

I. DESCRIPTION OF THE FILING

On October 30, 2006, METC and Midwest ISO filed proposed changes to Attachment O – METC of the Midwest ISO Open Access Transmission and Energy Market Tariff (“Tariff”).¹ Currently, METC’s rates under the Attachment O – METC formula are adjusted every June 1 to reflect changes in the company’s revenue requirement for the prior year as reported in METC’s FERC Form 1. *See* October 30 Filing at 2. Here, METC proposes to implement changes that would allow it to recover its transmission investment and associated costs based on estimated current year costs, subject to true-up. *Id.* Further, METC’s rates would be adjusted annually on January 1, rather than June 1 under the instant proposal. *Id.* at 4. To transition to this new framework, METC proposes to continue its existing rates, which are based on 2005 actual costs, through December 31, 2007, subject to true-up of actual 2007 expenses. *Id.* On January 1, 2008 and each year thereafter, rates would be based on the projected expenses for that year. *Id.* at 4-5. True-up amounts and accrued interest would be included in rates beginning in 2009. *Id.*; *see also* Proposed Original Sheet No. 1365Z.16B. METC would not charge rates based on its revenue requirement for 2006. *See* October 30 Filing at 4.

METC states that for 2008 and subsequent years, it will provide an estimate of its net revenue requirement by September 1 of the previous year. *Id.* at 5. This estimate will reflect a forecast of the average of the 13 monthly plant balances for the following year based on projections of the dates when plant is expected to be retired or new plant is expected to be placed in service. *See id.* at 5, n.10.

¹ Midwest ISO indicates that it takes no position on the substance of the filing, but simply joins METC in the filing to amend the Tariff in its capacity as administrator of the Tariff. *See* October 30 Filing at 1, n.1.

METC contends that modifying its formula rate to utilize estimated current costs rather than historical Form 1 data will eliminate the “lag in reflecting its actual expenditures for and investments in its transmission facilities.” *Id.* at 2. This change, METC asserts, will allow it “to continue to rebuild and strengthen the transmission grid in the lower peninsula of Michigan,” (*id.*), and will “more accurately match cost recovery with cost incurrence.” *Id.*

II. NOTICE OF INTERVENTION

The MPSC is an agency of the State of Michigan, created by 1939 Pub. Acts 3, Mich. Comp. Laws Ann. § 460.1 *et seq.* As the Michigan regulatory agency having jurisdiction and authority to control and regulate rates, charges, and conditions of service for the retail sale of electricity in the State, the MPSC is a “state commission” as defined in 16 U.S.C. § 796(15) and 18 C.F.R. § 1.101(k) (2006). Accordingly, the MPSC hereby provides its notice of intervention pursuant to 18 C.F.R. § 385.214(a)(2) (2006).

Copies of all pleadings and correspondence in the proceeding should be addressed to:

Michael A. Cox
Attorney General
David A. Voges (P25143)
Steven D. Hughey (P32203)
Patricia S. Barone (P29560)
Dept. of Attorney General
Public Service Division
6545 Mercantile Way, Suite 15
Lansing, MI 48911
(517) 241-6680
vogesd@michigan.gov
hugheys@michigan.gov
baronep@michigan.gov

David D'Alessandro
John E. McCaffrey
Stinson Morrison Hecker LLP
1150 18th Street, N.W.
Suite 800
Washington, DC 20036-3816
(202) 785-9100 (phone)
(202) 785-9163 (fax)
ddalessandro@stinsonmoheck.com
jmccaffrey@stinsonmoheck.com

III. PROTEST

A. METC Does Not Adequately Explain The Process It Will Use To Comply With The Limitations On Recovery Of Merger-Related Costs Imposed By The Commission In Docket No. EC06-123-000

In its September 21, 2006 order approving the acquisition of METC by ITC Holdings Corp., the Commission imposed a “hold harmless” requirement on METC and International Transmission Company, LLC (“ITC”), requiring them to insulate customers from any adverse effect on rates as a result of the merger (“Hold Harmless Condition”). *ITC Holdings Corp.*, 116 FERC ¶ 61,271 at P 48 (2006). To ensure compliance with the condition, the Commission imposed the following obligation on METC and ITC:

If Applicants seek to recover merger-related costs through their transmission rates, they must submit an informational filing to the Commission that details how they are satisfying the hold harmless requirement. In particular, in such a filing, Applicants must: (1) specifically identify the merger-related costs they are seeking to recover, and (2) demonstrate that those costs are exceeded by the savings produced by the merger.

Id.; *see also id.* at Ordering Paragraph (G). The Commission indicated that the required informational filing was intended to afford interested parties “the opportunity to scrutinize costs before they are included in the formula rate.” *Id.* at P 48.²

METC’s October 30 Filing does not explain the process METC will use to satisfy the Hold Harmless Condition in the context of an Attachment O formula rate based on forward-looking projections. METC’s only reference to the Hold Harmless Condition in the October 30 Filing is made in connection with its observation that, since METC does not propose to collect rates based on 2006 costs, its rates “will not reflect any 2006 merger-related costs.” October 30 Filing at 4. The fact that it will not use 2006 costs to

² METC accepted the Hold Harmless Condition. *See ITC Holdings Corp.*, Docket No. EC06-123-000, “Filing Accepting Conditions” (September 25, 2006).

set rates, METC asserts, will “help ensure compliance with the Commission’s directive . . . that merger-related costs not be reflected in rates.” *Id.*

METC’s October 30 Filing says nothing, however, about the process that will be used to ensure that post-2006 merger costs are not passed through the Attachment O formula rate. In this regard, it is quite possible that merger-related costs will persist after 2006, as new merger implementation costs are incurred or merger-related expenses are amortized over time. METC’s observation that 2006 merger-related costs will not be reflected in rates does not ensure compliance with the Hold Harmless Condition for subsequent periods.

The MPSC’s concerns about METC’s failure to explain the process for complying with the Hold Harmless Condition were heightened by recent comments from METC’s President and CEO Joseph L. Welch (METC’s witness in the instant docket) in which he suggested that the use of projections in METC’s Attachment O will diminish the need for METC to justify recovery of merger-related costs in accordance with the Hold Harmless Condition. On a November 2, 2006 ITC Holdings investor teleconference, Mr. Welch stated:

One of the nice outgrowths of this process by us going to forward-looking Attachment O – and hopefully having that implemented by the first of January, 2007 – one of the conditions that FERC had given us is that we could not recover any merger-related costs without doing the cost-benefit showing to customers. If we go to forward-looking Attachment O for METC, and FERC grants us our request, that takes us out of the proposition of having to make a lot of filings before FERC to cost justify all those merger-related costs. They’ll just not be part of that future showing, and so that would be a really good thing, so it’ll take us out of the litigation route.³

³ ITC Holdings has not yet published a transcript of the November 2 conference call. The quotation above is based on a review by MPSC Staff and counsel of an archived webcast of the November 2 call posted on

In response to a follow-up question regarding recovery of merger-related costs, Mr. Welch stated further:

There's no definition of what's a merger-related cost. If you look into all the guidance that you would get, there's no dictionary, if you will, that says merger-related costs are all of these. So, beauty is in the eye of the beholder as to what is a merger-related cost, and intervenors get very aggressive, if you will, on defining it. So we actually believe that everything that would ever be defined as a merger-related cost, we should be able to recover because there were also very large synergies that took place with this order. And so – FERC said we had to show the cost benefit – so once you start down that path as to what you're gonna start to lay out, we look at it as being possibly everything that is even associated with this transaction, so it means that you would be in there having a showing on everything that took place. And so, because the synergies are greater than that and the forward-looking Attachment O actually starts to give customers the benefit of those synergies day-one, we look at this as being a much more preferred route than trying to have a – getting a judgment on each and every one of those line items.⁴

Mr. Welch's comments imply that ITC Holdings is concerned about intervenor challenges to METC's recovery of merger-related costs, and that ITC Holdings believes that use of the forward-looking Attachment O requested in the instant case will ease recovery of such costs. It is not clear to the MPSC, however, why use of projections instead of historical Form 1 data in setting the Attachment O rate should materially affect METC's obligations under the Hold Harmless Condition. Regardless of whether the test year reflects historical costs or current projections, METC must justify recovery of any merger-related costs by submitting a filing that, at a minimum, specifically identifies the merger-related costs, and demonstrates that those costs are exceeded by merger savings.

Given the absence of any explanation in the October 30 Filing about the process METC intends to use to comply with the Hold Harmless Condition, and in view of Mr.

ITC Holdings' website. The webcast is available at <http://investor.itc-holdings.com/events.cfm>. The above quotation begins at 26:17 on the call.

⁴ See footnote 3, *supra*. This quotation begins at 28:14 on the November 2 conference call.

Welch's apparent belief that METC's "forward-looking" Attachment O proposal will diminish METC's burden under the Hold Harmless Condition, if the Commission otherwise accepts METC's proposal in this case, it should require METC to provide further information regarding the process it will use to comply with the Hold Harmless Condition.

B. The Commission Should Specify That The Information Sharing Procedures Proposed By METC Include the MPSC And Should Require METC To Provide Certain Detailed Information

Under its proposed tariff modifications, METC would be required each year to determine its projected net revenue requirement and load by September 1 for use in the formula rate in the following year. *See* October 30 Filing, Attachment 2, Proposed Original Sheet No. 1365Z.16A. METC would be obligated to "make available to customers its projected net revenue requirement, load, and resultant rates incorporating a True-up Adjustment including all inputs in sufficient detail to identify the components of METC's net revenue requirement." *Id.* In this connection, METC would hold a customer meeting by October 30 each year "to explain the formula rate input projections and cost detail" for the following year. *Id.*

As a threshold matter, the MPSC objects to the proposed information-sharing provisions to the extent that they apply only to *customers*. Proposed Original Sheet No. 1365Z.16A only requires METC to make information available to "customers." Likewise, the tariff would require METC to hold an annual "customer meeting" to explain the formula rate inputs and cost detail. Although the MPSC presumes that these provisions were not drafted with the intent of excluding the MPSC, by their terms they provide only for information sharing with METC customers. If the Commission otherwise accepts METC's proposed tariff changes, it should require that METC specify

in the tariff that the relevant information would also be available to state regulators such as the MPSC, and that state regulators would be explicitly entitled to attend and participate in the annual meeting.

Further, if the Commission otherwise accepts METC's tariff amendments, it should require METC to provide information regarding ongoing and projected construction expenditures as part of the information sharing procedures included in the revised tariff. Generally speaking, the move to forward-looking rates creates an additional need for information by customers and regulators to ensure that METC's projected rates and the underlying assumptions and inputs are accurate and reasonable. For example, customers or state regulators need information on construction schedules for new transmission projects that are not yet in service but are included in the forecasted rate base. The Commission should require METC, as part of its annual informational sharing process, to identify, for each ongoing or planned construction project: (1) the projected cost of the project in forecasted rate base; (2) the expected construction schedule and/or in-service date for the project, and the date that the project is included in the projected monthly transmission plant balance; and (3) a description of the need for each project. This would allow for a more informed review of transmission construction costs and the associated rate impacts as well as the prudence of particular investments.

Finally, MPSC notes that the issue of the scope of the information that METC should be required to provide in connection with its annual adjustment of the Attachment O rate is currently pending in Docket No. ER06-56-002.⁵ In particular, Consumers

⁵ See *Michigan Electric Transmission Co., LLC*, Docket No. ER06-56-002, "Prepared Direct and Answering Testimony of Steven L. Gaarde on Behalf of Consumers Energy Company," Exh. CEC-1 at 15-17 (April 21, 2006); "Prepared Direct and Answering Testimony of Kenneth A. Sosnick Witness for the Staff of the Federal Energy Regulatory Commission," Exh. S-14 at 5-8 (September 15, 2006); "Prepared

Energy Company (“Consumers”) has argued that METC should be required to provide certain information regarding annual construction expenditures, particularly projects that are not included in the Midwest ISO Transmission Expansion Plan (“MTEP”). Consumers’ view is that such information is necessary to allow for an assessment of the prudence of METC’s construction expenditures. As described above, the MPSC agrees that customers and regulators need to have access to information sufficient to allow them to assess whether expenses have been prudently incurred. METC has taken the position in Docket No. ER06-56-002, however, that the information sharing procedures proposed in the instant docket are a basis to reject Consumers’ position in Docket No. ER06-56-002.⁶ As discussed above, the MPSC disagrees that the instant filing resolves concerns about the scope of information that METC should be required to provide in connection with its Attachment O formula rate. At a minimum, the Commission should specify that any acceptance of METC’s proposal in this case is without prejudice and subject to the outcome of the information sharing and review issues pending in Docket No. ER06-56-002.

Cross-Answering Testimony of Steven L. Gaarde on Behalf of Consumers Energy Company,” Exh. CEC-7 at 2-5 (October 18, 2006); “Prepared Rebuttal Testimony of James H. Drzemiecki,” Exh. MET-17 at 22-24 (November 13, 2006).

⁶ See *Michigan Electric Transmission Co., LLC*, Docket No. ER06-56-002, “Prepared Rebuttal Testimony of James H. Drzemiecki,” Exh. MET-17 at 23-24 (November 13, 2006).

C. The MPSC Objects To The Use Of Current Year Projections In Setting METC's Attachment O Rates For The Same Reasons the MPSC Raised In Docket No. ER06-1006-000

In Docket No. ER06-1006-000, the MPSC raised a number of objections to ITC's use of current year projections in setting its Attachment O formula rate.⁷ The MPSC's objections to ITC's proposal included:

- ITC's proposal to adjust rates annually by projecting costs it expected to incur in the year ahead, coupled with a "true-up" mechanism, left ratepayers with no means of determining whether future test year estimates are accurate and provided ITC with little incentive to contain costs.
- The claims of regulatory lag made by ITC were overstated, and, in any case, such lag was not necessarily longer than under non-formula rates.
- The fact that existing Attachment O rates had been based on actual cost data submitted with the company's FERC Form 1 helped ensure the accuracy of such data, notwithstanding that annual adjustments to Attachment O are not filed with the Commission or otherwise subjected to regulatory review. If forward-looking estimates were used, the MPSC argued, there would be no adequate procedures in place to ensure that ITC's estimates were reasonable.
- The true-up mechanism could create artificial and unnecessary rate volatility.
- American Transmission Company's adoption of forward-looking Attachment O was distinguishable from ITC's proposal insofar as ATC's adoption of a forward-looking Attachment O was the product of a settlement that, among other concessions, included an agreement that ATC would forego any incentive return on equity for its existing facilities.

The MPSC recognizes that the Commission generally rejected these objections in approving the use of forward-looking data in Attachment O for ITC. *See International Transmission Co.*, 116 FERC ¶ 61,036 (2006). The MPSC further recognizes that METC's proposal here is substantially similar to that approved for ITC. The MPSC

⁷ *See International Transmission Co.*, Docket No. ER06-1006-000, "Notice of Intervention and Protest of the Michigan Public Service Commission" (June 7, 2006).

nonetheless reiterates its concerns with the use of forward-looking data subject to true-up under Attachment O, and submits that the Commission should reconsider its endorsement of such an approach.

The MPSC notes in this regard that use of the forward-looking approach is, if anything, even less justified in METC's case. For instance, while Mr. Welch's testimony includes general statements concerning alleged cash flow limitations caused by regulatory lag, METC's cash flow situation appears to be better than ITC's.⁸ Although METC's cash flow in 2005 was still negative, it has not demonstrated that its negative cash flow situation, in terms of the expected duration and degree, warrants a permanent change to forward-looking rates.

Finally, the MPSC submits that a 13.38% return on equity would not be just and reasonable for METC if the Commission were to accept its proposal to use a forward-looking Attachment O. As METC's own testimony indicates, adoption of a forward-looking Attachment O would, at a minimum, mitigate METC's cash flow risk. Accordingly, the Commission should not approve the forward-looking Attachment O for METC without requiring a reduction in allowed ROE in recognition of METC's reduced business risk.

IV. CONCLUSION

As set forth more fully above, the MPSC hereby provides its notice of intervention in this proceeding and protests the October 30 Filing. The Commission should: (1) require METC to provide further information regarding the process it will use

⁸ Compare *Michigan Electric Transmission Co., LLC*, Docket No. ER07-95-000, "Prepared Direct Testimony of Joseph L. Welch, Exh. METC-1 at 6 (October 30, 2006) (METC spent 109% of free cash in 2005) and *International Transmission Co., LLC*, Docket No. ER06-1006-000, "Prepared Direct Testimony of Joseph L. Welch, Exh. ITC-1 at 6 (May 17, 2006) (ITC spent 192% of free cash in 2005).

to comply with the Hold Harmless Condition imposed in Docket No. EC06-123-000; (2) specify that the information sharing procedures proposed by METC include the MPSC, require METC to provide additional information regarding construction expenditures and specify that any acceptance of METC's proposal in the instant docket is without prejudice and subject to the outcome of the information sharing and review issues raised in Docket No. ER06-56-002; and (3) revisit its endorsement of the forward-looking Attachment O based on the objections raised by the MPSC in Docket No. ER06-1006-000, including its refusal to require an adjustment to allowed ROE to reflect the reduced business risk associated with the forward-looking Attachment O framework.

Respectfully submitted,

Michael A. Cox
Attorney General
David A. Voges (P25143)
Steven D. Hughey (P32203)
Patricia S. Barone (P29560)
Dept. of Attorney General
Public Service Division
6545 Mercantile Way, Suite 15
Lansing, MI 48911
(517) 241-6680

/s/ John E. McCaffrey
David D'Alessandro
John E. McCaffrey
Stinson Morrison Hecker LLP
1150 18th Street, N.W.
Suite 800
Washington, DC 20036-3816
(202) 785-9100 (phone)
(202) 785-9163 (fax)

November 20, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary in this proceeding.

Dated at Washington, D.C. this 20th day of November, 2006.

/s/ John E. McCaffrey
John E. McCaffrey