

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter, on the Commission's own motion,)	
to establish appropriate accounting and ratemaking)	
treatment for STATEMENT OF FINANCIAL)	Case No. U-14292
ACCOUNTING STANDARDS NO. 143.)	
_____)	

In the matter, on the Commission's own motion,)	
to commence a rulemaking proceeding to amend the)	
uniform system of accounts for major and non-major)	Case No. U-14811
electric utilities, R 460.9001 and R 460.9019.)	
_____)	

In the matter, on the Commission's own motion,)	
to commence a rulemaking proceeding to amend the)	
uniform system of accounts for major and non-major)	Case No. U-14812
gas utilities, R 460.9021 and R 460.9039.)	
_____)	

At the June 26, 2007 meeting of the Michigan Public Service Commission in Lansing, Michigan.

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

OPINION AND ORDER

History of Proceedings

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 143, Accounting for Asset Retirement Obligations

(AROs).¹ That statement addresses financial accounting and reporting for costs associated with the retirement of tangible long-lived assets where there is a legal obligation to remove the asset.² In general, SFAS No. 143 requires all entities to conduct reviews of their long-lived assets to determine whether they have AROs based on the legal standards contained in the statement. If an ARO exists, the entity must determine the current removal cost, record a liability for that amount, and capitalize it as part of the original cost of the asset.

On April 9, 2003, the Federal Energy Regulatory Commission (FERC) issued Order No. 631 in Docket No. RM02-7-000. *See*, 68 Fed Reg 19610 (April 9, 2003). In that order, the FERC established uniform accounting and financial reporting for the recognition and measurement of liabilities arising from AROs. The objective of both the FASB and the FERC was to provide sound and uniform accounting and financial reporting for these types of transactions and events.

The Commission prescribes accounting standards for gas and electric utilities under its jurisdiction. The computation and recovery of costs related to the retirement of long-lived assets can have a dramatic effect upon the expenses found to be appropriate for ratemaking purposes. An SFAS No. 143 approach would be a shift from prior practice in Michigan because Michigan's regulated utilities have traditionally accounted for both legally required AROs and other AROs through the cost of removal (COR) component of depreciation. Now, Michigan's utilities must subdivide their historical asset retirement accruals into required ARO accruals and other ARO accruals, which are not required to be recorded under SFAS No. 143. FERC Order No. 631, while

¹SFAS No. 143 establishes the required financial accounting and reporting under generally accepted accounting principles (GAAP) in a situation where there is an unambiguous legal obligation to incur expenditures for the removal of a long-lived asset. The legal obligation to remove an asset may arise from an existing or enacted statute, ordinance, contract, or promissory estoppel. In contrast, for utilities, there are other AROs that may have an associated cost of removal but for which there is no legal obligation to remove the asset.

²The text of SFAS No. 143 is available at <http://www.fasb.org/pdf/fas143.pdf>.

not applicable to Commission-jurisdictional entities, provides some insight into appropriate regulatory accounting measures concerning SFAS No. 143. However, the FERC has not addressed the ratemaking implications of Order No. 631.

Finding that a uniform approach to this issue, rather than a company-by-company approach, would be beneficial to all Michigan-regulated entities, the Commission, on October 14, 2004, established the Case No. U-14292 proceeding to review future treatment of SFAS No. 143-related issues, proper future ratemaking policy regarding those issues, necessary Uniform System of Accounts (USoA) revisions, and other matters that are related to the retirement of tangible long-lived assets and the associated retirement costs. The October 14 order required Commission-jurisdictional electric utilities with more than 125,000 Michigan customers and Commission-jurisdictional gas utilities with more than 70,000 Michigan customers to participate in the proceeding by filing testimony and responses to specific questions asked by the Commission in the order. All remaining smaller Commission-jurisdictional entities and other interested parties were encouraged to intervene and respond as well. October 14, 2004 order, p. 5.

A prehearing conference was held on December 14, 2004 before Administrative Law Judge Daniel E. Nickerson, Jr. (ALJ). The Commission Staff (Staff) entered its appearance. The ALJ recognized The Detroit Edison Company and Michigan Consolidated Gas Company (collectively, Detroit Edison), Consumers Energy Company (Consumers), Aquila, Inc., d/b/a Aquila Networks-MGU (Aquila)³, and SEMCO Energy Gas Company (SEMCO) as respondents pursuant to the Commission's directive requiring the largest utilities to respond. Petitions to intervene were granted to numerous other entities as follows: Wisconsin Electric Power Company, Northern

³Michigan Gas Utilities Corporation (MGUC) was later substituted for Aquila as the party in interest in this proceeding. All subsequent references in this order shall be to MGUC and not to Aquila.

States Power Company, and Wisconsin Public Service Corporation (collectively, Wisconsin utilities); Upper Peninsula Power Company (Upper Peninsula); the Association of Businesses Advocating Tariff Equity (ABATE); Michigan Electric Cooperative Association (MECA); Adrian Energy Associates, L.L.C.; Cadillac Renewable Energy, L.L.C.; Genesee Power Station Limited Partnership; Grayling Generating Station Limited Partnership; Hillman Power Company L.L.C.; T.E.S. Filer City Station Limited Partnership; Viking Energy of Lincoln, Inc.; Viking Energy of McBain, Inc.; Michigan Power Limited Partnership; Cogeneration Limited Partnership; Attorney General Michael A. Cox (Attorney General); Indiana Michigan Power Company (I&M); the Residential Ratepayers Consortium; Midland Cogeneration Venture Limited Partnership; Michigan Electric and Gas Association (MEGA); and Alpena Power Company.⁴

On March 15, 2005, Detroit Edison, Consumers, MGUC, and SEMCO filed direct testimony. On July 1, 2005, the Staff, the Attorney General, ABATE, MECA, and the Wisconsin utilities filed direct testimony. On August 12, 2005, Detroit Edison, Consumers, SEMCO, and MECA filed rebuttal testimony.

On September 26-30, 2005, evidentiary hearings were held and the parties conducted direct and cross-examination of the witnesses. The record consists of 1,032 pages of transcript and 70 exhibits.

On October 21, 2005, initial briefs were filed by the Staff, Consumers, Detroit Edison, MGUC, the Attorney General, ABATE, Upper Peninsula, SEMCO, MECA, the Wisconsin utilities, and MEGA. On November 4, 2005, the above parties, with the exception of MEGA, filed reply briefs. I&M filed a reply brief on November 4, 2005.

⁴Alpena Power Company subsequently withdrew from the case.

On December 5, 2005, the ALJ issued a Proposal for Decision (PFD) in which he found that the Commission had failed to implement proper procedure for the proposed exercise of authority. The ALJ found that a generic contested case proceeding, such as this one, is neither a contested case proceeding nor rulemaking consistent with the procedural mandates of the Administrative Procedures Act (APA), MCL 24.201 *et seq.* As such, the ALJ found that the Commission lacked the appropriate jurisdiction and authority in this matter and that the Commission should either commence a contested case proceeding or commence rulemaking proceedings.

In an order issued on March 14, 2006, the Commission remanded this case for findings on the substantive issues raised by SFAS No.143. The Commission found that it is not precluded from reviewing future treatment of SFAS No. 143 related issues, proper future ratemaking policy regarding those issues, and other matters that are related to the retirement of tangible long-lived assets in a generic contested case proceeding. The Commission observed that its actions in this case were not analogous to the agency actions in the case relied upon by the ALJ⁵ because the parties to this proceeding were not deprived of important rights to participate in the formation of agency policy and because this proceeding qualifies as a contested case under the criteria stated in *Michigan Electric and Gas Assoc v Public Service Comm*, 252 Mich App 254; 652 NW2d 1 (2002). The Commission also opened rulemaking proceedings to address amendments to the USoA for both gas and electric utilities, in the event that the Commission determines that these rules should be changed in light of SFAS No.143 and FERC Order No. 631.⁶

⁵*Detroit Base Coalition for the Human Rights of the Handicapped v Dep't of Social Services*, 431 Mich 172; 428 NW2d 335 (1988).

⁶The Commission observes that the USoA for electric utilities, 1999 AC, R 460.9001 *et seq.* and the USoA for gas utilities, 1999 AC, R 460.9021 *et seq.* have not been updated since 1986. Thus, the rulemaking proceedings are intended to be very broad, encompassing all accounting standards in the USoA that require updating and modification.

On August 8, 2006, the ALJ issued a PFD in accordance with the Commission's March 14, 2006 order. On September 11, 2006, exceptions were filed by Consumers, Detroit Edison, I&M, SEMCO, MGUC, Upper Peninsula, ABATE, and the Attorney General. The Staff, the Attorney General, Consumers, I&M, MECA, the Wisconsin utilities, SEMCO, MGUC, Upper Peninsula, and Detroit Edison filed replies to exceptions on September 25, 2006.

Positions of the Parties

Staff

The Staff observed that while SFAS No. 143 standardized the method and financial accounting for costs associated with removal of required AROs, it did not address accounting treatment of removal costs associated with other AROs that have traditionally been included in utility rates and financial statements. Currently, the Commission allows rate recovery for both required AROs and other AROs through depreciation expense; thus, an order mandating accounting and ratemaking treatment for required AROs only would be a significant change from Commission practice.⁷

The Staff pointed to the Commission's October 14, 2004 order in Case No. U-12999, pp. 12-13, where the Commission noted a difference of up to \$50 million in depreciation expense calculated by the various parties in the case, depending on the method used for the cost of removal expense calculation. The Staff stated that it shared the Commission's concerns regarding large removal cost accruals that seem to have no correspondence with current removal costs and with calculation methods that may not provide an accurate estimate of future costs of removal. Nevertheless, the Staff agreed with the Commission that any shifts in accounting or ratemaking

⁷Nuclear decommissioning costs are an exception to this general rule.

treatment of required AROs and other AROs should be carefully analyzed and any changes should be accomplished in a series of measured steps.

The Staff asserted that the Commission should adopt SFAS No. 143 for accounting purposes only, and not for ratemaking purposes. If SFAS No. 143 is adopted for accounting purposes, regulated entities will be required to account for required AROs in the same manner as non-regulated entities, which would require that Michigan electric and gas utilities subdivide their historic asset retirement accruals into required ARO and other ARO accruals. The Staff noted that this conforms to the accounting treatment for legally required AROs and other AROs mandated by the FERC in Order No. 631 and that the Staff would support the Commission in promulgating rules requiring new accounts and instructions matching those required by the FERC.

Although the Staff did not recommend that the Commission adopt SFAS No. 143 for rate-making, it did recommend that the Commission revise the traditional cost-of-removal calculation method because, according to the Staff, the current approach no longer conforms to the principle of intergenerational equity.

The Staff identified two problems in the current approach for determining cost of removal accruals and recommended revisions accordingly. First, the Staff stated that the traditional method for calculating removal costs fails to accurately reflect the effects of inflation. Under the current method, removal costs in today's dollars are compared to the original cost of the asset being retired. According to the Staff, this method overstates the cost of removal to be accrued because it assumes a consistent rate of inflation. William G. Aldrich, Manager of the Accounting and Auditing Section of the Commission's Regulated Energy Division testified:

The average annual inflation for the latest 40-year period was over 4.6%, a historically high inflation rate caused primarily by high inflation rates during the

1965-1985 time period. However, inflation averaged only 3% during the last 20 years, and most projections assume that those lower inflation rates will continue in the future.

Although the difference between a 3% inflation rate and a 4.6% inflation rate may not seem too significant, over a 40-year time period the 4.6% rate will result in prices almost twice as high as the prices resulting from a 3% inflation rate. Likewise, if future inflation is consistent with current inflation rates, the current method of calculating future removal costs will greatly overstate future cost of removal accruals, in violation of the principle of intergenerational equity.

6 Tr 995.

The Staff requested that the utilities propose methods to address the inflation problem in the rebuttal portion of the case. The Staff reviewed the proposals and recommended that the Commission adopt the approach presented by Detroit Edison. Under that approach, explained by Philip Czech, Senior Business Financial Analyst in Regulatory Affairs for DTE Energy, the effects of inflation would be normalized through an elimination of excess escalation by applying a 5-step procedure:

1. Identify the actual cumulative escalation for each vintage year retirement.
2. Determine the normalized cumulative escalation for the vintage year retirement.
3. Calculate the excess escalation factor.
4. Apply the excess escalation factor to gross-up or gross-down the original cost of the plant retirement.
5. Compute the net salvage ratio using the adjusted retirements.

The Staff observed that this method eliminates the excess inflation escalation from each vintage year and also eliminates escalation rates that are significantly higher or lower than the

median. Therefore, the Staff recommended that the Commission approve the revision proposed by Detroit Edison and require all large utilities⁸ to adopt this method in their next depreciation case.

The Staff's second concern regarding the increasing cost of removal accruals centers on the fact that the Commission does not require Michigan utilities to use standard retirement units. As a result, one utility may set its retirement unit for gas distribution mains at 50 ft or 100 ft, and another may set its retirement unit at 1 ft. According to the Staff, the practice of using smaller retirement units has led to substantial increases in cost of removal estimates. Mr. Aldrich explained:

To illustrate the problem, consider the following example. Utility A sets its retirement unit for gas distribution mains at 100 feet. Utility B sets its retirement unit for gas distribution mains at 1 foot. Both companies installed their distribution mains 40 years ago at an average cost of \$10 per foot. In 2005, Utility A retires a 100-foot section of pipe with a cost of removal of \$200; Utility B retires a 1-foot section of pipe with a cost of removal of \$20. Since cost of removal percentages are developed by comparing removal costs in today's dollars with the original cost of the plant being retired, Utility A experiences a cost of removal percentage of 20% ($\$200/\1000), while Utility B experiences a cost of removal percentage of 200% ($\$20/\10). Thus, even though Utility A had removal costs of \$200 for its plant retirement, compared to Utility B's removal costs of only \$20, Utility A's cost of removal percentage is only one-tenth of Utility B's cost of removal percentage. If these percentages are carried forward to depreciation cases, Utility B will accrue cost of removal at 10 times the rate used by Utility A. Staff believes that both the shift from maintenance to plant and the resulting over-accruals of costs of removal, caused by the use of very small retirement units, are contrary to the traditional ratemaking concept of intergenerational equity.

6 Tr 991-992.

To address this problem, the Staff recommended that the Commission adopt the following standard retirement units for utilities under its jurisdiction:

⁸For this order, large utilities are defined as Commission-jurisdictional electric utilities with more than 125,000 Michigan customers and Commission-jurisdictional gas utilities with more than 70,000 Michigan customers.

For Natural Gas Utilities:

a/c # 367 – Transmission Mains: 50 linear feet
a/c # 376 – Distribution Mains: 50 linear feet
a/c # 380 – Services: one service line, main to meter

For Electric Utilities:

a/c # 365 – Overhead Wire: Termini to Termini
a/c # 367 – Underground Wire: Termini to Termini

The Staff argued that its recommendation complies with GAAP because it establishes a consistent accounting practice. The Staff also noted that none of the parties raised any major objection to this proposal; however, Consumers argued that the timing of the implementation of a standard retirement unit should be coordinated with utility revenue requirements. In response, the Staff recommended that the Commission establish a standard retirement unit in a rate case to account for the effects of the change on revenue.

The Staff observed that while the ratemaking and accounting revisions discussed above begin to address the large variation in non-ARO removal accruals, there nevertheless remains a significant gap between the various methods used to calculate depreciation expense and between accounting for required AROs and other AROs. Nevertheless, the Staff argued that the Commission should reject the alternative, more radical approaches advocated by the Attorney General and ABATE. Instead, the Staff recommended that the Commission order large utilities to file in their next depreciation cases both a traditional cost of removal calculation and a cost of removal calculation for required AROs and other AROs consistent with the SFAS No. 143 time value of money method.

The Staff agreed with ABATE's claim that the current method of projecting inflation in cost of removal calculations has contributed to high depreciation expense; however, the Staff disagreed

with ABATE's proposal that the large utilities should be required to separately account for removal costs.

Finally, the Staff recommended that the Commission waive any new accounting requirements for the Wisconsin utilities and the electric cooperatives.

Attorney General

The Attorney General observed that the fundamental dispute in this case is how removal costs should be projected, accounted for, and recovered by utilities regulated by the Commission. He further noted that Michigan utilities have traditionally included removal costs in their depreciation rates and reserves; however, before SFAS No. 143 utilities were not required to separately estimate and identify removal costs for AROs. The Attorney General asserted that under the previous, less transparent, accounting practice, utilities have overstated accruals and have developed excessive reserves for removal costs. According to the Attorney General, under SFAS No. 143 and FERC Order No. 631, utilities and other businesses are required to identify portions of their depreciation reserves that pertain to required AROs and declare prior excess recoveries as regulatory liabilities. The Attorney General therefore recommended that the Commission adopt SFAS No. 143 and FERC Order No. 631 for ratemaking purposes as well as accounting purposes.

The Attorney General stated that SFAS No. 143 has changed accounting practice by only allowing recognition of removal costs associated with required AROs and by requiring a specific present value analysis to determine the proper cost of removal. The Attorney General stated that the utilities advocate that the Commission authorize them to continue to recover costs of removal through rates using the same depreciation rates and accounting practice that existed before SFAS No. 143. According to the Attorney General, this will allow utilities to continue to calculate and accrue removal costs that do not reflect appropriate inflation rates or the time value of money.

The Attorney General recommended that the Commission separate removal costs from other components of depreciation and recommended that the utilities use average depreciation expense to calculate cost of removal in a manner analogous to that required under SFAS No. 143. Charles King, President of Snavely, King and Associates, an economic consulting firm, testified that the current method used to calculate future removal costs is seriously flawed. Mr. King noted that the procedure used by the utilities today for estimating removal costs compares the original cost of the plant retired with the current associated cost of removal. 3 Tr 346. While this approach may be valid for single large units such as power plants, according to Mr. King, this method is problematic when applied to smaller units of plant. Mr. King explained that plant removal costs are often quite arbitrary because it is difficult to assign costs for removal versus placement of new plant, as, for example, when a portion of an old distribution main is replaced. Moreover, according to Mr. King, the current method for calculating removal costs inevitably results in removal cost allowances that are substantially higher than actual removal costs and leads to a permanent and growing advance of money from ratepayers to the utility. 3 Tr 348.

Mr. King testified that if the Commission continues to use the traditional method for cost of removal estimation, it should adjust the removal values so that past inflation rates are not projected into future removal costs. However, Mr. King contended that this adjustment will not fully correct the problem because the current method fails to recognize the time value of money and assumes that a dollar collected today for removal costs will have the same value when the plant is removed in 30 or 40 years. Mr. King noted that under SFAS No. 143, an entity may only recognize the present value of removal cost when the asset is installed. 3 Tr 357.

Mr. King discussed several alternatives to the traditional method for estimating future costs of removal and opined that a modified SFAS No. 143 approach was most appropriate. 3 Tr 367.

Mr. King also recommended that the current removal cost reserves be subtracted from the present value of the removal costs to be recovered over the remaining life of the plant. Mr. King noted that for some utilities, it is probable that current reserves exceed the present value of future removal costs. In that case, no further removal cost allowances should be recovered. However, Mr. King cautioned that in some cases it may be necessary to disregard accumulated removal reserves, for the time being, to limit the effect on cash flow of the proposed accounting change.

ABATE

James T. Selecky of Brubaker & Associates, a regulatory consulting firm, testified that in his opinion the amounts included in electric and gas depreciation rates for removal costs are excessive compared to the expense actually incurred by the utilities. Mr. Selecky stated that he testified in both Consumers' and Detroit Edison's gas depreciation cases.⁹ According to Mr. Selecky, the two companies proposed net salvage related depreciation expenses of \$58.4 and \$33.9 million, respectively. However, Mr. Selecky testified that when he reviewed the two companies' average net salvage expense for the five year period from 1998 to 2002 he found that the figures should be six to seven times lower than those proposed by the companies. He also conducted a comparison for electric depreciation cases and found a similar result. 5 Tr 654-657.

Mr. Selecky opined that the discrepancy was due to the fact that the net salvage percentages reflect inaccurate estimates of future inflation; the depreciation rates may not capture economies of scale that would occur if large retirement activity occurred during a single year; past inflation may not be indicative of future inflation; and the rates may have been developed based on limited retirement experience that was not typical. 5 Tr 657-660.

⁹ Case Nos. U-12999 and U-13899.

To address this issue, ABATE proposed a cost of removal method that it claimed eliminates intergenerational inequities while more closely matching the actual cost of removal with estimated costs. Mr. Selecky summarized ABATE's proposal as follows:

- Separate for accounting purposes, removal costs that have been collected and included in the utilities' accumulated depreciation reserves.
- Separate depreciation rates into two components: One, related to the recovery of the original cost of the asset and the second that includes any of the removal or net salvage costs.
- Establish a separate rate for net salvage expense based on the five-year average of historical actual net salvage expense incurred for a particular mass account escalated for a five year forecast adjusted for expected inflation rate.
- Divide the net salvage expense by the plant-in-service for that account to calculate a net salvage ratio.
- Calculate an annual depreciation expense using the proposed net salvage ratio.
- Establish a separate rate to determine the recovery of the original cost of tangible assets over their useful life.

5 Tr. 662-663.

In summary, ABATE recommended that the historical five-year average actual expense for net salvage be the starting point for determining net salvage ratio. The historical five-year average could be adjusted to include up to five years of projected inflation. The net salvage expense would then be divided by the plant-in-service to develop a net salvage ratio.

Consumers

Consumers argued that the purpose of SFAS No. 143 was to standardize accounting treatment for removal costs where there is a legal retirement obligation. According to Consumers, SFAS No. 143 and FERC Order No. 631 were not intended to address appropriate ratemaking treatment for regulated utilities nor were they intended to change traditional methods of calculating costs of

removal. Consumers took the position that SFAS No. 143 does not require any change in rate-making for required AROs or other AROs, and the implementation of an SFAS No. 143 approach for ratemaking purposes would not be appropriate. Consumers maintained that cost of removal should continue to be recovered in rates as a component of depreciation expense to comport with the principle of intergenerational equity and that entertaining proposals to change the method of calculating future removal costs is beyond the scope of this proceeding.

Consumers contended that the Commission should adopt the accounts and accounting methods contained in FERC Order No. 631 for financial accounting purposes only. Consumers maintained that the FERC order is a reasonable regulatory response to SFAS No. 143. Consumers argued that the order provides for accounts that are consistent with the accounting and reporting requirements that jurisdictional entities use in their general purpose financial statements. Moreover, Consumers asserted that FERC Order No. 631 accommodates existing ratemaking treatment by providing for the recording of regulatory assets and regulatory liabilities to reflect differences between accounting and ratemaking, rather than requiring a change in ratemaking treatment. Thus, Consumers concluded that the adoption of FERC Order No. 631 by the Commission would provide for consistent accounting between the FERC and the Commission.

Consumers disagreed with the Staff's proposal to use sub-accounts for ARO reporting, arguing that this approach would add undue complexity and might require utilities to maintain separate accounts for the FERC and the Commission. Consumers recommended that the Commission formally adopt revisions to the USoAs for electric and gas utilities consistent with those adopted by the FERC.

Consumers requested that the Commission reaffirm that the use of regulatory asset and regulatory liability accounting for any timing differences between recovery of costs through

depreciation rates and accounting related to SFAS No. 143 is proper. Consumers argued that “This would be more efficient than requiring each utility to seek separate treatment in utility-specific cases for specific AROs.” 3 Tr 241.

Consumers argued that that use of the SFAS No. 143 method for ratemaking would not be appropriate because the recovery of removal costs through depreciation expense is more consistent with traditional regulatory principles, the use of the SFAS No. 143 method would result in a higher cost for customers than the current approach, the use of the SFAS No. 143 method would add additional complexity to calculations, and because ratemaking using SFAS No. 143 would result in two different calculations depending on whether an asset was a required ARO or not.

Consumers admitted that the Staff’s proposal to adopt standard retirement units appeared to have merit, but recommended that the proposal be assessed on a utility-specific basis. Patrick M. Fitzgerald, Director of Property Accounting for Consumers, testified as follows:

Among the important issues that need to be resolved are the following: (i) it is important to make sure that there is a common understanding between the Consumers Energy Company and the Staff as to how retirement unit terminology will be interpreted, (ii) it is important to determine how the transition will be implemented, (iii) it is important to verify that use of any revised retirement units is practical from an accounting standpoint and that use of the retirement units is feasible in the field, (iv) is important to verify that any necessary modifications to the accounting system are practical, (v) it is important that adequate time be allowed to implement any change, and (vi) it is important that any change in retirement units be coordinated with revenue requirements so that the revenue impact of any change in retirement units is reflected in the revenue requirement included in rates concurrently with when the change in retirement units is implemented.

5 Tr 703-704.

Mr. Fitzgerald further observed that the retirement units currently used by Consumers are consistent with the USoA and most have been in place since 1983. The standard retirement units proposed by the Staff would increase the size of retirement units used by Consumers.

Mr. Fitzgerald testified that if the Staff's proposal were adopted by the Commission, Consumers would face a significant increase in their operations and maintenance expense because the larger retirement units would shift expenses from removal to maintenance. 5 Tr 708-710.

Finally, Consumers argued that the method for calculating removal costs should not be changed. Consumers maintained that in a depreciation study, actual costs of removal are evaluated to determine if historical costs are representative of future costs. If not, Consumers argued that alternatives can be proposed. Consumers claimed that the parties have not shown that there are flaws in the current method used to calculate removal costs, only that cost of removal accruals have increased. Consumers asserted that this is not sufficient basis for abandoning the traditional calculation method. Moreover, Consumers argued that the Staff's proposal is "a fundamental change in approach. The methodology is not a recognized depreciation methodology and would abandon traditional depreciation principles." 2 Tr 37. Consumers contended that if the Commission adopts larger retirement units, the increases that have occurred in cost of removal in depreciation rates would be mitigated. According to Consumers, this provides an additional reason to reject arguments for any significant changes in the method for determining removal costs.

Detroit Edison

Detroit Edison argued that the Commission should continue to approve the traditional method of calculating costs of removal for ratemaking purposes for both required AROs and other AROs and should adopt FERC Order No. 631 for accounting and reporting of AROs. Detroit Edison asserted that all of the parties to this proceeding agree that neither SFAS No. 143 nor FERC Order No. 631 requires any change to depreciation or ratemaking.

Michael G. VanHaerents, Manager of Revenue Requirements for Detroit Edison, explained that by adopting FERC Order No. 631 accounting and implementing SFAS No. 143 in 2003,

Detroit Edison grosses-up the balance sheet through the use of a regulatory asset amount as provided under FERC Order No. 631. He explained that the regulatory asset solves the timing problem associated with the remaining life of the related SFAS No. 143 asset. 6 Tr 911-913.

Mr. VanHaerents stated that there are only minor regulatory accounting adjustments required for implementing SFAS No. 143 through FERC Order No. 631. He suggested that the Commission provide specific accounting authority for accounts titled “Other Regulatory Asset Account 182.3” and/or “Other Regulatory Liability Account 254.” According to Mr. VanHaerents, this makes it clear that SFAS No. 143 does not alter ratemaking or net income for Michigan utilities.

Detroit Edison argues that the Commission should establish Form P-521 and Form P-522 pages relating to SFAS No. 143 consistent with the reporting convention described in FERC Order No. 631. *See*, Exhibit DE/MC-13.

Mr. VanHaerents recommended that the Commission continue the current Michigan rate-making policy that recovers removal costs using depreciation rates based on a ratable straight-line accrual over the remaining life of an asset. Detroit Edison contended that there has not been evidence presented in this proceeding that would justify a deviation from a longstanding Michigan ratemaking and depreciation policy. Detroit Edison adds that this policy satisfies intergenerational equity by matching customers receiving the benefits from the use of the underlying assets with the obligation to pay for the full cost of the asset, including removal costs. 6 Tr 914-915.

Detroit Edison also argued that while the Staff’s proposal regarding standardized retirement units is a reasonable goal, the proposal must be implemented, if at all, contemporaneously with a final order in a future general rate and depreciation case. Detroit Edison claimed because a change to standard retirement units would affect the relationship between capital expenditures and maintenance expense in a different manner for each utility, any changes must be implemented in a

general rate case to avoid unnecessary financial effects on utilities. Moreover, Detroit Edison contended that if the Commission were to adopt the Staff's proposal for standard retirement units, such action may require a change in the USoA through proper rulemaking procedures.

MEGA

MEGA argues that the record in this case does not support a generic policy applicable to all utilities. MEGA points to the claim that the Wisconsin utilities require separate treatment so that Commission procedures parallel those required by the Public Service Commission of Wisconsin (PSCW). MEGA further observed that some utilities do not have any removal costs and others lack necessary information on vintage retirements and removal cost accruals. MEGA argued that the Staff's proposal regarding standard retirement units would have different effects on different utilities depending on past utility practice.

MEGA took the position that the Commission should continue its current method and practice for calculating the removal costs for required AROs and other AROs. MEGA asserted that the depreciation method currently used to calculate future removal costs is adequate and that periodic depreciation studies have proven to be an appropriate method to adjust depreciation rates.

SEMCO

SEMCO stated that it does not have any AROs as defined by SFAS No. 143. SEMCO currently follows the accounting requirements of SFAS No. 143, but asserted that ratemaking treatment for removal costs should not be changed as a result of SFAS No. 143. Likewise, SEMCO argued that the traditional method for determining removal costs, including the monitoring of net removal costs through depreciation studies and depreciation rate adjustments for any over or under-accrual, is appropriate because it assures full and timely capital recovery.

SEMCO further observed that the Commission's current method "is the method used by a large majority of electric and gas utilities and adopted by most Commissions." 4 Tr 565-567.

In response to alternative methods for calculating removal costs proposed by the Staff, the Attorney General, and ABATE, SEMCO argued that the proposed revisions were unsuitable "because they violate the matching principle, do not result in timely capital recovery, and represent a radical change in method and depreciation expense." 4 Tr 565. However, if the Commission determines that the current method requires modification, SEMCO recommended an alternative that would incorporate the adoption of a five-year average of historical net removal costs divided by the cost of the average retired plant.

SEMCO observed that the Staff's recommended standardized retirement units are smaller than those that the company currently uses. Therefore, SEMCO indicated that it would accept any change that required standard units as proposed by the Staff. Finally, SEMCO contended that any changes regarding the method of computing and accruing removal costs for ratemaking purposes should only be done in the context of its next depreciation case, which should coincide with a general rate case.

MGUC

In 2003, MGUC implemented SFAS No. 143 in its accounting and indicated that it has identified only a few required AROs in its Michigan operations. Nevertheless, MGUC stated that it is continuing to study whether there may be additional required AROs from its Michigan operations. According to MGUC, the removal costs included as part of depreciation in its income statement are accrued at the rate authorized by the Commission in the company's last depreciation rate case, Case No. U-13393.

MGUC recommended that required AROs identified as a result of SFAS No. 143 should be reported and accounted for under the Commission's USoAs consistent with SFAS No. 143 and FERC Order No. 631. However, MGUC took the position that such treatment should not be required for interim retirements and other AROs. Instead, MGUC argued that the Commission should continue the current practice regarding these asset retirements and should not implement a SFAS No. 143 approach.

MGUC argued that continuing the current accrual method for calculating other ARO removal costs is appropriate because the method is consistent with FERC regulations, it comports with the intergenerational equity principle, and it provides opportunity for adjustments through periodic depreciation cases, once actual costs are known.

Upper Peninsula

Upper Peninsula observed that it has been accruing depreciation for ratemaking purposes in accordance with methods approved by the Commission in its January 22, 2002 order in Case No. U-13001. In its most recent application in a depreciation case, Case No. U-14633, Upper Peninsula has requested that the Commission approve the continuation of its current depreciation methods and rates.

Like the other utilities, Upper Peninsula follows SFAS No. 143 for accounting but not rate-making purposes. Upper Peninsula argued that its traditional method of calculating and allocating removal costs on a straight-line basis over the life of the asset is the correct approach and that there is no evidence that the use of this method by the company has resulted in excessive removal cost reserves. Moreover, Upper Peninsula asserted that conducting periodic depreciation studies serves a corrective function that adjusts removal cost accruals and addresses issues associated with changes in inflation levels, the time value of money, and intergenerational equity.

Upper Peninsula contended that if the Commission finds that the calculation method for removal costs should be changed, revisions to the current method should be implemented, rather than replacing the traditional method with an alternative one.

Upper Peninsula stated that it uses a 25-foot line retirement unit for replacement of overhead and underground wire. Upper Peninsula asserted that this is a reasonable retirement unit and is the same one used by the Wisconsin Public Service Corporation.

Upper Peninsula agrees that the Commission should establish regulatory asset and liability accounts to record differences in expense recognition under SFAS No. 143 and past accounting. Finally, if the Commission decides to change the method for calculating removal costs, Upper Peninsula requested that it be authorized to continue use of the currently approved method until it files a new depreciation case.

MECA

MECA pointed out that the Michigan electric distribution cooperatives are financed by the Rural Utilities Services (RUS) or the National Rural Utilities Cooperative Finance Corporation (CFC). MECA contended that there are no Michigan electric distribution cooperatives that have any AROs that meet the requirements of SFAS No. 143.

However, because the RUS adopted FERC Order No. 631 and the accounting requirements for SFAS No. 143 AROs, the electric distribution cooperatives would account for them consistent with SFAS No. 143. MECA stated that the removal costs associated with required AROs are part of normal utility operations and are recoverable through utility rates.

MECA observed that electric distribution cooperatives address removal costs differently than other utilities in the state by using RUS Bulletin 183-1 dated October 28, 1997. The bulletin contains depreciation guideline curves for adjusting depreciation rates if they become excessive or

inadequate. According to MECA, this eliminates the need for periodic depreciation studies. Thus, electric distribution cooperatives typically do not track cost of removal for mass asset accounts.

MECA recommended that the electric distribution cooperatives should be exempt from any requirement to separately track removal costs for retirements because this would create new accounting and administrative obligations without a corresponding positive effect on the cooperatives or their customers.

Wisconsin Utilities

The Wisconsin utilities, which are largely regulated by the PSCW, currently follow the accounting requirements of SFAS No. 143 and FERC Order No. 631 for accounting purposes but not for ratemaking purposes. The Wisconsin utilities asserted that for ratemaking purposes the PSCW has ordered that the cost of removal for both required AROs and other AROs will continue to be part of depreciation rates.

The Wisconsin utilities contended that most of the retirement units currently in use by the companies are consistent with the Staff's proposal and that none of the retirement units they currently use could be characterized as very small units. The Wisconsin utilities argued that they should be exempt from any of the changes required by the Commission in this case and should be allowed to continue the requirements of the PSCW with regards to the accounting and depreciation matters at issue in this case. In addition, the Wisconsin utilities argued that, consistent with authorization granted by the PSCW, each of the Wisconsin utilities should be permitted to establish a regulatory asset account and a regulatory liability account to record differences in expense recognition under SFAS No. 143 for required AROs and to record differences in such accounts as regulatory assets and liabilities.

Proposal for Decision

The ALJ observed that the parties agreed that the Commission should adopt SFAS No. 143 and FERC Order No. 631 for accounting, but not ratemaking, purposes. Because of the general concurrence on this issue, the ALJ recommended that the Commission adopt SFAS No. 143 and FERC Order No. 631 for accounting purposes and amend the Commission's USoA accordingly.

The ALJ found that the parties also concurred that the Commission should continue to allow the accrual of removal costs through depreciation expense. Nevertheless, the ALJ observed that there was wide disparity in the parties' views of whether, or how, the calculation of removal costs should be revised.

The ALJ recommended that the Commission consider the Staff's proposal for standardizing retirement units, noting that most of the smaller utilities already use standard retirement units or, at least, endorse the concept. The ALJ also found that the arguments opposing the use of standard retirement units involved uncertainty about the actual application of these units and cost recovery in future rate cases, rather than opposition to the proposal in general.

The ALJ agreed with the Staff and the Attorney General and recommended that the Commission should not approve the proposal made by most utilities to establish regulatory asset and regulatory liability accounting. The ALJ reasoned that there has not yet been any modification of the USoA to reflect the Commission's adoption of SFAS No. 143 and FERC Order No. 631.

The ALJ agreed with the Attorney General, the Staff, and ABATE that there should be some adjustment to the process for estimating removal costs. The ALJ found that the record reflected numerous instances where removal costs were overstated.

The ALJ was persuaded that the current method for projecting future inflation, which is based on historical inflation rates, has skewed removal cost estimates so that future costs of removal are

no longer realistic. While not endorsing any particular method, the ALJ recommended that the Commission consider revising the traditional method for calculating removal costs. The ALJ also agreed with the Staff and ABATE that the Commission should waive any new accounting requirements as they apply to the cooperatives and the Wisconsin utilities. The ALJ noted that accounting requirements for the cooperatives are set by their creditors and the PSCW sets accounting and reporting standards for the Wisconsin utilities that operate predominately in that jurisdiction.

Exceptions and Replies

None of the parties takes exception to the ALJ's recommendation that SFAS No. 143 and FERC Order No. 631 should be adopted for accounting purposes; however, Consumers and Detroit Edison observe that the ALJ erred in not specifically recommending that the Commission promulgate rules to update the Commission's USoA in accordance with the accounting established by the FERC in Order No. 631. *See*, Exhibit CE-2. The Attorney General takes exception to the ALJ's finding that none of the parties advocated that SFAS No. 143 and FERC Order No. 631 should be used for ratemaking purposes. According to the Attorney General, although neither SFAS No. 143 nor FERC Order No. 631 mandate their use for ratemaking purposes, these pronouncements nevertheless provide a solid rationale to adopt them for ratemaking purposes for both required AROs and other AROs. The Attorney General further argues that the ALJ erred in limiting his discussion of proposed modifications to those that would not interfere with utility specific accounting practices and ratemaking and reasserts his support for the adoption of the modified SFAS No. 143 approach explained by Mr. King. 3 Tr 363-368.

Consumers, MGUC, Upper Peninsula, I&M, and SEMCO take exception to the ALJ's recommendation that the Commission should consider implementing standard retirement units and interest rate adjustments in calculating costs of removal. Upper Peninsula argues that no party

specifically requested that Upper Peninsula change the size of its retirement units. SEMCO argues that it already uses retirement units that are larger than those that the Staff proposed.

Consumers argues that this recommendation should be rejected because the selection of retirement units involves utility-specific issues and because any changes in retirement units needs to be coordinated with revenue requirements. Therefore, according to Consumers, standardization of retirement units should not be addressed in a rulemaking proceeding. Consumers cautions that any change to the retirement units it currently uses could result in unforeseen financial consequences. Thus, Consumers recommends that any proposals to adopt standard retirement units should be thoroughly analyzed and discussed before implementation. Detroit Edison likewise argues that the development of standard retirement units should be examined in each utility's next depreciation case and that the standard units should be limited to the accounts identified by the Staff.

Other utilities argue that there is no evidence in the record that demonstrates that they have unduly accrued depreciation expenses for removal costs and that therefore appropriate retirement units should be addressed on a utility-by-utility basis in individual depreciation cases. Similarly, all of the utilities assert that the traditional method for calculating future removal costs has not proven to be deficient, nor does it require adjustment. The utilities argue that the current method comports with FERC rules and that it matches the use of the asset with the costs of the asset, including net salvage cost. Moreover, the utilities assert that over or under-accruals for retirement costs can be corrected in periodic depreciation rate cases. The utilities claim that the alternative methods presented by the Staff, the Attorney General, and ABATE would violate the principle of intergenerational equity, would not result in timely capital recovery, or would represent a radical departure from established methods.

In contrast, ABATE and the Attorney General claim that the ALJ erred in failing to recommend that the Commission take specific action regarding a change to the method of calculating removal costs. ABATE argues that the Commission should direct the major utilities, with the exception of the Wisconsin utilities and the electric cooperatives, to file depreciation cases within 90 days of the issuance of the final order in this case. The Attorney General similarly argues that all jurisdictional utilities, including the Wisconsin utilities and the electric cooperatives, should be required to file depreciation cases by September 1, 2007, using 2006 plant balances and applying the modified SFAS No. 143 approach. The Attorney General asserts that neither the Wisconsin utilities nor the electric cooperatives should be exempt from any Commission-approved changes. ABATE also recommends that the Commission direct the Staff to file testimony in each depreciation case addressing standard retirement units and implementing the revised depreciation method proposed by ABATE. The Attorney General argues that the ALJ erred in failing to recommend adoption of the standard retirement units proposed by the Staff, subject to proof in future cases that there is a basis for deviation from the standard unit method.

In reply to the Attorney General, the Staff, and ABATE, Detroit Edison again argues that the Commission cannot impose policy changes as a result of this proceeding without following the mandates of the APA.

SEMCO, Consumers, MGUC, Upper Peninsula, and I&M take exception to the ALJ's recommendation that regulatory asset and liability accounts should not be approved until after the changes to the USoA rules are adopted. These parties argue that there was no evidence showing that regulatory asset and regulatory liability accounting was inappropriate for accounting for timing differences resulting from the adoption of SFAS No. 143 for accounting. Indeed, according to the utilities, both SFAS No. 143 and FERC Order No. 631 recognize the continued use of

regulatory asset and liability accounts. The utilities argue that it would be inefficient and unnecessary for the Commission to defer approval of the requested accounting pending changes to the USoA.

In response, the Attorney General argues that under SFAS No. 71, regulated entities must comply with GAAP but that a regulated enterprise may nevertheless accrue a regulatory asset or liability if a regulator provides assurance of cost recovery, or requires that any collection from ratepayers over a utility's just and reasonable costs be returned to ratepayers, or imposes a liability. According to the Attorney General, these are the only permissible reasons to deviate from SFAS No. 143 accounting. The Attorney General claims that an approval of the utilities' request for authority to implement regulatory asset/liability accounting requires assurance of rate recovery by the Commission and granting such "blanket" approval in this case would amount to an assurance of recovery of unspecified and unidentified amounts. The Attorney General further contends that this interpretation conflicts with FERC Order No. 631, wherein, according to the Attorney General, the FERC declined to include specific instructions on regulatory asset and liability accounting and decided that case-by-case determinations would become the preferred method for deciding when to implement regulatory asset and liability accounts.

Discussion

SFAS No. 143 addresses financial accounting and reporting for obligations related to the retirement of tangible long-lived assets and the associated asset retirement costs where there is a legal obligation to remove the asset. SFAS No. 143, which applies to all entities including public utilities, was the result of a ten year effort that began with a focus on accounting for the legal costs of decommissioning nuclear power plants. Subsequently, the scope was expanded to include similar legal obligations in the utility and other industries. According to the FASB:

The Board decided to address the accounting and reporting for asset retirement obligations because:

- Users of financial statements indicated that the diverse accounting practices that have developed for obligations associated with the retirement of tangible long-lived assets make it difficult to compare the financial position and results of operations of companies that have similar obligations but account for them differently.
- Obligations that meet the definition of a liability were not being recognized when those liabilities were incurred or the recognized liability was not consistently measured or presented.

SFAS No. 143, p 4.

SFAS No. 143 has been effective for all financial statements issued for fiscal years beginning after June 15, 2002.

In general, SFAS No. 143 requires all entities to conduct reviews of their long-lived assets to determine whether they have AROs based on the legal standards summarized in the statement. If a required ARO exists, the entity must measure the present value of its cost of removal, record a liability for the amount, and capitalize it as part of the original cost of the asset.

As the ALJ observed, the parties were in agreement that SFAS No. 143 should be adopted for accounting purposes through changes in the Commission's USoAs for gas and electric utilities and that any changes should correspond to the accounting prescribed by the FERC in Order No. 631. The Commission agrees. FERC Order No. 631 provides for accounting that is consistent with the accounting and reporting requirements that utilities use in their general purpose financial statements, it accommodates existing ratemaking treatment, and the adoption of the FERC accounting for AROs by the Commission would provide for consistent reporting between the FERC and the Commission.

Regulated utilities are required to account for transactions under a USoA so that utilities provide the Commission and the public with consistent financial reporting. Comparable

information is essential when customer bills are based on the costs of a utility. Currently, Michigan gas and electric companies record transactions under two accounting systems—one for the FERC and one for the Commission. The Commission’s policy has been to maintain an accounting system that is in close conformity with the FERC and with GAAP. However, the Commission has not revised its system of accounts for some time, while the FERC USoAs have been extensively updated. As a result, the number of differences between the two accounting systems has increased over the years.

While this proceeding was initiated in part to consider potential changes to the Commission’s USoAs resulting from SFAS No. 143 and FERC Order No. 631, the rulemaking proceedings in Case Nos. U-14811 and U-14812 were intended to be broad and encompass all necessary changes to the Commission’s accounting systems and were not intended to consider only amending the rules to comport with SFAS No. 143 and FERC Order No. 631. The Commission further observes that most state commissions have adopted the FERC USoAs for electric and gas utilities as a means to reduce the costs of recordkeeping for companies that also report to the FERC and to update their systems of accounts to assist in complying with GAAP.

The Commission finds that rescinding the current accounting rules for electric utilities, 1999 AC, R 460.9001 *et seq.*, and the current accounting rules for gas utilities, 1999 AC, R 460.9021 *et seq.*, and adopting by reference the current FERC USoAs for electric and gas utilities is a reasonable solution to the need to update the Commission’s systems of accounts. Moreover, this action will serve to eliminate burdensome recordkeeping requirements for the utilities that currently report to the FERC and to the Commission.

To this end, the Commission directs the Staff to review the FERC uniform system of accounts for electric utilities, 18 CFR 101 *et seq.*, and the FERC uniform system of accounts for gas

utilities, 18 CFR 201 *et seq.*, and make recommendations to the Commission regarding the adoption of these rules by reference. The Staff should also determine whether there are any FERC accounts, rules, or procedures that should be changed or that should not apply to utilities under the Commission's jurisdiction and include this information in their recommendation.

The remainder of this proceeding focused on whether the Commission should change the way it establishes cost of removal depreciation rates. The utilities prefer to continue the traditional approach, arguing that even if the method for calculating future costs of removal is imperfect, periodic depreciation cases serve to adjust any over or underaccrual of cost of removal reserves. The Staff, the Attorney General and ABATE argue that at least some changes to the method of calculating future costs of removal are appropriate. If there is a change in the way the net cost of removal is calculated, then a second issue arises—should the change to the cost of removal be implemented on a prospective basis, with the changes assigned to customers over the remaining life of the assets, or should the utilities be required to adjust their previous calculations and possibly provide customers with a refund? ABATE and the Staff support the first choice and the Attorney General supports the second choice.

In Consumers' and Mich Con's most recent gas depreciation cases, Case No. U-12999 and Case No. U-13899, respectively, the Commission expressed concern over the size of cost of removal accruals. In the April 28, 2005 order in Case No. U-13899, p. 52, the Commission observed, "The absolute size of Mich Con's negative net-salvage accounts concerns the Commission, as does the inordinately high level of negative net salvage when compared to the company's actual historical experience as noted by the ALJ." Likewise, in the October 14, 2004 order in Case No. U-12999, p. 12, the Commission found:

The positions presented by the parties vary widely in the amount of annual depreciation expense produced by the proposed rates—the differences are caused

by the methods of calculation and recovery of net-salvage values. Consumers would continue the traditional approach to calculating and recovering net salvage; that approach maintains the status quo but does not address the singular issue raised by the remaining parties regarding the absolute size of the negative net salvage values proposed by Consumers and the formidable present net-salvage level within the company's books.

The Commission agrees with the Staff, the Attorney General, and ABATE that there are apparent problems with the current method for calculating future cost of removal expense as demonstrated by the significant (and increasing) cost of removal depreciation expense accruals for several utilities. *See e.g.*, Exhibit S-1. The Commission also agrees with the Staff that the more radical approaches proposed by the Attorney General and ABATE are problematic because of their potential effects on utility revenues. Thus, the Commission agrees that the method for adjusting historic interest rates, presented by Mr. Czech, coupled with the Staff's recommendation to implement standard retirement units, is a reasonable approach to begin bringing estimated future removal costs in line with the utilities' actual retirement costs. Moreover, the Commission agrees with the Staff and ABATE that these changes should be implemented on a going-forward basis.

As the Staff pointed out, as retirement units become smaller, costs are shifted from being recorded as maintenance expenses to being recorded as capitalized costs recoverable through depreciation, thereby resulting in increasing cost of removal accruals. The Commission agrees that the proposal to adopt standard retirement units is a logical one. The use of standard retirement units is not contrary to GAAP, the retirement units used by some utilities for certain accounts are clearly too small and tend to favor plant additions over maintenance expense, and current practice permits arbitrary distinctions between different types of retirements.

The Commission likewise agrees that the current practice of calculating cost of removal ratios, by comparing removal costs in today's dollars with the original cost of the plant being retired, is no longer suitable. As the Staff observed, the first problem with this approach is that it assumes

that past, generally higher inflation rates will continue into the future. Second, the traditional method fails to take into account the time value of money. As Mr. Aldrich explained:

If a utility incurs an obligation to expend \$200 in 20 years, the utility would not record a liability of \$200 on its books this year. Instead, under GAAP, the utility would record the net present value of that \$200 future obligation, or \$52 if an interest rate of 7% is used. The utility would then increase the liability at 7% per year over 20 years, resulting in a liability of \$200 at the end of 20 years. However, this is not how the current cost of removal methodology works. Instead, the same \$200 is expensed and collected from customers ratably over 20 years at \$10 per year, a methodology that overcharges customers in the early years, and undercharges customers in the later years as compared to the net present value approach mandated by SFAS 143 for asset retirement obligations. By ignoring the time value of money, the current cost of removal methodology violates the principle of intergenerational equity.

6 Tr 995-996.

While the proposal to adjust historic inflation does not address the time value of money issue in calculating future removal costs, the Commission nevertheless agrees with the Staff that an SFAS No. 143 approach applied to required ARO and other ARO accounts would be informative, even if the Commission determines that SFAS No. 143 should not be used for ratemaking. The Commission therefore directs the large utilities to file new depreciation cases in 2008, using 2007 cost of removal expenses as a basis, and to calculate cost of removal depreciation under: 1) the current method for calculating cost of removal; 2) the current method for calculating cost of removal using the standard retirement units proposed by the Staff; 3) the method proposed by Mr. Czech and using the standard retirement units proposed by the Staff; and 4) an SFAS No. 143 approach that considers the time value of money applied to required AROs and other AROs, with and without the standard retirement units proposed by the Staff. This additional information will allow the Commission to assess the propriety of the different proposals and the efficacy of implementing them for each individual utility. The Commission also agrees that any determinations

regarding the Wisconsin utilities and the electric cooperatives should be deferred until the first round of depreciation cases involving large utilities is completed.

The Commission also agrees with the Staff and the Attorney General that the approval of regulatory asset and regulatory liability accounting should be deferred until the Commission's USoAs are amended. As the Staff points out, although the utilities were required to adopt SFAS No. 143 for accounting purposes, SFAS No. 143 has not yet been added to the Commission's USoAs. Furthermore, as the Staff observed, this case is a generic one instituted for the purpose of acquiring information regarding SFAS No. 143 and related issues. It is not a rate case and the Commission therefore declines to authorize regulatory asset/liability accounting in this proceeding because such action could be considered a rate action.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 106, as amended, MCL 460.551 *et seq.*; 1909 PA 300, as amended, MCL 462.2 *et seq.*; 1919 PA 419, as amended, MCL 460.51 *et seq.*; 1929 PA 9, as amended, MCL 483.101 *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. The Staff should review the FERC uniform system of accounts for electric utilities contained in 18 CFR 101 *et seq.* and the FERC uniform system of accounts for gas utilities contained in 19 CFR 201 *et seq.* and make recommendations to the Commission regarding the adoption of these rules by reference. The Staff should also determine, and advise the Commission, whether there are any FERC accounts, rules, or procedures that should be changed or that should not apply to utilities under the Commission's jurisdiction.

c. All Commission-jurisdictional large electric utilities and large gas utilities should file new depreciation studies and cases from 2008-2009, using the previous year's removal cost figures as a basis.

d. Commission-jurisdictional large utilities should include cost of removal estimates derived from applying an SFAS No. 143 method for legally required AROs and other AROs and a cost of removal estimate that mitigates the effect of past inflation and uses standard retirement units, in addition to cost of removal calculations based on the current method used for estimating future removal costs in their next depreciation cases.

e. The Commission should defer approval of regulatory asset and regulatory liability accounting until after the USoAs for electric and gas utilities are amended.

THEREFORE, IT IS ORDERED that:

A. The Commission Staff shall review the Federal Energy Regulatory Commission uniform system of accounts for electric utilities contained in 18 CFR 101 *et seq.* and the Federal Energy Regulatory Commission uniform system of accounts for gas utilities contained in 18 CFR 201 *et seq.* and shall make recommendations to the Commission regarding the adoption of these rules by reference. The Commission Staff shall also determine, and advise the Commission, whether there are any Federal Energy Regulatory Commission accounts, rules, or procedures that should be modified or that should not apply to utilities under the Commission's jurisdiction.

B. Consumers Energy Company, for its gas operations, shall file a new depreciation study and case by August 1, 2008, using 2007 removal costs as a basis for its calculations. Michigan Consolidated Gas Company shall file a new depreciation study and case by November 3, 2008, using 2007 removal costs as a basis for its calculations. SEMCO Energy Gas Company shall file a new depreciation study and case by February 2, 2009, using 2008 removal costs as a basis for its

calculations. Michigan Gas Utilities Corporation shall file a new depreciation study and case by May 1, 2009, using 2008 removal costs as a basis for its calculations. Consumers Energy Company, for its electric operations, shall file a new depreciation study and case by August 3, 2009, using 2008 removal costs as a basis for its calculations. The Detroit Edison Company shall file a new depreciation study and case by November 2, 2009, using 2008 removal costs as a basis for its calculations.

C. The utilities referenced in Part B of this ordering paragraph shall include cost of removal estimates derived from applying an SFAS No. 143 method for calculating future costs of removal for legal retirement obligations and for non-legal retirement obligations and a cost of removal estimate that mitigates the effect of past inflation and uses standard retirement units in addition to cost of removal calculations based on the current method used for estimating future removal costs in their next depreciation cases.

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

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

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ J. Peter Lark

Chairman

(S E A L)

/s/ Monica Martinez

Commissioner

By its action of June 26, 2007.

/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

Chairman

Commissioner

By its action of June 26, 2007.

Its Executive Secretary