

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of)
CONSUMERS ENERGY COMPANY for authority)
to increase its rates for the distribution of natural)
gas and for other relief.)
_____)

Case No. U-13730

At the December 18, 2003 meeting of the Michigan Public Service Commission in Lansing,
Michigan.

PRESENT: Hon. J. Peter Lark, Chair
Hon. Robert B. Nelson, Commissioner
Hon. Laura Chappelle, Commissioner

OPINION AND ORDER

I.

HISTORY OF PROCEEDINGS

On March 14, 2003, Consumers Energy Company (Consumers) filed an application seeking authority to increase its rates for the transportation, storage, and distribution of natural gas in the annual amount of not less than \$155,997,000 and for other relief. At the same time, Consumers submitted a motion pursuant to MCL 460.6a for partial and immediate rate relief in the annual amount of not less than \$155,997,000, which it proposed to apportion among its customer classes based on a class cost of service study and to collect through use of an interim surcharge. Consumers' rates were last adjusted by the November 7, 2002 order in Case No. U-13000, which granted the utility a \$55.7 million annual increase in its rates.

A prehearing conference was conducted by Administrative Law Judge James N. Rigas (ALJ) April 17, 2003, at which petitions for leave to intervene filed by the Association of Businesses Advocating Tariff Equity (ABATE), Attorney General Michael A. Cox (Attorney General), and the Midland Cogeneration Venture Limited Partnership (MCV) were granted. The Commission Staff (Staff) also participated in the proceedings. The ALJ also established a schedule.

On August 26 and 27, 2003, the ALJ conducted the evidentiary hearing on Consumers' motion for partial and immediate rate relief. At the outset of the hearing, Consumers reduced its interim rate relief request to \$106,766,000. See, 2 Tr. 31, Exhibit A-7, Section B, Schedule A-1 Revised, p. 1. Consumers' stated reason for the reduction was that it sought to limit the issues that need to be addressed in the interim phase of the case so as to expedite review of its request for interim rate relief. During the course of the two-day interim hearing, 20 witnesses testified and 71 exhibits were received into evidence.

On September 16, 2003, briefs were filed by Consumers, the Staff, the Attorney General, and ABATE. In its brief, Consumers indicated another reduction of its request for interim relief to \$86,254,000.

On December 8, 2003, Consumers again reduced the amount of rate relief requested in the interim phase of this proceeding. Consumers' December 8 pleading indicates that the Commission should reduce the previously requested amount of \$86,254,000 by \$19,256,000 for unspecified reasons, and by \$34,000,000 to reflect the revenue effect of a voluntary reduction in the gas depreciation expense used in developing its interim rate request. The combination of these two adjustments lowers Consumers' request for interim rate relief to \$33,000,000.

II.

POSITIONS OF THE PARTIES

Consumers

Consumers presented 18 witnesses and 69 exhibits in support of its motion. For the purposes of interim relief, Consumers relies upon historical 2002 test year data. Consumers states that its interim rate relief request reflects a critical financial need associated with its cash flow situation. According to Consumers, its cash flow projections show cash expenses exceeding cash revenues in both 2003 and 2004 by substantial amounts despite constrained expenditures. Consumers insists that prompt and significant interim rate relief is critical given its current financial condition.

At the August 26-27, 2003 hearing, Consumers' witnesses and exhibits supported a \$106,766,000 interim rate increase. By the time Consumers filed its brief on September 16, 2003, its request for relief had shrunk to \$86,254,000. Consumers' explanation for the sudden \$20,512,000 shrinkage of its interim rate request is that the company decided to accept all but two of the Staff's adjustments to the company's case for interim purposes as illustrated in Appendix A attached to Consumers' brief.

As amended, Consumers' interim case is based on the capital structure and rate of return approved in Case No. U-13000. Consumers proposes an overall rate of return of 7.45% on an after-tax basis. According to Consumers, its interim rate request primarily reflects the difference between operation and maintenance (O&M) expenditure levels used to establish current rates (\$263 million) and the level of those expenses supported by Consumers in this case (\$312 million). Similarly, Consumers stresses that its projected 2004 test year capital expenditure levels are higher than those built into its last rate case. Consumers maintains that the O&M and capital expenditure levels requested are based on what the utility will need to operate the system in the current environment and given the current status of the system. Consumers also contends that its existing

revenues are not sufficient to assure the financial soundness of the utility. Given its significant cash flow problems, Consumers argues that its current financial conditions simply do not reflect normal expenditure levels. Rather, Consumers insists that it has artificially reduced its expenditure levels well below those that are necessary to operate as a well-managed utility should be expected to do. For example, Consumers projects that it will spend over \$10 million in 2003 to comply with provisions of the federal pipeline integrity bill signed into law in December 2002, as well as additional costs in future years, over \$4 million in 2004 to implement a federally-required security plan, and over \$6 million a year to move inside meters to outside locations in accordance with an agreement with the Commission's Gas Safety Section.

In summary, Consumers argues that the evidence establishes that it is experiencing significant negative cash flow from operations currently and that this situation is anticipated to continue during 2004 in the absence of immediate rate relief. Consumers insists that despite undertaking self-help measures, it will be impossible for the company to fully offset its negative cash flow from operations absent rate relief, which will force it to operate at constrained, emergency levels.

Finally, as amended by its December 8 filing, it is Consumers' position that interim relief in the annual amount of \$33 million should be collected by applying the same percentage increase to all classes of customers.

The Staff

The Staff presented one witness and two exhibits in support of its contention that partial and immediate rate relief should be set at \$80,446,000. William J. Celio, Director of the Commission's Energy Operations Division, presented the Staff Report on Consumers' motion for partial and immediate rate relief. Mr. Celio, who sponsored two exhibits, testified that the Staff assessed Consumers' overall financial and operational situation and determined that the utility was in

immediate need of rate relief in the annual amount of \$80,466,000. However, the Staff recommendation is conditioned upon Consumers' voluntary agreement to limit dividend payments to its parent company, CMS Energy Corporation (CMS), to no more than \$190 million annually.

Mr. Celio described the Staff's proposal as a utility cash flow stability plan for Consumers that is intended to maintain the utility's financial health and limit the transfer of the gas rate relief to its financially distressed parent.

The difference between the Staff's calculation of Consumers' revenue deficiency and Consumers' calculation of its revenue deficiency is outlined on Exhibit S-71, page 4 of 6. The Staff made three adjustments to Consumers' projected rate base and six adjustments to the company's projected net operating income (NOI). According to Mr. Celio, the Staff used a "top down" approach to calculate its revenue deficiency. Starting with Consumers' request of \$156 million, the Staff removed many of Consumers' proposed "financial structure" changes, which had the effect of reducing the interim rate request by \$50 million.

The Staff then trimmed another \$8.4 million through several rate base adjustments that were consistent with previous Commission authorized approaches or traditional Staff positions. Adjustments to NOI were then made that reduced the revenue deficiency by \$17.9 million. Again, these adjustments are consistent with previous Commission orders or the Staff's positions in other rate cases.

On December 15, 2003, the Staff responded to Consumers' December 8 filing. According to the Staff, Consumers' proposal to reduce its request for interim rate relief mitigates the effect on customers while providing the company with necessary funds during the pending heating season. Specifically, the Staff states that reliance on Consumers' revised depreciation rates from Case No. U-12999 effectively reduces the requested rate relief by \$34 million. However, the Staff

renews its request that the Commission condition any grant of interim relief to Consumers through use of its voluntary dividend limitation proposal.

ABATE

ABATE presented the testimony of one witness in support of its contention that Consumers' request for interim rate relief should be denied in its entirety. Nicholas Phillips, Jr., a consultant in the field of public utility regulation, described Consumers' request for interim rate relief as unusual with respect to the Commission's past practice. Citing 15 reasons, Mr. Phillips urged the Commission to reject Consumers' request for rate relief. According to him, Consumers' approach in this case represents a marked departure from the approach followed in Case No. U-13000. Mr. Phillips noted that Consumers' request for a rate increase is based on a fully projected 2004 test year, rather than historical data adjusted only for known and measurable changes. Mr. Phillips complained that Consumers' methodology makes it impossible for anyone to audit or verify the basis for the rate increase. Mr. Phillips stated that Consumers' gas utility revenues and NOI increased in prior years, which he attributed to the interim and final rate relief granted to the utility in Case No. U-13000. With regard to the issue of rate design, Mr. Phillips stated that each rate class should have its rates increased by an equal percentage amount. Specifically, he contended that the projected 2004 cost of service study should not be used to set interim rates.

In its brief, ABATE argues that Consumers has not demonstrated a need for interim rate relief. In so doing, ABATE argues that the Commission must recognize that its prior rate increase for Consumers in Case No. U-13000 has simply not had time to produce results and that it would be premature to grant such a sizable rate increase at this time. According to ABATE, there is evidence that even without the effect of the November 7, 2002 order in Case No. U-13000,

Consumers' revenues and NOI significantly increased during 2002, which is the historical test year in this proceeding.

ABATE also argues that the malaise affecting Consumers' electric business and the financial plight of CMS simply do not justify granting Consumers a rate increase for its otherwise healthy gas business. Indeed, ABATE asserts that the Commission should consider what will happen to the interim rate increase dollars. Citing the Staff's concern that Consumers could dividend the enhanced revenues to bail out CMS, ABATE contends that the Commission should avoid granting Consumers a gas rate increase primarily because the utility's parent is encountering financial difficulties. ABATE also stressed that the Commission should withhold rate relief until substantial concerns about the cost of removal issue contained in the utility's long-delayed depreciation case, Case No. U-12999, are resolved.

In its reply to Consumers' December 8 filing, ABATE argues that the filing by Consumers validates ABATE's depreciation case concerns. Moreover, ABATE asserts that the Commission cannot consider Consumers' allegations without an additional hearing. According to ABATE, Consumers' December 8 filing is essentially an admission that its testimony in this case is meaningless.

Attorney General

The Attorney General did not present a witness, but he did file a brief opposing Consumers' request for interim relief. The Attorney General argues that the record does not justify interim relief. With Consumers' gas revenues increasing and the utility earning a 16.3 % return on common equity in March 2003, which is well above the company's authorized rate of return of 11.4%, the Attorney General asserts that Consumers is not entitled to interim rate relief at this time.

The Attorney General maintains that Consumers has not shown that it is unable to arrange financing at reasonable rates or that it has experienced a sudden and distinctive decline in revenues. Rather, the Attorney General contends that the record demonstrates that Consumers' revenues and NOI are increasing. Moreover, the Attorney General also expresses concern over the possibility of excessive depreciation expense due to flawed removal costs in Case No. U-12999.

The Attorney General insists that Consumers' and the Staff's focus on Consumers' cash flow problem is misplaced. According to the Attorney General, a utility's cash flow is not an expense for ratemaking purposes. The Attorney General also attacks the Staff's attempt to restrict Consumers' payment of dividends to CMS. The Attorney General maintains that Consumers has not expressed any interest in the restriction of such dividends. He also stresses that the Commission has no clear authority over Consumers' payment of dividends, which makes enforcement of the condition problematic.

With regard to the December 8 filing, the Attorney General contends that Consumers' filing must be construed as an admission that any rate relief above \$33 million would not be just or reasonable. Further, the Attorney General insists that the December 8 filing adds nothing new to the record. Accordingly, the Attorney General states that the Commission must decide Consumers' interim relief request based on the record and briefs of the parties, as reduced by the December 8 filing.

III.

STANDARDS FOR PARTIAL AND IMMEDIATE RATE RELIEF

The statutory authority for the Commission to grant partial and immediate rate relief is set forth in MCL 460.6a(1), which states in part:

When a finding or order is sought by a gas or electric utility to increase its rates and charges, or to alter, change, or amend any rate or rate schedules, the effect of which will be to increase the cost of services to its customers, notice shall be given within the service area to be affected. The utility shall place in evidence facts relied upon to support the utility's petition or application to increase its rates and charges, or to alter, change, or amend any rate or rate schedules. After first having given notice to the interested parties within the service area to be affected and affording interested parties a reasonable opportunity for a full and complete hearing, the commission, after submission of all proofs by any interested party, may in its discretion and upon written motion by the utility make a finding and enter an order granting partial and immediate rate relief. A finding or order shall not be authorized or approved ex parte, nor until the commission's technical staff has made an investigation and report.

The parties do not contest that the procedural requirements have been met.

The statute does not specify any substantive standards for the granting of a motion for partial and immediate rate relief. Over the years, the Commission has adopted various standards through the issuance of interpretive statements, guidelines, and case-by-case determinations. Having reviewed the Commission's prior statements and considered current circumstances, the Commission concludes that the primary purpose of interim relief is to provide additional revenues on an expedited basis when the utility is experiencing a significant revenue deficiency and the revenue deficiency is likely to be experienced for a prolonged period of time.

Consumers is alleging an immediate need for a revenue increase of \$33 million. It is undisputed that Consumers is about to enter its peak revenue months, which exacerbates the company's potential revenue shortfall if any appropriate rate relief is delayed. It is also well established that the schedule set for the hearing of this case will not permit issuance of a final order until near the end of the heating season. Consequently, the failure to consider interim relief at this time will cause a hardship to the utility due to the loss of revenues that can never be recouped. It is well established that the Commission cannot set a future rate to permit a utility to recover revenue lost during the pendency of a permanent increase request. Michigan Consolidated

Gas Co v Public Service Comm, 389 Mich 624; 209 NW2d 210 (1973), General Telephone Co v Public Service Comm, 341 Mich 620; 67 NW2d 882 (1954), and Michigan Bell Telephone Co v Public Service Comm, 315 Mich 533; 24 NW2d 200 (1946). Therefore, the Commission turns to the issue of whether, in light of all of the evidence, the Commission should exercise its discretion to grant any or all of the interim relief sought by Consumers. However, the Commission finds that it should advise the parties to this proceeding and other interested persons that, in future proceedings, they would be well advised not to rely on the “top down” approach to support their positions in rate case proceedings. Rather, the Commission continues to support the methodology used in the November 7, 2002 order in Case No. U-13000, wherein the Commission favored use of historical test year data adjusted for known and measurable changes.

IV.

DISCUSSION

The Commission finds that the starting point for analyzing Consumers’ request for interim rate relief should be the \$80,466,000 position taken by the Staff in its report to the Commission, not the \$86,254,000 position taken by Consumers in its brief nor the \$33 million amount proposed in Consumers’ December 8 filing. The Commission is well aware of the relationship of the Staff’s number to the position taken by Consumers. The difference between the Staff’s calculation of Consumers’ revenue deficiency and Consumers’ calculation of its revenue deficiency is outlined on Exhibit S-71, p. 4 of 6. The Staff made three downward adjustments totaling \$8,434,000 to Consumers’ projected 2004 working capital amount for accounts receivable financing [\$4,670,000], other post employment benefits liability [\$3,104,000], and manufactured gas plant [\$660,000]. The Staff also made six downward adjustments to Consumers’ adjusted NOI totaling \$17,870,000 for weather normalization [\$5,255,000], elimination of transportation discounts

[\$579,000], company use, lost, and unaccounted for gas (company use) [\$6,665,000], service initiatives [\$1,844,000], executive compensation [\$2,797,000], and manufactured gas plant amortization [\$3,730,000].

Consumers acquiesced in all but two of the Staff's adjustments. According to Consumers, the Staff made an arithmetical error in calculation of its \$6,665,000 company use adjustment. Consumers explains that the Staff inadvertently increased the interim revenue deficiency by \$2,684,000 when it omitted the company's lost and unaccounted for gas volume from the calculation on line 10 of Exhibit S-72, which resulted in an understatement of its expense level.

Consumers also insists that the Staff improperly calculated its adjustment for other post employment benefits liability. According to Consumers, by definition, the basic equation for calculating working capital uses current assets less current liabilities. Consumers contends that the Staff's other post employment benefits liability calculation is flawed because it includes non-current assets and liabilities in addition to current assets and liabilities. It is Consumers' position that Appendix C to its brief shows the correct result when non-current assets and liabilities are excluded from the calculation. Consumers maintains that the Staff's calculation of a negative \$31,591,993 working capital effect should be changed to a positive \$1,305,789, which, when multiplied by the Staff's pre-tax rate of return of 9.82%, indicates that there should be a net increase of \$128,228 in the interim revenue requirement, not the \$3,104,000 decrease proposed by the Staff. Therefore, Consumers maintains that the Staff's downward adjustment should be reversed.

The Commission finds that Consumers' contention that the Staff erred with regard to the arithmetical calculation of its \$6,665,000 company use adjustment has merit and should be adopted, which will result in an upward adjustment of the revenue deficiency of \$2,684,000.

However, the Commission rejects Consumers' argument with regard to the Staff's adjustment for other post employment benefits liability. The premise for Consumers' position is incorrect. The June 11, 1985 order in Case No. U-7350, which addressed the appropriate methodology to be used to determine a working capital allowance in rate cases, indicates that utilities should use the balance sheet method for ratemaking purposes. In so doing, the Commission stated that the balance sheet approach involves an analysis of all of the assets of the utility to determine which are used to provide service and an analysis of all utility liabilities to determine the extent to which assets are funded by capital that is tied to the earnings of the utility. The Commission also noted that the capital funds are acquired at a cost and are identified and used to establish the rate of return. Accordingly, the Commission rejects Consumers' contention that the Staff's adjustment for other post employment benefits liability is flawed.

Next, the Commission considers whether Consumers' proposed other O&M increases are appropriate for inclusion in interim rate relief. Carl L. English, President and Chief Executive Officer of Consumers' Gas Division, testified that its current rates are based on an annual other O&M expense level of \$263 million, whereas his company's request for interim relief is based on an annual other O&M expense level of \$312 million, which is derived entirely by means of test year 2004 projections.

The Commission finds that the \$49 million increase over the amount of other O&M included in Consumers' rates by virtue of the November 7, 2002 order in Case No. U-13000 is excessive for interim purposes. Rather, the Commission finds that the increase in other O&M included for interim purposes should be limited to \$19,190,000, which is derived from the safety-related other O&M expenses, both distribution and transmission and storage related, set forth on Exhibits A-13

and A-47.¹ The distribution-related other O&M involves \$1,585,000 for material condition, \$1,871,000 for corrosion control, \$771,000 for pipeline integrity, \$2,091,000 for damage prevention, \$5,185,000 for operator qualification, \$97,000 for metering technology, \$511,000 for gas leak response, and \$1,669,000 for security. The gas transmission and gas storage other O&M costs include \$2,161,000 for gas compression, \$1,359,000 for gas storage, and \$1,890,000 for measurement, regulation, and pipeline costs. Consumers has established, for interim purposes, that these safety-related expenses are necessary to assure reliable service to its customers.

Finally, the Commission turns to the issue of whether it should give any credence to Consumers' December 8 filing. ABATE opposes use of any of the information contained in that filing. However, the other three active parties to this proceeding support the Commission's right to use the information for the purposes of determining interim relief.

The Commission agrees with Consumers, the Staff, and the Attorney General that, to the extent that the December 8 filing constitutes an admission by Consumers of its need for less interim rate relief, it should be considered. Toward this end, the Commission finds that the entirely unexplained \$19.3 million adjustment must be rejected. Consumers made no effort to explain the basis for this adjustment or to tie it to the record. Therefore, the Commission is in no position to determine whether or not the sizable other O&M adjustment adopted by this order covers the same adjustment proposed by Consumers. However, the Commission finds that the \$34,000,000 depreciation expense adjustment proposed by Consumers should be adopted.

¹The Commission notes that the amount of other O&M included in this order is slightly more than the amount of other O&M currently included in Consumers' rates by virtue of the November 7, 2002 order in Case No. U-13000 escalated at a rate of 3% compounded on an annual basis.

Summary

The calculation of the revisions adopted by this order is set forth in the following table:

1. Staff's proposed interim rate relief.	\$80,466,000
2. Addition for company use.	\$2,684,000
3. Subtotal of 1 plus 2.	\$83,150,000
4. Consumers' depreciation reduction.	\$34,000,000
5. Subtotal of 3 minus 4.	\$49,150,000
6. Other O&M reduction.	\$29,810,000
7. Interim rate relief equals line 5 minus line 6. (subject to dividend limitation condition)	\$19,340,000

Dividend Limitation

The Staff proposed that interim relief for Consumers should be conditioned on Consumers' voluntary agreement to accept a limitation on the ability of Consumers to send dividends in excess of \$190,000,000 annually to CMS.

Consumers maintains that the dividend limitation is a poor policy decision. According to Consumers, restricting the dividend will inhibit needed equity investment in the utility by CMS. Consumers reasons that any restriction on the amount of money that Consumers sends to CMS will adversely affect the amount of equity that CMS will be able to infuse into the utility to help restore its capital structure. Moreover, Consumers asserts that the dividend limitation will not set well with investors and could negatively affect Consumers' ability to borrow money.

Finally, Consumers contends that if the Commission adopts a dividend limitation, the limitation should be restricted to the time period during which interim rate relief remains in effect.

The Commission finds that the dividend limitation proposed by the Staff should be adopted and should remain in effect so long as Consumers is receiving interim relief.² The Commission

²The Commission agrees that the issue of whether the dividend restriction should continue after issuance of a final order is not ripe at this time.

notes that other regulatory agencies have placed similar restrictions on the companies they regulate. For example, in 6690-UR-113, decided June 2, 2002, the Wisconsin Public Service Commission (WPSC) required Wisconsin Public Service Corporation not to pay a dividend greater than 109% of the prior year's dividend without WPSC approval.

The Commission notes that the testimony of Consumers' witnesses references the continued financial plight of CMS. To the extent that the dividend limitation prevents Consumers from sending rate relief to its parent, the Commission concludes that the limitation is appropriate and should be adopted.

Rate Design

The Commission finds based on concurrence of the parties, that Consumers' interim rate relief should be implemented through use of an equal percentage increase by rate class as illustrated in Exhibit S-71.

The Commission FINDS that:

- a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCL 462.2 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1999 AC, R 460.17101 et seq.
- b. There is a substantial probability that Consumers is experiencing a revenue deficiency of \$19,340,000 on an annual basis.
- c. An award of partial and immediate rate relief in the annual amount of \$19,340,000 is warranted, subject to the dividend limitation adopted by this order.

d. The partial and immediate rate relief increase should be implemented through use of an equal percentage increase by rate class.

e. Consumers should be required to file with the Commission a bond suitable to ensure that appropriate refunds will be made to its customers in the event that the final rate order in this proceeding provides for an annual rate increase of less than \$19,340,000.

THEREFORE, IT IS ORDERED that:

A. Consumers Energy Company is authorized to increase its annual gas revenues by \$19,340,000 and to place into effect the interim surcharges that are attached to this order as Exhibit A for service rendered on and after the day following the submission of a letter signed by Kenneth Whipple, Chairman and Chief Executive Officer of CMS Energy Corporation and Consumers Energy Company, to the Commission's Executive Secretary agreeing to the dividend limitation adopted by this order.

B. Consumers Energy Company shall file with the Commission a bond suitable to ensure that appropriate refunds will be made to its customers in the event that the final rate order in this proceeding provides for an annual rate increase of less than \$19,340,000.

C. Within 30 days, Consumers Energy Company shall file revised rate schedules reflecting the rates approved in this order and set forth on Exhibit A.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ J. Peter Lark
Chair

(S E A L)

/s/ Robert B. Nelson
Commissioner

/s/ Laura Chappelle
Commissioner

By its action of December 18, 2003.

/s/ Mary Jo Kunkle
Its Executive Secretary

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

Chair

Commissioner

Commissioner

By its action of December 18, 2003.

Its Executive Secretary

In the matter of the application of)
CONSUMERS ENERGY COMPANY for authority)
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_____)

Case No. U-13730

Suggested Minute:

“Adopt and issue order dated December 18, 2003 granting, in part,
Consumers Energy Company’s motion for partial and immediate rate relief
in the annual amount of \$19,340,000 as set forth in the order.”