM proposal more comprehensively captures the improvements in customer energy efficiency by comparing the average use per customer, as determined by the Commission for purposes of setting rates in this case, with the actual average use per customer experienced by Consumers. The company argues that approval of Consumers' RDM proposal will better ensure that customers' rates reflect the reality of actual sales on an annual basis and will eliminate the disincentive towards energy conservation.

In its exceptions, the Staff argues that a decoupling mechanism will mitigate the utility's disincentive to provide energy efficiency measures. Although the Staff prefers the EO lost revenues tracker, the Staff supports the adoption of Consumers' revised RDM in the event the Commission does not adopt the Staff's proposal.

In his exceptions, the Attorney General agrees with the ALJ that the proposed decoupling mechanisms should be rejected, but disagrees with the ALJ that the Commission has authority to adopt such mechanisms.

In its reply to exceptions, Consumers states that, contrary to the ALJ's finding, the Staff is correct that the record contains clear evidence regarding the effect a decoupling mechanism would have on customers and the use of fossil fuels. Consumers asserts that the intent of Act 295 is to reduce dependence on fossil fuels through aggressive energy efficiency and conservation efforts.

In its reply to exceptions, ABATE states that it opposes the implementation of the RDM and the uncollectible expense tracker on both legal and policy grounds. ABATE states that Section 97(4) of Act 295 does not authorize the Commission to decouple electric rates. In addition, ABATE claims that the record does not include any analysis of the potential rate impact a decoupling mechanism would have on all classes of customers.

In its reply to exceptions, Energy Michigan states that, if the Commission adopts an RDM or other decoupling mechanism, the decoupling mechanism should calculate separate factors or adjustments for distribution service and generation service.

The Commission agrees in concept with both Consumers and the Staff. A decoupling mechanism is typically created as a solution to further the public policy objectives of assisting customers to use energy more efficiently and reduce the utility's reliance on certain existing fuel sources, while reducing overall costs. The principal purpose of decoupling is to transform the current regulatory paradigm that gives a utility a strong incentive to sell as much electricity as possible, without regard to the negative effects upon overall costs and individual customer bills. Decoupling can be utilized to manage changes in electricity sales attributable to updated building codes, expanded energy efficiency programs (including federal and state weatherization programs), upgrades in appliance efficiency, and other similar demand side policies.

Decoupling is a ratemaking mechanism that removes the link between energy sales, or throughput, and the utility's non-fuel revenues. With decoupling, differences between projected and actual sales, and the associated differences in the utility's revenues, are reconciled periodically. A well-crafted decoupling mechanism will likely mean that changes in revenue resulting from changes in consumption will no longer cause a utility to file a general rate case. Rather, a utility's need to file a general rate case will be driven by changes in the utility's underlying costs.

The Commission disagrees with the decision of the ALJ, in that the Commission should await a future proceeding to address the need to shift the current regulatory structure to meet today's 21st century energy policy goals outlined by the State of Michigan and those espoused by the federal government. The Commission finds that the record is more than sufficient. Furthermore, contrary to the arguments made by ABATE and the Attorney General, the Commission finds it has full authority over rate design and regulatory mechanisms, such as decoupling. The Commission has broad ratemaking authority over all aspects of a utility's rates, and nothing in Act 295 indicates that the Commission lacks authority or precludes the Commission from utilizing trackers or a decoupling mechanism. In light of this, the Commission finds it is timely to put a decoupling mechanism in place, so that it might fully assess the benefits and consequences of a specific decoupling mechanism with real world experience.

Given the issues raised by all parties, the Commission is cognizant of the importance of creating a new regulatory mechanism that balances the interests of customers and the utility. Therefore, in this order the Commission is choosing to establish a pilot decoupling mechanism that is contingent upon the utility 1) meeting certain reporting requirements, 2) exceeding the benchmarks for the energy optimization program established pursuant to Public Act 295 of 2008, 3) committing to provide enhanced energy efficiency programs and demand side resources that enable all customers classes to effectively manage rising energy costs, including proposals to accomplish this in the next filed rate case, and 4) surpassing minimum reliability standards under rule and law. Accordingly, the Commission directs Consumers to institute a pilot decoupling mechanism described in this order, effective December 1, 2009. Consumers shall file in this docket at least quarterly, actual sales data information by rate. Consumers shall also comply with any other reporting requirements as directed by the Staff.

The pilot decoupling mechanism shall be based upon Consumers' revised revenue decoupling mechanism as illustrated in revised Exhibit No. A-105, with modifications. The pilot decoupling mechanism shall be symmetrical and shall reconcile non-fuel/non-purchase power revenue. In the utility's annual decoupling mechanism reconciliation proceeding, which shall be filed on or before March 1 of each year, Consumers' actual (non-weather adjusted) sales per customer during the 12-month period from December 1 to November 30 will be compared with the base sales per customer level amount established in this case. Any sales per customer variance will be multiplied by the non-fuel revenue (distribution charge) per kWh in order to obtain the non-fuel revenue variance per customer. Then, multiply the non-fuel revenue variance per customer by the average monthly number of customers established in this rate case in order to obtain the resulting nonfuel revenue variance. Any overage or shortfall shall be credited or surcharged on a per kWh basis going forward. A deadband is not included in the pilot mechanism. The application of the mechanism upon specific customer groups, customer classes, or a combination thereof, will be determined in the reconciliation proceeding.

The company's annual decoupling mechanism reconciliation proceeding shall be conducted as a contested case proceeding. All parties to the utility's most recent general rate proceeding shall be allowed to intervene in the reconciliation in accordance with the same intervenor status. Other intervenors may also participate in accordance with the Commission's Rules of Practice and Procedure, R 460.17101 et seq.

The utility's annual March 1 filing shall include all testimony and exhibits necessary for the reconciliation proceeding, including how the mechanism will apply to customer groups, customer classes, or a combination thereof and shall be simultaneously served on all parties to its most recent general rate case proceeding. Specifically, in each annual decoupling reconciliation application, Consumers shall file data on its average per customer sales levels. In the event Consumers has filed a new rate case and self-implemented new rates in the 12-month period, Consumers shall include a very detailed proposal with specific explanation as to how self-implementation fits with the decoupling mechanism and proposed reconciliation. Discovery shall be allowed to all parties in accordance with the Commission's routine contested case procedures. Upon receipt of the application, the Commission will commence a decoupling reconciliation proceeding as administratively efficient as possible.

In future proceedings, the Commission encourages parties to file comments or proposals to address the regulatory lag involved in annual reconciliations, exclusion of revenues (sales) attributable to severe outages or other similar circumstances, risk assessment for both the utility and customers, and recommendations for adjustment and evaluation of the pilot.

B. Uncollectibles Tracker Mechanism

Consumers proposed an uncollectibles expense tracker mechanism (UETM) that utilizes a +/- 5% deadband. Mr. Stubleski states that:

> [I]f actual uncollectibles expense in future years are within 5% of the base uncollectibles expense amount, no adjustment would be made. However, if the annual uncollectibles expense is 105% or greater of the base uncollectibles expense level, then the company would, following notice and hearing, prospectively adjust rates upward, through an appropriate surcharge, so that it is collecting 100% of the amount over the 5% deadband. If on the other hand, the annual uncollectibles

> expense is 95% or less of the base uncollectibles expense level, then the Company would refund the amount outside the 5% deadband.

7 Tr 711.

The Staff requests that the Commission adopt the Staff's proposed UETM, as it did for Michigan Consolidated Gas Company (Mich Con) in Case No. U-13898, with modifications. According to the Staff:

> The UETM should be implemented and remain in effect until a final Order is issued in the Company's next rate case. The Company should make the UETM filing on or before March 31 of each calendar year with the initial filing being made for the period January 1 through December 31, 2009. It would be based on ninety percent of the difference between the actual uncollectibles expense and the uncollectibles expense built-in to Staff's filing in this case of $10,220,000. This amount is the average of 2005-2007 uncollectible expenses net of write offs or PeopleCare reimbursements. The surcharge or credit to be applied would be calculated on all sales for the period including ROA sales and excluding Rate E-1 sales, which would not participate in any surcharge or credit for reasons discussed in the Palisades refund proposal.

10 Tr 1382.

In addition, the Staff notes that in Case No. U-13898, the Commission stated that:

> Each March 31 filing must fully describe the methods used to calculate the uncollectibles expense for the preceding year, detailing any changes in methodology from the previous year, and fully explaining the reasons for any changes of methodology. The annual filing must provide in detail the calculations for the uncollectibles expense for the preceding year, along with support for all assumptions made in the uncollectibles expense calculations.

April 28, 2005 order, Case No. U-13898, p. 72.

If the Commission does not implement the proposed UETM, the Staff requests that the Commission increase the amount of uncollectible expense built into the Staff's revenue requirement to reflect an average of 2006 through 2008 net expenses. Consumers accepted the Staff's proposed addition of a true-up mechanism that is similar to the mechanism approved by the Commission in Case No. U-13898.

The ALJ recommended that the Commission reject the UETM at this time. The ALJ reasoned that in Mich Con's case, the Commission had strong evidence that cost increases driving the uncollectible expenses were attributable to rising natural gas prices and relatively beyond the ability of Mich Con to control. The ALJ found no evidence of a similar problem in this case.

In its exceptions, Consumers argues that the Commission has repeatedly recognized that the volatility associated with certain costs is such that they are difficult, if not impossible, to predict with reasonable accuracy in periodic rate cases, and has therefore adopted rate adjustment mechanisms to avoid unfairness to Consumers or its customers. Consumers asserts that the ALJ erred in not adopting the Staff's proposed UETM.

In its exceptions, the Staff continues to advocate for the UETM. The Staff states that, similar to Mich Con, Consumers is faced with an economic situation in Michigan that is beyond its control. The Staff further recommends that the UETM and the appropriate uncollectible expense level and methodology be reviewed and adjusted annually.

In its reply to exceptions, Consumers states that it agrees with the Staff's analysis.

The Commission adopts a UETM in which Consumers shall compare its uncollectibles expense for the preceding calendar year with the base level of jurisdictional uncollectibles expense contained in the company's rates as discussed earlier in this order. Consumers would remain at risk for twenty percent of uncollectibles expense to provide an incentive to minimize its actual expense level. Eighty percent of the difference between those amounts will be collected from, or refunded to, Consumers' customers through a temporary surcharge or credit over the subsequent specified period. The surcharge or credit will be implemented by Commission order after an opportunity for hearing on the annual application.

On or before March 31 of each year, Consumers shall file an application as a continuation of this docket. Each March 31 filing must fully describe the methods used to calculate the uncollectibles expense for the preceding year, detailing any changes in methodology from the previous year, and fully explaining the reasons for any changes of methodology, along with support for all assumptions made in the uncollectibles expense calculations. In the event Consumers has filed a new rate case and self-implemented new rates in the 12-month period, Consumers shall include a very detailed proposal with specific explanation as to how self-implementation fits with the UETM and proposed reconciliation. The surcharges or credits for each rate class would be calculated based upon the percentages of uncollectibles expense allocated to the rate class in the cost of service study utilized in the final rate design.

Carrying charges shall be assessed to the uncollectibles expense. Carrying charges shall be calculated monthly and compounded annually on December 31 by applying the company's average short-term borrowing rate to underrecoveries and the company's authorized rate of return on common stock that was determined in the latest rate case to overrecoveries. Furthermore, carrying charges shall be calculated for each year's overrecovery or underrecovery on a stand alone basis rather than on the sum of all outstanding amounts.

Additionally, in Consumers' next rate case, the Commission invites any party to include proposals for programs that might minimize company expense related to uncollectibles.

C. Electric Choice Incentive Mechanism

Consumers requested that the Commission retain the electric choice incentive mechanism (ECIM) because it provides protection for customers and Consumers from a significant variation in ROA sales levels as compared to those estimated in setting base rates.

The ALJ notes that the Staff did not take a position on whether to retain or discontinue the ECIM. However, according to the Staff, the ECIM must be recalculated to reflect amounts for non-fuel prices and base choice sales approved in the final order. Because the ECIM was only recently adopted by the Commission, the ALJ recommends that the Commission continue it in this case, thereby allowing the Commission to evaluate it on the basis of further actual experience.

Consumers did not except to the ALJ's recommendation.

In his exceptions, the Attorney General argues that the ECIM should be subsumed into the sales and uncollectibles tracker mechanism, or the mechanism should be structured to exclude sales losses to electric choice in order to prevent a double-recovery for Consumers.

The Commission finds that the ECIM has become unnecessary in light of changes in circumstances since Consumers' last rate case. The effect of the tracker mechanisms adopted in this order, together with implementation of statutory restrictions on choice, is to mitigate much of the potential for revenue instability. Therefore, the ECIM shall terminate on November 30, 2009, which is the end of the final period for reconciliation of the current ECIM. The company shall file its final ECIM reconciliation byApril 1, 2010.

D. Advanced Metering Infrastructure Commitment

Consumers requested $25,219,000 for 2008 AMI funding and $38,475,000 for 2009 AMI funding, and $2,188,000 for 2009 operations and maintenance expenses. The Staff proposed $14,257,000 for 2008 actual AMI expenses and $1,049,000 for 2009 actual AMI expenses. Initially, the Staff recommended this reduction to reflect Consumers' potential for funding under a grant through the American Recovery and Reinvestment Act (ARRA) of 2009. However, the Staff recognized that there are some uncertainties involved with the ARRA funding. Therefore, the Staff agreed to provide full year 2009 AMI expenses on the condition that Consumers provide annual tracking reports of its expenditures and that any portion of the AMI expense be refunded if supplemented by ARRA funding in any given year.

The ALJ did not determine whether the Staff's agreement to provide full year 2009 AMI expenses should be considered a "tracker" or be designated something else. However, the ALJ stated that it is appropriate that it be recognized in the Commission's final order. Therefore, the ALJ recommended that the capital and O&M expenses associated with the AMI program included in rates in this proceeding be expressly conditioned on appropriate refunds to ratepayers in a subsequent rate case, to the extent of any ARRA funding that is received.

In its exceptions, Consumers notes that the PFD states that Consumers has agreed to refund to customers amounts of AMI expenditures included in rates which are also recovered through ARRA grants received for capital and O&M expenses associated with the AMI program in a subsequent rate case.

The Commission finds that Consumers shall receive its full year proposed 2009 AMI expenses. The Commission rejects the proposal to refund any portion of these funds, whether or not the ARRA grant or any other available grant funding is received. This project is essential to the future of Michigan, and the Commission expects Consumers to expend all the available monies on AMI infrastructure.

E. Taft-Hartley Training Trust Fund

The Utility Workers Council requested that the Commission require Consumers to establish a Taft-Hartley Training Trust that would set aside funds for worker training. According to the Utility Workers Council, the electric utility workforce is aging, and there is a shortage of trained utility workers. The Utility Workers Council adds that the aging utility workforce has additional training requirements to ensure safety of the workers and the public.

Consumers opposed the Utility Workers Council's request, arguing that the Commission lacks authority to require the utility to adopt what is essentially a term of a collective bargaining agreement. According to Consumers, a Taft-Hartley Training Trust can only be established pursuant to 29 USC 186(6), through the agreement of management and the labor unions.

The Staff, on the other hand, supported the Utility Workers Council's request in part and recommended that the Commission direct $11,424,859 in funds to a utility training trust. According to the Staff, this amount represents 25% of the utility's total gas and electric training expenditures planned for 2009 and 2010.

The ALJ determined that there was insufficient analysis in this record to decide the legal question raised by Consumers, and there was insufficient information to determine the amount of funds the utility should devote to training. The ALJ therefore recommended that the Commission direct Consumers to file a report evaluating its present and expected future training needs including the amount of its budget presently devoted to training, its estimated future training costs, and the potential costs and benefits to the utility and the public of a ratepayer-funded training trust. The ALJ added that the analysis should consider whether using funds currently provided in rates to establish a trust might have the unintended consequence of reducing funds available for training in the short run.

In its exceptions, Consumers reasserts that the issue of a Taft-Hartley Trust is properly the subject of collective bargaining and not utility regulation. Consumers therefore urges the Commission to reject both the ALJ's recommendation and the request of the Utility Workers Council.

The Staff and the Utility Workers Council state that they support the ALJ's recommendation to require Consumers to file a report regarding the company's present and future training needs and budget, provided that Consumers "aggressively implements the ALJ's recommendations." Staff's exceptions, p. 4. The Staff also requests that the Commission direct Consumers to file the report in the docket in this case, before filing its next rate case, so that the legal and factual issues presented can be fully addressed in the next rate case.

The Commission agrees that the coming shortage of trained line workers and electricians is a critical problem that must be addressed. As the Utility Workers Council points out, Consumers' own data indicates that a significant portion of the company's line workers and electricians will be retiring within the next five years. The Commission also agrees that the legal question of whether a trust may be established outside of a collective bargaining agreement has not been fully addressed by the parties. Therefore, the Commission directs that Consumers file in this docket, within 90 days of the date of this order, a report regarding utility workforce training that conforms to the recommendations in the PFD.

F. Palisades Refunds

In its March 27, 2007 order in Case No. U-14992, the Commission directed that $255 million available from the sale of Palisades be returned to electric customers by a negative surcharge over an 18-month period on an equal mills per kWh basis. In its June 10, 2008 order in Case No. U-15245, the Commission directed that Consumers file a final Palisades reconciliation addressing final transaction costs, identifying all decommissioning and other funds relating to Palisades including interest, and providing a computation of a negative surcharge to spread the refund over nine months.

In its report filed on July 10, 2008, Consumers identified an additional $109 million available for refund. In its May 12, 2009 order in this case, the Commission ordered Consumers to provide a partial refund of the remaining Palisades money of $36.04 million to offset the company's self-implemented rate increase for residential customers. The Commission also indicated that it intended to address the refund of the remaining Palisades proceeds in the final order in this case.

The Staff identified three sources of refund monies to be considered in the final order including: 1) the remainder of the estimated $255 million refund required in Case No. U-14992, 2) the remainder of the $36.04 million refund directed by the May 12, 2009 order in this docket, and 3) the remaining $72.96 million from the $109 million identified in Case No. U-15245 ($109 million less $36.04 million). According to the Staff, Consumers has not filed a final reconciliation of the $255 million refund stemming from the sale approved in Case No. U-14992, nor will it have filed a final reconciliation of the $36.04 million stemming from the May 12, 2009 order by the issuance date of the final order in this proceeding.

The Staff recommended that Consumers file a report in Case Nos. U-14992 and U-15645 describing the final reconciliation of the $255 million refund. The Staff proposed that, within 15 days of the date of the final order in this case, Consumers should file an update of Attachment B contained in its April 25, 2007 letter in Case No. U-14992. Attachment B described the calculation of the $255 million negative surcharge and the update to this attachment should reflect actual data available through the final order in this proceeding and identify any remaining amounts to be returned to customers.

With regard to the remainder of the $36.04 million ordered refunded on May 12, 2009, the Staff recommended that Consumers file a report in this docket describing the final reconciliation of the refund in the same format as Attachment B, discussed above. The Staff further recommended that Consumers file the report no later than 15 days after the date of issuance of the final order in this proceeding and that any interested person should be permitted to file comments regarding the accuracy of the calculation within seven days of Consumers' filing.

Regarding the remaining $72.96 million identified in Case No. U-15245, the Staff recommended that Consumers be required to determine a negative surcharge that would refund the remaining $72.96 million, plus interest, to all bundled sales and ROA customers based on actual 2008 sales over a six month period and again recommended that Consumers provide a reconciliation in the same format as Attachment B described above. The Staff added that the reconciliation of the $72.96 million negative surcharge should include the interest accruals based on the $109 million available from April 2007, as well as the offset amounts from the monthly disbursements of the $36.04 million refund to residential ratepayers. For all refunds, final true-ups would be filed in Case No. U-12505, with over/undercollections resolved through one-time surcharges or credits. The Attorney General supported the Staff's position.

Consumers did not file testimony on this issue, but argued in its brief that reasonable ratemaking practices support the use of such funds, such as the Palisades proceeds, to directly offset other rate increases, minimizing the effect on customers of rate changes. Consumers also urged the Commission to reserve $44 million of refund monies to offset recovery of whatever amount of Big Rock decommissioning costs the Commission determines should be recovered from customers in Case No. U-15611. Consumers recommended modifications of the refund procedures proposed by the Staff, arguing that current sales at the time of distribution should be used rather than 2008 sales levels, and opposing the use of the securitization true-up case, Case No. U-12505, to avoid adversely affecting the company's securitization charges or bond ratings. The company also claims to need 45 days, rather than 15, to review the appropriate billing records to determine current sales.

The Municipal Coalition argued that no further reconciliations are required before refunding begins, pointing out that the Commission did not wait for a reconciliation before ordering the partial refund to residential ratepayers provided for in the May 12, 2009 order in this docket. ABATE also argued that immediate refunds should be ordered refunding $109 million, less the amount used as a set off to the residential rate increase.

The ALJ made no recommendations with respect to procedures that the Commission should adopt in refunding remaining amounts from Case No. U-14992. The ALJ agreed with the Municipal Coalition and ABATE that no further reconciliation proceedings are required for the approximately $109 million identified following Case No. U-15245. The ALJ observed that the Staff's suggested procedure provides a reasonable opportunity for the parties to be able to comment on the negative surcharge amounts determined and that a similar procedure was used in Case No. U-14992. The ALJ added that no party objected to the six month time frame for refunds that the Staff recommended or to the recommendation that the negative surcharge for the $36.04 million be continued at the current rate until fully refunded. The ALJ also agreed that the $36.04 million refund to residential customers should be "backed out" of the remaining $72.96 refund.

The ALJ rejected Consumers' recommendation that refunds should be established on the basis of current sales, rather than the Staff's recommended 2008 sales, on grounds that the required analysis would delay the refund. The ALJ therefore recommended that the Commission use 2008 sales data for calculating the negative surcharge and that any over- or underrecovery should be addressed in Consumers' next rate case.

Consumers takes exception to the ALJ's recommendation to distribute the remainder of the $109 million without allowing the company to retain $44 million to cover final decommissioning costs at the Big Rock nuclear facility.

The Staff takes exception to the ALJ's recommendation that any over- or underrecovery should be addressed in Consumers' next rate case arguing that the true up process could extend indefinitely into the future.

The Commission generally agrees with the Staff's original proposal as set forth in its initial brief, and subsequently modified. The Commission agrees that the final reconciliation of the $72.96 million negative surcharge remaining to be refunded as part of this proceeding should be filed in this docket. The Commission disagrees with ABATE's suggestion that "[t]he calculation of the refund should explicitly back out of the remaining refund owing to residential customers the $36.04 million setoff amount." ABATE's initial brief, p. 40. The remaining balance should be allocated among rate classes without allowance for the previous refund, which was structured to accommodate unique circumstances presented at the time of the temporary order. The Commission therefore directs Consumers, within 30 days of the date of this order, to file a report in this docket and in Case No. U-14992 addressing a final reconciliation of the estimated $255 million identified for refund in Case No. U-14992 in accordance with the Staff's proposed procedures. The Commission further directs the company to file tariff sheets, calculated in accordance with the Staff's recommendation, for an equal mills per kWh negative surcharge to be applied across all customer classes, except Rate E-1, to refund the remaining $72.96 million, plus interest, of Palisades monies. Finally, the Commission directs Consumers to file a final reconciliation of $36.04 million refund authorized by the May 13, 2009 order at the same time it files the reconciliation of its self-implemented rate increase. Subsequent to the termination of the negative surcharges resulting from these three pools of refund monies, the Commission further directs that any residual amounts determined to be over- or underrefunded to customers should be reflected in Consumers' next rate case.

G. PSCR Base

The Staff recommended that the Commission establish a new PSCR base, 48.66 mills per kWh at generation, based on the Consumers' PSCR factor in effect in February 2009. No party opposed this request, and the ALJ recommended its adoption. The Commission finds that the new PSCR base shall be based on the company's PSCR factor in effect in February 2009.

H. Appliance Service Program

Phillip Forner presented testimony addressing costs associated with Consumers' Appliance Service Program (ASP). Mr. Forner claimed that Consumers' ASP is not adequately compensating the utility for the costs of using the utility's system. Mr. Forner requested that Consumers' rates be adjusted to reflect additional reimbursement from the ASP for including ASP charges on monthly electric bills, processing the ASP payments, and use of the utility's call center.

In response, Consumers contended that one of the purposes of the ASP program is to generate revenue to offset the gas utility's O&M expenses by providing gas utility employees, vehicles, tools and equipment to perform repairs for customers. Consumers asserted the ASP contributed $974,661 for various services provided by the utility for 2008 and that the company is complying with 2004 PA 88 by allocating expenses to the ASP based upon the amount of use by the program. In addition, the Staff and Consumers contended the Commission has already addressed and rejected Mr. Forner's arguments in previous cases.

The ALJ reviewed previous proceedings where Mr. Forner had raised similar claims. The ALJ noted that, beginning in Case No. U-13089, on the basis of a complaint brought by Mr. Forner, the Commission found that Consumers had violated the Code of Conduct adopted in Case No. U-12134 and directed the company to address the subsidies created by allowing access by the ASP to equipment and personnel in Consumers' regulated divisions. Subsequently, in Case

Nos. U-14329 and U-15245, the Commission addressed other arguments that Mr. Forner again raised here. The ALJ pointed to the fact that the Commission made clear that questions regarding alleged subsidies to the ASP were not appropriately within the scope of a rate case but should be considered separately in a complaint case. The ALJ added that the Commission had also determined that the Commission reasonably evaluated the costs and revenue associated with the ASP program in gas rate cases.

The ALJ found that Consumers and the Staff had effectively rebutted Mr. Forner's claims regarding a subsidy on the electric side through a $235,000 billing system cost adjustment included in Case No. U-15245 and again in this case. The ALJ recommended that the Commission reject Mr. Forner's claims on grounds that his claims have been addressed and because his complaint was not properly raised in a rate case.

Mr. Forner filed exceptions in which he reiterated the arguments in his brief.

The Commission agrees with the ALJ that the issues raised by Mr. Forner in this proceeding have been previously addressed by the Commission. The rate adjustments requested by Mr. Forner are therefore rejected.

I. MBT Tax Accounting

Consumers provided testimony explaining the differences between the Michigan Single Business Tax and the Michigan Business Tax and requested that the Commission confirm that deferred tax accounting under SFAS 109 is permissible. No party opposed the company's request, and the ALJ recommended its adoption. No party filed exceptions. Consumers' requests regarding MBT accounting are granted.

VII.

ADJUSTED NET OPERATING INCOME

Based on the modifications to the PFD discussed above, Consumers' has an adjusted net operating income for the 2009 test year of $343,155,000 on a total company basis, and $343,643,000 on a jurisdictional basis.

VIII.

BASE REVENUE DEFICIENCY

In accordance with the foregoing findings, Consumers' jurisdictional base revenue deficiency for the test year is computed as follows:

Rate Base	$6,146,847, 000
Rate of Return	6.98%
Income Required	$429,050,000
Adjusted Net Operating Income	$343,643,000
Income Deficiency[9]	$85,407,000
Revenue Multiplier	1.6323
Revenue Deficiency	$139,411,000

IX.

COST OF SERVICE

Consumers and the Staff presented complete cost of service studies (COSS). Consumers' COSS was presented by Mr. Keaton, and the results are summarized in Exhibit A-19. The Staff's COSS was presented by Mr. Miller and a team of Staff members, and the results are summarized

[9]The income deficiency is measured from the level of rates authorized in the utility's most recently completed rate case, Case No. U-15245.

in Exhibit S-6, Schedule F1. Exhibit S-6, Schedule F1.2 lists the changes made by the Staff to Consumers' COSS.

A. Production Cost Allocation

MCL 460.11(1) mandates the realignment of electric rates to make them equal to the cost of providing service for all customer classes (with the exception of industrial metal melters) by October 6, 2013. The effect of realignment on residential and industrial metal melting rates may not exceed 2.5% per year. MCL 460.11(2). Section 11(1) further provides that "The cost of providing service to each customer class shall be based on the allocation of production-related and transmission costs based on using the 50-25-25 method of cost allocation."

In Consumers' last rate case, the Commission applied the 25/50/25 method for allocating production costs, which consisted of a 25% weighting of peak demand, a 50% weighting of on-peak energy use, and a 25% weighting of total energy use. In the December 23, 2008 order in Case No. U-15244 (Detroit Edison's last general rate case), p. 77, the Staff proposed, and the Commission agreed, that the allocation formula mandated by the Legislature should be understood to consist of a 50% weighting of peak demand, a 25% weighting of on-peak energy use, and a 25% weighting of total energy use. All parties agree to this interpretation.

The parties disagree on the coincident peak component of the weighted cost allocation. This component is not addressed in the statute. The multi-hour 4 coincident peak (MH4CP) method was applied in the most recent Consumers and Detroit Edison rate cases. The MH4CP method, supported by Consumers, ABATE, and other parties to this proceeding, uses a multi-hour approach, which looks at a seven-hour time period, from 1:00 p.m. to 8:00 p.m., on the peak day of each summer month, June through September. Alternatively, the 12 coincident peak (12CP) method, supported by the Staff and the Attorney General, uses the peak hour from each month of the year, and was recently endorsed by the Commission in Case No. U-15244.

The ALJ recommended adoption of the 12CP method, both because it results in less cost shifting, and because of the Commission's expressed preference for it in the Detroit Edison rate case.

Kroger argues that the ALJ erred in recommending the 12CP method. Kroger contends that the Staff supports this method simply as a way of directing more costs to primary customers. Kroger argues that the change in demand weighting required by the statute does not create a basis for changing the distribution of coincident peaks. Kroger points out that in a previous rate case the Staff successfully argued that 12 hours was too narrow a basis on which to allocate rates. *See,* the December 22, 2005 order in Case No. U-14347, pp. 73-74.

ABATE also takes exception to the 12CP method. ABATE argues that "The Legislature had to know what methods were being employed by the Commission to allocate costs," and "the only logical conclusion that can be drawn is that the Legislative intent was to leave the MH4CP alone." ABATE's exceptions, p. 4. ABATE notes that the Commission's statements regarding the 12CP method in Case No. U-15244 were dicta. ABATE further argues that the 12CP method would violate the statutory prohibition against adopting a new cost allocation method that allocates more costs to primary customers. *See,* MCL 460.11(1). ABATE contends that the MH4CP method provides retail customers with an incentive to move consumption to off-peak periods, and the 12CP method does not. ABATE contends that "There is no support for using marginal costs to allocate revenue responsibility among the classes and then using average cost to design rates." ABATE's exceptions, p. 11.

The Municipal Coalition also argues that, based on Commission precedent and the language of the statute, Consumers correctly applied the MH4CP method in its COSS. The Municipal Coalition argues that the Staff's position is simply an overt compromise and is not based on sound reasoning, because it deflects attention from the important summer peak period. The Municipal Coalition points out that the Legislature chose to increase the weighting of the demand allocator, and it thwarts legislative intent to change the calculation of the demand allocator to dilute its importance. The Municipal Coalition argues that the rules of statutory construction demand that the MH4CP method not be changed.

Consumers takes exception to the 12CP method, arguing that it violates clear legislative intent, and shifts costs to the primary class in violation of MCL 460.11(1). Consumers also argues that the discussion in Case No. U-15244 is dicta, and that the Staff itself acknowledges that the 12CP method will shift approximately $20 million to the primary and secondary voltage classes from the residential and lighting classes. *See,* 10 Tr 1284-1285.

In reply, the Staff argues in favor of the 12CP method because it will shift fewer costs than the MH4CP method will when applied in conjunction with the required 50/25/25 allocation method. The Staff estimates that the MH4CP method would shift over $40 million in production costs away from the commercial and industrial (C&I) classes and onto the residential class, but the 12CP method will shift half of that amount away from the residential class and onto the C&I classes. The 12CP method, the Staff contends, comports with the Legislature's apparent intent to shift some costs away from the primary class, because it results in allocating $15 million in reduced costs to primary customers, and $20 million in increased costs to residential customers, in comparison to the previously adopted MH4CP 25/50/25 method. *See,* 7 Tr 1284-1285.

The Legislature chose to mandate the 50/25/25 method, but clearly left it to the Commission to decide which CP measurement to use with the new weight of 50% specified for the peak demand component, because no coincident peak component was specified in the statute. The Commission notes that from 1976 to 2005 it applied the 12CP 75/25 method (75% weighting of peak demand), and only in 2005 changed to the 25/50/25 method (25% weighting of peak demand). The effect of the Legislature's action was to shift the weighting of peak demand halfway back (to 50%) to where it had been prior to 2005, without specifying the coincident peak component. It seems logical to the Commission to reevaluate the coincident peak component of the method at the same time that the new mandatory method, which doubles the weight of peak demand, is first applied, particularly in light of the fact that a 50% weight has not been previously used.

The Commission agrees with the ALJ and adopts the 12CP 50/25/25 method. This method results in a smaller shift of costs to the residential class – the class currently undergoing rate realignment – than the company's proposed method. The primary purpose of MCL 460.11 is to establish rates for each customer class that equal the cost to serve that class. The Commission applied the 12CP component for many years, and abandoned it only when deciding to cut the weighting of peak demand in the overall equation by two-thirds. The Commission finds that 12CP is a better fit with the 50% weighting of peak demand than the MH4CP component would be, because it accomplishes a reasonable shift of costs from the primary class to the residential class, consistent with the mandates of the statute.

B. Transmission Cost Allocation

Most recently, the Commission has used a 75/25 weighting of peak demand and energy for allocating transmission costs. Finding that different allocations may lead to confusion, the ALJ recommended that the Commission use the same allocations for production and transmission costs.

Kroger contends that the ALJ erred in her recommendation. Kroger argues that this constitutes a change in Commission policy without sufficient justification. Kroger notes that the Commission upheld the 12CP 75/25 method in the last two successive rate cases based on cost causation principles, and urges the Commission to continue to require this method. Kroger notes that transmission service is almost entirely demand related, and could even be classified as 100% demand based. Thus, Kroger argues, the Commission should, at a minimum, adopt a 75/25 allocation.

In reply, the Staff argues that MCL 460.11(1) clearly applies equally to "production-related and transmission costs." The Staff points out that there is no historical basis for any allocation other than 12CP for transmission costs. The Staff further notes that transmission costs have historically been determined using the 75/25 method of weighting, and the statute requires the change to 50/25/25. The Staff contends that Kroger fails to show that keeping the 75/25 method would "better ensure rates are equal to the cost of service," as required by the statute. MCL 460.11(1). The Staff points out that the old method would shift rates even further away from the cost of service.

The Commission agrees with the Staff and the ALJ, and adopts the same calculation method for transmission and production costs – 12CP 50/25/25. As with production costs, the statute requires use of the 50/25/25 method for computing transmission costs**.** Modifications to this method may be made only "to better ensure rates are equal to the cost of service if this method does not result in a greater amount of production-related and transmission costs allocated to primary customers." MCL 460.11(1). Kroger made no demonstration that adherence to the old 75/25 method would move rates towards the cost of service.

C. Fuel and Interchanged Power Allocation

The ALJ recommended that the Commission adopt Consumers' allocation of fuel and purchased and interchanged power costs as modified by the Staff. No party excepted.

D. GPD Distribution Costs

ABATE recommended a change in the allocation of distribution costs among the voltage levels within the Rate GPD (general primary distribution) class. According to ABATE's analysis, costs should be shifted by 50% away from CVL1 and CVL2, and towards CVL3. In the interests of caution, and in order to mitigate the effect of errors in the analysis, the ALJ accepted the Staff's proposal that costs should be shifted by only 25%. All parties agreed that Consumers should be directed to treat each voltage level as a separate rate group in the COSS it files in its next rate case.

ABATE takes exception to the recommendation to eliminate 25% of the differential between these rates. ABATE states that its analysis reveals that CVL1 customers incur 3.6% of total class distribution related costs, but, under Consumers' proposed rate design, will pay 15.2% of such costs; CVL2 customers incur 14.9% of costs, but will pay 26%; and CVL3 customers incur 81.5% of costs, but will pay only 58.8%. ABATE notes that Consumers agreed with the analysis, and proposed to eliminate 50% of the difference between these categories. The ALJ cut this amount in half based upon the Staff's criticisms of ABATE's analysis, which ABATE describes as minimal.

In reply, Consumers points out that, in its reply brief, the company agreed with the Staff's recommendation.

The Commission agrees with Consumers and the Staff, and adopts the recommendation of the ALJ to eliminate 25% of the differential between these rates, with the remainder of the differential to be addressed in the company's next rate case, where each voltage level will be treated as a separate rate group in the COSS.

X.

RATE DESIGN AND TARIFF ISSUES

Consumers' proposed rate design appears in Exhibit A-67; the Staff's appears in Exhibit S-6, Schedule F3. Several minor rate design changes are not in controversy.

Consistent with the mandates of MCL 460.11, the company proposes to phase out all discounted rates, and realign rates to their fully allocated cost of service over the remaining four years of the rate realignment schedule, with the exception of discounts (or extensions) expressly provided for in the statute.

Two demand response pilot programs, the direct load cycling pilot (DLCP) and the critical peak pilot (CPP), are proposed by the company, with voluntary participation. The Staff supports the programs, the ALJ recommended that they be approved, and the Commission concurs.

The company will revise its discounted general educational institution (GEI) rate to meet the requirements of MCL 460.11(4), which provides that rates for educational institutions must be set at the cost of service.

A. Rate Realignment Subsidy

The parties offered different calculations of the realignment subsidy ($73 million for Consumers, $93 million for the Staff). MCL 460.11 limits the rate impact on residential customers from rate realignment to no more than 2.5% per year. The statute also requires that this rate impact be determined using the 50/25/25 cost allocation method. The ALJ found that Consumers failed to use this method in determining the residential rate impact in its COSS, and instead relied on the Commission's determination of the amount of the subsidy in Case No. U-15245. PFD, p. 193. Thus, the ALJ found that Consumers was unable to show that its proposed residential rates were under the 2.5% limit. The ALJ found that the Staff's COSS contained residential rates that met the rate impact limitation, and recommends adoption of the Staff's rate design.

Consumers argues that the ALJ's findings are in error. Consumers contends that the Staff has inflated its new subsidy determination by $20 million by producing a revised COSS and then proposing a rate design that reduces the subsidy by $20 million. Consumers contends that it makes sense to, instead, begin with the original amount of $73 million. Consumers argues that only the Commission can determine the amount of the subsidy in a final order; it is not determined by a COSS. The company posits that it has offered the only plan that will result in total rate realignment in the required time, and that the Staff's approach means that subsidies may never be phased out.

In reply, Energy Michigan notes that the Commission's previous finding of a $73 million subsidy amount occurred before the implementation of the required 50/25/25 method. Energy Michigan points out that recalculation of the subsidy using the new method is required by the statute.

The Commission notes that it did not make a finding on the amount of the subsidy in the June 10, 2008 order in Case No. U-15245, nor did it adopt a percentage reduction for any particular subsidy amount. Rather, the Commission ordered Consumers to reduce the subsidy by $19.9 million by raising residential rates by 1.5 mills, thus making a start on rate realignment.

The Commission agrees with the ALJ and finds that the Staff's COSS and rate design, using the 12CP 50/25/25 method, should be adopted for use in this case, as modified by the findings of this order. The Staff's finding on the size of the subsidy is not inflated; rather, as Energy Michigan points out, the statute requires that the amount of the subsidy be determined using the 50/25/25 method, and thus the subsidy had to be recalculated, and will have to be recalculated in every rate case until it is eliminated. Consumers is directed to file calculations of realigned rates by 12:00 p.m. on November 5, 2009, simultaneous with the filing of conforming tariff sheets. The Commission intends to issue a follow-up order no later than November 13, 2009, adopting realigned rates and tariffs. The realigned rates shall be calculated to achieve complete realignment by October 6, 2013.

B. Metal Melting Subsidy

Consumers and the Staff agreed that the credit established for qualifying furnace or metal melting customers who were moved into general service rates must be phased out, and that, consistent with MCL 460.11, cost-based rates for this class must be phased in over at least nine years.

C. Municipal Rates

In Case No. U-15245, the Commission eliminated municipal pumping service rates in an effort to shift all customers toward cost of service based rates. Municipalities were rolled in to the same rate classes as C&I customers. The Commission also adopted a temporary municipal pumping credit to alleviate customer rate shock.

1. Municipal pumping service credit

In the immediate case, Consumers proposed to reduce the pumping credit by 20%, with a complete phase out within the remaining four years of the rate realignment period. With one modification, the Staff recommended that the Commission adopt Consumers' proposal. The Staff recommends that the pumping credit only be assessed to full-service customers within each applicable general municipal service provision rate schedule during the five-year phase out period, rather than to all customers (including ROA customers), as proposed by Consumers.

The ALJ recommended adopting Consumers' and the Staff's proposal of reducing and phasing-out the municipal pumping credit.

In its exceptions, the Municipal Coalition requests that the Commission reject the ALJ's recommendation. The Municipal Coalition requests that the Commission continue the municipal pumping credit established in Case No. U-15245. The Municipal Coalition disputes Consumers' claim that the pumping credit creates a subsidy; the pumping credit does not result in rates below the cost of service. The Municipal Coalition claims that phasing out the pumping credit would cause the municipal pumping class to pay a greater share of the cost of service and rate of return (ROR) than it was paying under the current rates. In addition, the Municipal Coalition contends that reducing and phasing out the pumping credit will impose a substantial rate shock on municipal pumping customers.

In its reply to exceptions, Consumers states that the purpose of the pumping credit was to alleviate rate shock and provide a more gradual rate increase for customers. Consumers claims that the Municipal Coalition's witness, Nicholas Phillips, Jr., made a substantial mistake when he testified that municipal pumping customers are not paying less than their cost of service. According to Consumers, Mr. Phillips used the actual jurisdictional ROR in his analysis, which is not equivalent to the Commission authorized ROR from Consumers' previous rate case. Using the Commission's defined ROR from the previous rate case, Consumers states that the revenues produced by rates charged to the municipal pumping customers, viewed as a separate class, are deficient and would not cover the allocated revenue requirements.

In its reply to exceptions, the Municipal Coalition again requests that the Commission reject the PFD's recommendation, maintain the pumping credit, and recognize that the only evidence on the record for the test year indicates that the municipal pumping credit does not create a subsidy for municipalities.

The Commission is persuaded that Consumers' and the Staff's proposal to reduce the municipal pumping credit by 20% for the first year and automatically for the next four years is reasonable. Section 11 of Act 286 requires that, within five years of the effective date of the Act, the Commission shall phase-in cost of service rates for each electric customer class. There is no exception for municipalities or municipal pumping customers.

In addition, the Commission adopts the Staff's suggestion that the pumping credit shall only be assessed to full-service customers within each applicable C&I rate during the four year phase-out period. This is consistent with other Commission orders regarding allocation of the credit.

2. Municipalities as a separate rate class

The Municipal Coalition asserted that municipalities should not be rolled in to the same rate class as C&I customers because governmental regulations, load, demand, and legal obligations differ greatly between the classes. The Municipal Coalition disagrees with mixing all of the municipal rates with other classes because municipalities cannot track whether they are subsidizing other customers or being subsidized. However, the Municipal Coalition opposes the creation of a separate class for just municipal pumping customers. The Municipal Coalition proposed that all municipal rates for all municipal uses be treated as a separate class of service, including lighting, administrative offices, maintenance and operations facilities, water pumping, water treatment, and waste water pumping and treating.

Additionally, the Municipal Coalition requested from Consumers a 2009 test year cost study for the municipal class. Although the Municipal Coalition did eventually receive the requested information, it claims it did not receive the information in a timely manner.

The Staff opposed creating a separate rate class for municipalities.

Relying on Case No. U-15245, the ALJ rejected the proposal to create a new rate class for municipal pumping customers. The ALJ found no clear evidence that the energy consumption characteristics for municipalities as a whole are clearly distinct from the characteristics of the rate classes from which they take service. The ALJ noted that the Municipal Coalition acknowledged that there is not enough evidence on the record to establish municipal class rates in this proceeding. PFD, p. 204.

In its exceptions, the Municipal Coalition claims that the ALJ ignored clear evidence that municipal pumping customers have different governmental regulations, load, demand, and legal obligations than industrial and commercial customers. The Municipal Coalition states that adding such a rate class would not require any revamping of the current rate structure; it only requires placing all municipal uses into one separate rate class. In addition, the Municipal Coalition asserts that the ALJ failed to consider whether there is any basis to exclude a municipal class on cost of service principles.

In reply, Consumers states that the Municipal Coalition has not presented sufficient evidence to persuade the Commission to reverse its decision in Case No. U-15245. Consumers reiterates that, should the Commission decide to create a separate class for municipalities, revenues would not cover the revenue requirements allocated to that class. Consumers acknowledges that it did not have the 2009 test year cost study for the municipal class when it was first requested, but did eventually provide it.

In its reply to exceptions, the Municipal Coalition again requests that the Commission reject the PFD's recommendation, establish all municipal uses as a separate rate class, and require Consumers to create such a rate class in future rate cases.

The Commission finds no compelling reason to reverse the decision it made in Case No. U-15245. The Commission finds that the Municipal Coalition did not demonstrate that the energy consumption characteristics for municipalities as a whole are clearly distinct from the characteristics of the rate classes from which they take service. The municipalities have similar enough characteristics to C&I customers to include them in the same rate classes.

D. Rate GU

Consistent with the requirement to phase out discounts, the ALJ found that the Commission should continue with the effort to realign rates under Rate GU, general unmetered service, by 20% per year.

MCTA describes the cable industry as in severe economic distress. MCTA members take unmetered service under this rate, and, in their exceptions, argue that the 19.8% rate increase reflected in Consumers' rate realignment proposal is the largest increase in any proposed rate, and fails to reflect the principle of gradualism. MCTA argues that, in order to avoid rate shock, no more than half of the revenue deficiency attributed to Rate GU should be reflected in the rate increase. MCTA argues that the ALJ erred in deciding that Rate GU must be realigned, because Rate GU is not a misaligned rate.

In reply, Consumers argues that Rate GU does not create a separate class, but is part of the lighting and unmetered class, which is subject to rate realignment like all other classes.

Consumers avers that if this rate is phased in more gradually, the company will not make the five-year deadline. Consumers contends that MCTA is proposing to rewrite the statute.

Rate GU is indeed part of the lighting and unmetered class and, as such, subject to rate realignment. A rate increase that does not keep pace with rate realignment will simply result in a much larger increase in the next rate case. The Commission finds that Rate GU should be realigned in the same way that the other rates within its class are realigned. The statute is clear about the timeline for realignment, and about the few exceptions that exist. Rate GU does not fit among any of the exceptions.

E. ROA Customers

Consistent with the Commission’s June 10, 2008 order in Case No. U-15245, the ALJ recommended rejecting Consumers’ proposal to collect skewing-related subsidies from ROA customers. Consumers excepts to this finding, arguing that there should be parity in distribution rates between ROA and full service customers, especially since full service customers are required to contribute to stranded costs. The Commission finds that Consumers has failed to demonstrate any change in conditions that would warrant a change in the Commission’s view. ROA distribution charges shall continue to be free of the residential realignment subsidy.

F. Rate E-1

Consumers proposed to spread the revenue requirement generated by the Rate E-1 discount to all other customers based on the number of customers in each rate class. The company further proposed that a portion of the discount be collected from PSCR customers because some of the costs the company incurs in providing the discount are power supply costs, and because this will mitigate potential underrecoveries associated with inaccurate sales estimates. The company also proposed that a portion of responsibility for the discount should be assigned to ROA customers.

The Staff proposed to spread the Rate E-1 discount to all customers, including ROA customers, on the basis of energy consumption rather than the number of customers. The Staff argued that this is fair because all customers benefit from the expansion of load associated with Rate E-1.

The ALJ found that “Businesses and residential customers alike benefit from the increased economic activity associated with new business and new employment,” and recommended that the Staff’s proposal for recovery of the Rate E-1 discount be adopted. PFD, p. 199. The ALJ found the Staff’s proposal more equitable, and further found that Consumers’ fear of underrecovery, as reflected in its request to collect some of the discount through the PSCR mechanism, exists with every rate recovery item, thus conferring no justification for recovering this particular discount through the PSCR process.

ABATE takes exception to the ALJ’s recommendation, arguing that the discount should be allocated on the basis of the number of customers. ABATE argues that the economic discount in this rate is designed to promote job growth, and that any benefits flowing to large C&I customers as a result of the discount are unrelated to the level of a residential customer’s energy consumption. ABATE contends that a pure energy allocator raises the rates of industrial customers, which simply contradicts the goal of the discounted rate. ABATE states that moving to an energy based allocator will increase costs to the GPD class by approximately $8 million. ABATE argues that the customer count basis was applied by the Commission in previous orders, and continues to be justified on grounds that the residential class has the most to gain from economic development activity.

Consumers also takes exception to the ALJ’s recommendation, arguing that the Commission should continue the approach that was adopted in Case No. U-15245 of spreading the revenue impact of the Rate E-1 discount to all other customers based on the number of customers in each rate class. Consumers contends that the Staff presented no evidence showing that simply because a customer uses more energy, that customer benefits more from the creation of the Rate E-1 discount. Consumers also favors collection of part of the discount through the PSCR mechanism, stating that it would support collection through base rates only if an annual tracking mechanism were also approved, to guard against over or under collections.

Rate E-1 is an economic development rate. The Commission finds that the Rate E-1 discount should not be used to reduce PSCR revenues. Only full service customers pay the PSCR factor, though all customers benefit from economic development. As the ALJ noted, the risk of underrecovery that Consumers describes is inherent in all rates. The Commission is not persuaded that there is a reason to treat this discounted rate differently from other discounted or subsidized rates. The Commission further adopts the ALJ's recommendation to spread the revenue recovery associated with Rate E-1 to all other customers, including ROA customers, on the basis of energy use. The allocation was collected on the basis of customer count in Case No. U-15245. However, this basis for collection puts a greater burden on the residential class. As stated, all customers, including business customers (whether choice or full service), benefit from economic development. Power supply costs are recovered on the basis of use, which the Commission has found many times to be fair and equitable.

Rate E-1 generated a second issue regarding its termination date. Consumers proposed to revise the rate's termination date from November 30, 2015 to October 5, 2013, consistent with the mandates of MCL 460.11. Hemlock (the only customer on Rate E-1) opposed this proposal, arguing that it interferes with contractual rights. Hemlock further argued that, as the only customer taking this rate, it does not constitute a customer "class" as that term is used in the statute.

The ALJ found that any proposal to modify the Rate E-1 termination date is "unnecessary and premature." PFD, p. 206.

Consumers objects to this finding, arguing that Rate E-1 must be moved to cost based rates, under the statutory mandate, just like all other discounted rates that are not exempt. Consumers contends that tariff language cannot take precedence over a statutory requirement, and notes that no legal argument was put forward by any party that would support the proposition that the tariff controls.

In reply, Hemlock argues that the ALJ was correct. Hemlock maintains that it would be poor policy for the state to renege on its commitment to provide Rate E-1 service for the prescribed ten-year period. Hemlock notes that Rate E-1 was adopted in the November 22, 2005 order in Case No. U-14692, for a ten-year term. Hemlock states that it has made significant investments in reliance upon the order and the terms of the tariff. Hemlock contends that there is no support in this record for terminating the rate over two years earlier than prescribed.

Hemlock further argues that there is no evidence to show that as of October 5, 2013, Rate E-1 will not be in compliance with the statute in any case, because future revenues, costs, and statutory requirements are unknown at this time. Hemlock posits that Consumers may well be fully recovering its costs of providing service under this rate at that time. Hemlock avers that, simply because a rate is discounted compared to other rates, does not mean that the rate is not recovering its costs. Hemlock argues that Rate E-1 should not be evaluated from a "fully embedded cost to serve perspective," but rather should be looked at from an incremental cost perspective, since the purpose of the rate is to attract incremental load. Using the Staff's COSS, Hemlock's witness found that Rate E-1 is recovering its incremental cost to serve, and contributes $9.29 per MWh to Consumers' fixed costs. 7 Tr 273. Thus, Hemlock argues, Rate E-1 is not a subsidized rate and not subject to rate realignment. Hemlock further argues that Rate E-1 is a rate schedule and not a customer class; it is part of the primary business class that is currently providing revenues above its cost to serve. Finally, Hemlock points out that the Staff is opposed to the premature termination of Rate E-1. 10 Tr 1271.

A decision on the termination date for this rate will not affect any aspect of this rate case, which is the first rate case subject to the significant time constraints imposed by the new legislation. The Commission declines to revise the rate's termination date at this time.

G. GSG Rate

The general self generation (GSG) service rate is also a discounted rate that is incremental. Consumers proposed, and the ALJ recommended finding, that these costs are production costs that should be allocated to other classes based on the production costs otherwise allocated to each class. The Commission agrees.

Hemlock proposed a change to Rate GSG that would provide greater recognition of customer-supplied equipment. Hemlock argued that it has a separate agreement with Consumers whereby Hemlock compensates the utility for distribution costs associated with building and maintaining certain additional equipment required for providing service to Hemlock, but that Consumers also collects these costs through its tariff, resulting in a double recovery. The ALJ noted that no party took issue with Hemlock's request and recommended its adoption.

Consumers takes exception to this finding, arguing that Hemlock did not provide evidence of any double recovery. Consumers contends that Hemlock's argument ignores the distinction between normal and premium facilities. Consumers states that a customer is required to pay, through a separate agreement, for premium facilities that are dedicated to that customer and benefit no other customer; but this agreement does not preclude charging the customer for its contribution to recovery of normal distribution facilities costs through distribution rates. Consumers points out that the Staff's COSS includes these same costs in its proposed distribution costs.

In reply, Hemlock begins by pointing out that Consumers did not oppose Hemlock's proposal until the exceptions phase of the case. Hemlock filed testimony on this issue on April 27, 2009. Hemlock points out that, if Consumers contested the proposal it should have filed rebuttal testimony on May 18, 2009, thus giving both parties the opportunity to question witnesses regarding the issue during the hearing. Hemlock argues that Consumers seeks to circumvent the contested case process; the proposed tariff amendment was unrebutted.

Hemlock contends that Consumers will overrecover its distribution costs without the proposed amendment. Hemlock again argues that the Rate GSG tariff currently provides no credit for situations where the customer has already separately compensated the company for all incremental distribution costs. In such situations, Hemlock contends, the delivery capacity and distribution charges should not apply. Hemlock contends that under its recent facilities agreements with Consumers, Consumers is compensated for all of its distribution costs through the separate agreement, not just costs associated with premium facilities. Hemlock argues that the proposed amendment would apply in a non-discriminatory fashion "to all similarly situated Rate GSG-2 self-generation customers who receive standby service over separate facilities for which they have already paid pursuant to the terms of a separate facilities agreement." Hemlock's replies to exceptions, p. 32.

The ALJ is correct that no party disputed the proposed tariff amendment. However, the Commission finds that Hemlock has failed to provide record evidence demonstrating the need for the tariff amendment. Hemlock's argument relies entirely on its assertion that the distribution charges at issue are already paid for under the terms of a "separate facilities agreement." Hemlock's replies to exceptions, pp. 23, 26, 27, 28, 29, 30, 32. Yet Hemlock failed to quote the relevant language from such an agreement, or to even put such an agreement into evidence. Exhibit HSC-2 is a contract for electric service entered into by Hemlock and Consumers on January 1, 2006, at the outset of Rate E-1. The Commission assumes that this is not the agreement that Hemlock refers to, because Hemlock never relies on this exhibit for the argument, and further states that the double recovery arises from agreements that are "recent" and "new." Hemlock's replies to exceptions, p. 29. Additionally, even if HSC-2 were the relevant agreement, the entire contract, with the exception of the first paragraph, has been redacted, leaving the Commission unable to determine whether there is relevant language in that contract relating to the double recovery argument. Finally, the Commission finds Hemlock's argument confusing at times, in that Hemlock states that it is now required to compensate Consumers, under recent separate facilities agreements not in evidence, for "all of its distribution costs," whereas the testimony of Hemlock's witness is that Hemlock "compensates Consumers for all incremental distribution cost." Hemlock's replies to exceptions, p. 29; 7 Tr 260.

As Hemlock itself states, Consumers failure to address this issue on the record has left the Commission to resolve it "based on a lesser developed record." Hemlock's replies to exceptions, p. 24. The Commission rejects Hemlock's proposed tariff amendment. The Commission encourages Hemlock, in Consumers' next rate case, to reintroduce the issue supported by exhibits showing the language of the separate facilities agreement(s) that demonstrates the double recovery of certain distribution costs. A separate facilities agreement does not preclude charging the customer for its contribution to recovery of normal distribution facilities costs through distribution rates, unless, of course, the agreement itself makes clear that this charge has already been collected.

H. GP and GPD Rates

Kroger argued that Consumers' rate design proposal shifts $4 million in costs from the general primary (GP) class to the general primary demand (GPD) class. Consumers argued that the shift was necessitated by the need for a clear break-even point between the two rates, in order to reduce the incentive to switch rate categories. The Staff argued that its rate design does not contain this cost shifting. The ALJ accepted the Staff's rate design.

In its exceptions, Kroger argues that "it is not clear what the PFD recommends concerning the resolution of the issue." Kroger's exceptions, p. 5. Kroger reiterates its argument that the shift of costs is inappropriate and inconsistent with the goal of cost based rates. Kroger urges the Commission to direct Consumers to reverse the proposed assignment of these costs to GPD customers, and return them to GP customers.

Consumers also takes exception to the PFD, arguing that when customers migrate between rates because a clear crossing point has not been established, the company cannot collect the authorized revenue requirement that has been established through a sales forecast.

In reply, Consumers again argues that clear crossing points are necessary.

No party appears to dispute the fact that the Staff's proposed rate design does not contain this cost shift. Because the Commission adopts the Staff's rate design, it finds this issue to be moot.

I. ROA Customer Cancellation Period

Consumers proposed several changes to ROA tariff provisions. Of these proposals, only the length of the cancellation period for a residential ROA contract was disputed. Consumers proposed 30 days. The Staff proposed 14 days. Energy Michigan proposed five days. Consumers later supported 14 days.

Based upon the fact that the rescission period in effect for Detroit Edison is 14 days, the ALJ recommended adoption of the Staff's proposal.

Energy Michigan argues that the ALJ erred, and that the Commission should limit the period during which a residential customer can cancel an ROA contract to five days. Energy Michigan contends that 14 days is unnecessary and costly for AESs, as it will allow customers to shop for a better price in a volatile market while the AES is required to hold the offer open. Energy Michigan argues that no party showed that five days is inadequate.

In reply, Consumers points out that, in its rebuttal testimony, the company agreed to the Staff's proposal of 14 days. Consumers notes that its gas customer choice program allows 30 days for rescission.

The Commission notes that there are no residential ROA customers; however, should any materialize, the Commission is convinced that three or five days is not enough time to allow a residential customer to cancel an ROA contract. As with Detroit Edison, the Commission adopts a 14-day cancellation period for residential ROA customers.

J. Low-income and Senior Citizen Customer Rates

MCL 460.11(3) provides:

> Notwithstanding any other provision of this act, the commission may establish eligible low-income customer or eligible senior citizen customer rates. Upon filing of a rate increase request, a utility shall include proposed eligible low-income

> customer and eligible senior citizen customer rates and a method to allocate the revenue shortfall attributed to the implementation of those rates upon all customer classes. As used in this subsection, "eligible low-income customer" and "eligible senior citizen customer" mean those terms as defined in section 10t.

Consumers witness Stubleski testified that MCL 460.11(3) caused the utility to revise its existing Residential Income Assistance (RIA) and Residential Senior Citizen (RSC) provisions, which offer discounts to customers who qualify for these provisions. The RIA credit is $6 per month. The RSC credit is $3 per month. Mr. Stubleski testified as follows:

> The Company has modified the eligibility of its Income Assistance Tariff Provision so that customers who meet the criteria under MCL 460.10t will qualify for the rate provision. Specifically, the income qualification was modified from the current 110% of the Federal poverty level to 150%, and participation was expanded to include customers receiving 1) assistance from a State emergency relief program, 2) food stamps, or 3) Medicaid. The Company is also proposing to open its Senior Provision for the Residential Service Secondary Rate RS and Residential Service Time-Of-Day, which was closed to new customers by Commission order in the Company's previous electric rate case. All customers 65 and older would be eligible for the Senior Provision if approved by the Commission. The Company is proposing to maintain the current level of discounts previously approved by the Commission for these customers.

7 Tr 696.

Mark J. Pung, a Departmental Analyst in the Commission's Rates and Tariffs' Section, supported the company's positions on these issues.

The ALJ noted that no party challenged Consumers' proposed revisions to the RIA and RSC provisions. She also observed that MCL 460.11(3) expressly provided that "the revenue shortfall attributable to the implementation of these discounts be allocated to 'all customer classes,'" and that both Consumers and the Staff had allocated these discounts to all customer classes, including ROA customers. PFD, p. 200.

Given the express statutory guidance and the lack of exceptions, the Commission finds that the revisions to the RIA and RSC provisions proposed by Consumers shall be approved.

K. Summary

The Commission adopts the Staff's rate design proposal as modified by this order. The recommendations of the PFD regarding tariff issues for which no party filed an exception are hereby adopted. Consumers is directed to file conforming tariff sheets by 12:00 p.m. on November 5, 2009.

L. Refund Procedures

As previously noted, this rate case has taken the participants into new regulatory territories. Consumers is the first public utility in Michigan to avail itself of the file-and-use provision in MCL 460.6a(1). On May 14, 2009, Consumers chose to raise its rates by self-implementing a $179 million increase, which equates to an overall 5.5% increase. The rate increase authorized by this order increases Consumers' rates by only $139,411,000, which equates to a 4.25% increase over the rates set by the Commission in Case No. U-15245. Accordingly, Consumers has the distinction of being the first utility to be subject to the following provision of MCL 460.6a(1):

> If a utility implements increased rates or charges under this subsection before the commission issues a final order, that utility shall refund to customers, with interest, any portion of the total revenues collected through application of the equal percentage increase that exceed the total that would have been produced by the rates or charges subsequently ordered by the commission in its final order.

MCL 460.6a(1).

On its face, Consumers is clearly obligated to make a refund in accordance with MCL 460.6a(1). Therefore, the refund required by MCL 460.6a will have to await another day. While the principal amount of the refund will soon be determinable, the refund amount will continue to increase due to interest that will continue to accrue until the refund occurs.

The Legislature has defined the Commission's authority to add interest to the principal refund amount as follows:

> The rate of interest for refunds shall equal 5% plus the London interbank offered rate (LIBOR) for the appropriate time period. For any portion of the refund which, exclusive of interest, exceeds 25% of the annual revenue increase awarded by the commission in its final order, the rate of interest shall be the authorized rate of return on the common stock of the utility during the appropriate period. Any refund or interest awarded under this subsection shall not be included, in whole or in part, in any application for a rate increase by a utility.

MCL 460.6a(1).

The Legislature has also provided the following guidance regarding how refunds to the various customer classes should be accomplished:

> The commission shall allocate any refund required by this section among primary customers based upon their pro rata share of the total revenue collected through the applicable increase, and among secondary and residential customers in a manner to be determined by the commission.

MCL 460.6a(1).

Consumers will need to provide the parties and the Commission with its calculations of (1) the total revenues collected through application of the self-implemented rate increase and (2) the total revenues that would have been produced by the rates and charges ordered by the Commission in its final order. Further, given its responsibility for causing the overcollection, the Commission finds that Consumers should also be directed to propose a refund method**,** gather the interest rate information regarding the LIBOR component of the interest, calculate interest to the midpoint of the proposed refund month, and distribute all such information, calculations, and work papers to the parties.

The Commission is persuaded to allow Consumers until January 6, 2010 to file an application for authority to conduct the refund required by MCL 460.6a(1). The Commission assumes that Consumers will be able to pull together the data necessary to determine refund amounts in two months and determine application of the statutory refund allocation methodology for its primary customers. If two months proves to be insufficient for the company to perform these tasks, then Consumers should file an application for an extension of time.

THEREFORE, IT IS ORDERED that:

A. Based on this order's findings adopting a 2009 test year, a jurisdictional rate base of $6,146,847,000, an authorized rate of return on common equity of 10.7%, an authorized overall rate of return of 6.98%, and a jurisdictional revenue deficiency of $139,411,000, Consumers Energy Company is authorized to implement rates that increase its annual electric revenues by $139,411,000 as directed by this order.

B. Due to the utility's self-implementation of a rate increase on May 14, 2009, Consumers Energy Company's current rates for the sale and distribution of electric power are too high and shall be reduced **by** $39,589,000 on an annual basis as directed by this order.

C. Consumers Energy Company's power supply cost recovery base is reset to 48.66 mills per kilowatt-hour at generation.

D. Consumers Energy Company shall present a proposal to establish a trust for pre-1983 DOE liability in the company's next rate case if filed on or before January 3, 2011. Otherwise, the company shall file the proposal to establish a trust for its pre-1983 DOE liability in a new docket on January 4, 2011.

E. Consumers Energy Company is authorized to adopt a pilot decoupling mechanism as described in this order.

F. Consumers Energy Company is authorized to adopt an uncollectibles expense tracker mechanism in which Consumers shall collect from, or refund to, its customers eighty percent of the difference between its actual uncollectibles expense for the calendar year and the base level of uncollectibles expense contained within the company's rates through a temporary surcharge or credit over the subsequent 12-month period.

G. Consumers Energy Company shall terminate the Electric Choice Incentive Mechanism as of November 30, 2009, and a reconciliation of the final period as established in Case No. U-15245 shall be filed by Consumers Energy Company in the manner set forth in the order.

H. Consumers Energy Company shall redesign rates using the Commission Staff's cost of service study, as rerun by the Commission Staff, and the Commission Staff's rate design, reflecting changes resulting from this order. The redesigned rates shall include surcharges and credits for future phases that shall be calculated to achieve rate re-alignment by October 6, 2013.

I. Consumers Energy Company shall file redesigned and realigned rates and tariff sheets, along with calculations and workpapers, conforming to the Commission's findings in this order, by 12:00 p.m. on November 5, 2009, and shall serve copies on all parties to this proceeding on that date. Parties to this case may file comments on the filed rates and tariff sheets by 12:00 p.m. on November 9, 2009.

J. Consumers Energy Company shall revise its Residential Income Assistance Provision in accordance with MCL 460.11(3) and the company's Residential Income Assistance credit shall remain at $6 per month.

K. Consumers Energy Company shall revise its Residential Senior Citizen Provision in accordance with MCL 460.11(3) and the company's Residential Senior Citizen credit shall remain at $3 per month.

L. Consumers Energy Company shall file an application for authority to conduct the refund required by MCL 460.6a(1) by January 6, 2010.

M. Consumers Energy Company's requests regarding Michigan Business Tax accounting are approved.

N. Approval of expense levels for forestry activities is conditioned upon Consumers Energy Company's compliance with the requirements of this order. To that end, Consumers Energy Company shall submit a letter, signed by the Chairman and the Chief Executive Officer of the utility on behalf of the company, which agrees to make the forecasted forestry expenditures or to refund any unexpended amounts to its customers. The letter shall also contain a waiver of Consumers Energy Company's right to object to the refund provisions on grounds of retroactive ratemaking and an agreement to submit annual tracking reports regarding forestry and line clearing activities as directed by this order.

O. If a 12-month reconciliation period for any tracker or decoupling mechanism includes a period of time during which the utility has self-implemented rates in accordance with MCL 460.6a(1), then the actual value being tracked during the self-implementation period shall be reconciled with the established sales level or expense as in the final order in the utility's most recent rate case approved by the Commission.

P. Within 90 days of the date of issuance of this order, Consumers Energy Company shall file a report in this docket on utility worker training needs and costs. The report shall also contain a complete briefing regarding the establishment of a Taft-Hartley Trust.

Q. Within 15 days of the date of issuance of this order, Consumers Energy Company shall file in this docket and in the docket in Case No. U-14992, a final reconciliation of the $255 million Palisades Nuclear Power plant refund. Consumers Energy Company shall file tariff sheets reflecting the negative surcharge for all customer classes, except Rate E-1, for refunding the remaining $72.96 million of Palisades monies within 15 days of the date of this order.

Implementation of the negative surcharge shall begin with the first billing cycle that begins 30 days after the date that the tariff sheets are approved. Consumers Energy Company shall file a final reconciliation of the $36.04 million refund directed by the Commission on May 13, 2009 at the same time the company files the reconciliation of its self-implemented rate increase.

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, under MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

Orjiakor N. Isiogu, Chairman

Monica Martinez, Commissioner

Steven A. Transeth, Commissioner

By its action of November 2, 2009.

Mary Jo Kunkle, Executive Secretary