

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

| | | |
|--|---|------------------|
| In the matter, on the Commission’s own motion, |) | |
| regarding the regulatory reviews, revisions, |) | |
| determinations, and/or approvals necessary for |) | Case No. U-15890 |
| MICHIGAN CONSOLIDATED GAS COMPANY to |) | |
| fully comply with Public Acts 286 and 295 of 2008. |) | |
| _____ |) | |

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

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

OPINION AND ORDER

Procedural History

On March 4, 2009, Michigan Consolidated Gas Company (Mich Con) filed an application, with supporting testimony and exhibits, requesting approval of its proposed energy optimization plan (EOP), authority to implement energy optimization surcharges, and other related relief, in accordance with the Michigan Clean, Renewable, and Efficient Energy Act, 2008 PA 295, MCL 460.1001 *et seq.* (Act 295), and the Commission’s December 4, 2008 Temporary Order in Case No. U-15800 (Temporary Order).

On March 13, 2009, a prehearing conference was held before Administrative Law Judge Barbara A. Stump (ALJ), at which petitions to intervene filed by the Association of Businesses Advocating Tariff Equity (ABATE), Attorney General Michael A. Cox (Attorney General), and

the Michigan Community Action Agency Association (MCAAA) were granted. The Commission Staff (Staff) also participated in the proceedings.

A hearing was held on April 20, 2009, at which the testimony of all witnesses was bound into the record and their exhibits were admitted into evidence. On May 5, 2009, Mich Con, the Staff, the Attorney General, and ABATE filed briefs, and reply briefs were filed by the same parties on May 12, 2009. The record consists of 334 pages of testimony and 28 exhibits admitted into evidence.

Positions of the Parties

Mich Con's proposed EOP covers 2009 through 2011, in accordance with the requirements for EOPs set forth in the Temporary Order. Mich Con proposes to have its energy optimization programs jointly administered with those of The Detroit Edison Company (Detroit Edison) by establishing a combined organization for program administration of energy optimization programs for both utilities. According to Mich Con, this consolidated administration will optimize the effective and efficient spending of energy optimization funds and provide administrative efficiency.

According to Mich Con, the company developed its portfolio of programs with the assistance of Morgan Marketing Partners, a consulting firm that provides energy efficiency consulting services, including program design. Mich Con states that it proposes to offer five residential programs (Residential and Small Business ENERGY STAR Products, Residential HVAC, Multi-family, Residential New Construction, and Residential Audit and Weatherization) that are based on combinations of measures that have proven to be cost effective in other states. Mich Con will also offer specialty programs to assist low income customers in reducing energy consumption and

lowering their energy bills through local non-profit organizations that assist low income customers in home weatherization.

Mich Con will offer two basic types of programs to its commercial and industrial customers, including end use transportation (EUT) customers: 1) prescriptive and 2) non-prescriptive. Mich Con described the prescriptive program as one that provides fixed incentives based on proven technologies identified in the Michigan Energy Measures Database (MEMD). For custom applications in buildings and facilities, Mich Con proposes a non-prescriptive program to allow for the implementation of custom energy savings measures to be supported with a financial incentive that varies according to the amount of gas savings.

Mich Con's low income program plan component focuses on: 1) providing funding to organizations that specialize in weatherizing and refurbishing low income housing; and 2) supporting existing residential measures and programs in low income areas. Mich Con's EOP also includes programs for customer education, and the piloting of new technologies and marketing approaches, in accordance with MCL 460.1071(4)(a) and the Temporary Order.

Mich Con asserts that its EOP satisfies the utility system resource cost test and is reasonable and prudent. Mich Con claims that its energy efficiency program is estimated to produce 206,969,898 hundred cubic feet (Ccf) of energy savings over its 22-year lifetime and that these savings have a present value of \$109 million. *See*, Exhibit A-10. Mich Con notes that in developing its energy savings targets, it used a 10-year normalized weather pattern to project its demand requirements and required reductions. Mich Con asserts that its programs collectively demonstrate a utility system resource cost test score of 2.96. *See*, Exhibit A-9.

Mich Con asserts that it has satisfied the requirements of MCL 460.1071(3)(d) by creating a tracking system to ensure that revenues from a rate class will be spent on programs for that rate

class. Any under or over collection of spending by rate class will be subject to reconciliation with the EOP's actual results. Mich Con further contends that its EOP is designed to ensure that the applicable energy optimization standards set forth in MCL 460.1077(3) are met or exceeded.

Mich Con asserts that it has satisfied the EOP evaluation requirements under MCL 460.1071(3)(i) by contracting with an independent energy program evaluation provider, TecMarket Works. Mich Con adds that ongoing evaluation of the energy optimization programs will be performed by an independent third-party evaluation firm, which will evaluate energy savings realized and the effectiveness of measures installed by Mich Con's customers.

Mich Con notes that the Temporary Order, p. 34, states: "The Commission finds that it is reasonable that the providers began energy optimization plan and program development as soon as PA 295 was enacted. The Commission authorizes deferred accounting of actual costs incurred by a provider in implementing its energy optimization plan under Act 295, Subpart B." Accordingly, Mich Con states that it has deferred the incremental program development costs accrued since October 6, 2008, and has included them as part of the 2009 surcharge.

In accordance with MCL 460.1089(4), Mich Con requests authorization to capitalize certain incentives and associated third-party costs, and proposes a five-year amortization period for recovery of these costs. Mich Con argues that capitalization under Act 295 means that a utility will be allowed to earn a return on all capitalized costs, as well as a return of those costs.

Mich Con requests approval to include a provision for uncollectible costs through the energy optimization surcharge. Mich Con claims that its request has precedent in Case No. U-12478, where a provision for uncollectibles was included in the surcharge. Mich Con observes that with declining sales and increasing uncollectibles, the company should not be forced to wait until a reconciliation process to collect this money.

Mich Con also requests a provider performance incentive, as provided in MCL 460.1075. Under Mich Con's proposed mechanism, the performance incentive would be phased-in on a graduated scale, with the maximum incentive (15% of program spending) occurring if 105% or more of the target savings is achieved. Mich Con contends that it will achieve at least 105% of the energy optimization target each year of its plan. Mich Con also proposes to collect each year's performance incentive as it is being earned. Mich Con asserts that because the incentive is a cost of the program, it is appropriate to collect that cost as the program operates.

Mich Con contends that it developed and filed its EOP with the understanding that the Commission would approve its entire filing, without material modification, including Mich Con's proposed incentive mechanism. Mich Con asserts that the alternative proposals regarding an incentive mechanism (as well as various other proposals to alter Mich Con's proposed EOP) "ignore Act 295's directives and attempt to both distort the nature of this case and contravene the spirit and the intent of Act 295." Mich Con's initial brief, p. 5. Mich Con maintains that any changes to its proposed financial incentive mechanism must have the company's consent as provided under MCL 460.1021(5).

The Staff recommends that the Commission approve Mich Con's EOP and proposed surcharges associated with program costs. The Staff asserts that the plan meets the requirements of Act 295 and the Temporary Order and is reasonable and prudent with respect to its proposed spending levels and savings targets. The Staff further recommends that the Commission reject Mich Con's proposal to include estimated uncollectibles in the surcharge, and reject the company's proposed financial incentive mechanism in favor of the Staff's proposed alternative mechanism.

With respect to Mich Con's proposal to include uncollectibles as part of the surcharge, the Staff asserts that it does not consider uncollectible expenses as a qualifying energy optimization program cost. According to the Staff, uncollectible expenses are properly recovered in a utility's general rate case, where the reasonableness of collection efforts can be evaluated. The Staff maintains that to include uncollectible expenses in EOP surcharges, as Mich Con has proposed, would result in a free-pass on recovery, which is not in the public interest. The Staff recommends that the Commission order Mich Con to recalculate the EOP surcharge after removing the projected uncollectible expense.

The Staff argues that the criteria for approving or rejecting a utility's EOP do not require the approval of any financial incentive mechanism. The Staff contends that Mich Con's proposed financial incentive mechanism is unreasonable because the mechanism is not consistent with the requirements of Act 295, which allow the Commission to authorize "a commensurate financial incentive ...for exceeding the energy optimization performance standard." MCL 460.1075. According to the Staff, the word "commensurate" means corresponding in scale. The Staff maintains that Mich Con's proposed incentive computation provides for additional performance (percent above target) that is critically compressed. "This compression causes the mechanism to plateau at the statutory maximum for actual performance that is likely in the range of uncertainty of an EO plan designed to meet the target. In the performance range beyond 5% above target, Mich Con's mechanism provides for a fixed incentive equal to the statutory cap of 15% of spending." Staff's initial brief, pp. 8-9 (internal citation omitted). The Staff asserts that its proposed incentive mechanism, shown in Exhibit S-1, is a commensurate incentive for exceeding energy optimization targets.

The Staff does not recommend that the Commission approve Mich Con's proposal to begin collecting the financial incentive now, as part of the energy optimization surcharge. The Staff argues that incentive payments should be recovered after the fact, in future surcharges. According to the Staff, the annual reconciliation process is appropriate to verify savings levels and to adjust future surcharges to recover incentive payments.

Finally, the Staff recommends the establishment of an evaluation workgroup with key stakeholders, to continue to evaluate and improve upon the EOP.

The Attorney General contends that uncollectibles should not be recovered in the EOP surcharge because they are already recovered through base rates, as well as through the uncollectible expense tracking mechanism (UETM). The Attorney General points out that the UETM will still reconcile the actual uncollectibles for this new monthly amount against projected uncollectibles in the base rates.

The Attorney General opposes the proposed financial incentive mechanism. The Attorney General argues that the incentive is not commensurate with performance, and that any incentive during this time of economic downturn should be denied. The Attorney General contends that if any financial incentive is approved then the Commission should not approve any future decoupling.

The Attorney General opposes use of the DSMORE modeling program for determining the cost effectiveness of the EOP, because, the Attorney General argues, the model is based upon flawed assumptions and inputs. The Attorney General objects to the fact that the inputs are derived from Mich Con, and points out that the inputs may turn out to be incorrect. The Attorney General further objects to the use of deemed savings and small samples to determine the energy

savings from the EOP. The Attorney General contends that an independent evaluator must make these determinations.

The Attorney General objects to Mich Con's use of 10-year weather normalization rather than 30-year. The Attorney General argues that the longer period results in greater accuracy.

Finally, the Attorney General urges the Commission to reject the EOP because all ratepayers must pay for it, but only a few ratepayers will be able to take advantage of it. The Attorney General points out that certain programs allow only very limited participation. The Attorney General also argues that the part of the program that is targeted at low income customers is too large.

ABATE argues that the plan to surcharge gas transportation customers is unwarranted and unlawful. ABATE argues that the Commission erred in the Temporary Order when it determined that the term "natural gas customers" includes natural gas transportation customers. Temporary Order, pp. 32-33. ABATE contends that these customers should be excluded because they do not purchase natural gas from Mich Con, but simply use Mich Con's system to transport gas from a third-party supplier to their facility. ABATE argues that Section 93(1) of Act 295 is obviously intended to exclude gas transportation customers from EOP surcharges. MCL 460.1093(1). ABATE asserts that gas transportation customers cannot help to reduce the consumption of natural gas in Mich Con's service territory because they do not purchase gas from Mich Con.

ABATE urges the Commission to disapprove the financial incentive mechanism. ABATE points out that the incentive is permissive, and argues that the proposed incentive is unnecessary, not cost effective, and improperly constructed. ABATE argues that Mich Con's shareholders are fairly compensated for the risk of lost revenue from the EOP through the allowed return on equity. ABATE asserts that the appropriate remedy for uncompensated lost revenues is an increase in base

rates, and a rate case is the proper place for such a review. ABATE objects to the fact that the incentives are collected prior to acquiring proof that the targets have been exceeded. ABATE urges the Commission to encourage voluntary customer conservation efforts. Like the Attorney General, ABATE argues that if an incentive is approved then future decoupling is unjustified.

ABATE agrees with the Attorney General that uncollectibles should not be part of the EOP, and that 10-year weather normalization should be rejected in favor of 30-year.

Findings of Fact and Conclusions of Law

Subpart B of Part 2 of Act 295 concerns energy optimization. Among other things, Subpart B requires the filing with the Commission of EOPs by each electric provider (other than alternative electric suppliers) and all rate-regulated natural gas distribution utilities. The overall goal of an EOP is to reduce the future costs of provider service to customers. Energy optimization plans are to be “designed to delay the need for constructing new electric generating facilities and thereby protect consumers from incurring the costs of such construction.” MCL 460.1071(2). Each provider’s proposed energy optimization plan is subject to review and/or approval in the same manner as an electric provider’s renewable energy plan under Subpart A of Act 295. A provider is permitted to combine its energy optimization plan with its renewable energy plan. Providers are also permitted to request Commission approval of the payment of a financial incentive to reward the provider for positive performance.

The EOP must: 1) propose a set of programs that will meet energy savings targets established by Act 295; 2) include offerings for each customer class, including low income residential; 3) specify necessary funding levels; 4) propose cost recovery mechanisms that will allow recovery of EOP costs; 5) demonstrate that the energy optimization programs, excluding program offerings to low income residential customers, will be cost effective; and 6) provide for the practical and

effective administration of the proposed programs. Act 295 further provides that the Commission may authorize a financial incentive for exceeding the energy optimization performance standard.

Section 73(2) of Act 295 provides:

The commission shall not approve a proposed energy optimization plan unless the commission determines that the EO plan meets the utility system resource cost test and is reasonable and prudent. In determining whether the EO plan is reasonable and prudent, the commission shall review each element and consider whether it would reduce the future cost of service for the provider's customers. In addition, the commission shall consider at least all of the following:

- (a) The specific changes in customers' consumption patterns that the proposed EO plan is attempting to influence.
- (b) The cost and benefit analysis and other justification for specific programs and measures included in a proposed EO plan.
- (c) Whether the proposed EO plan is consistent with any long-range resource plan filed by the provider with the commission.
- (d) Whether the proposed EO plan will result in any unreasonable prejudice or disadvantage to any class of customers.
- (e) The extent to which the EO plan provides programs that are available, affordable, and useful to all customers.

The Commission agrees with the Staff's position that Mich Con's EOP meets the requirements for approval under Section 73 and that, although there are problems with the EOP, these problems do not rise to the level where the plan should be found unreasonable.

The Commission agrees with the Staff that accurate information about implementation of energy efficiency measures and energy savings is essential to successful implementation and verification of the EOP for Mich Con and the other electric and gas providers. For this reason, the Commission established a collaborative to provide program evaluation support in the May 26, 2009 order in Case No. U-15805, pp. 29-30, 33.

The Commission also finds that approval of a financial incentive is at the Commission's discretion, and the incentive must be commensurate with the degree to which the provider's program exceeds the energy optimization targets. The Commission agrees that Mich Con's proposed financial incentive mechanism is not proportionate with additional energy savings above

the statutory targets. As the Staff points out, Mich Con's proposed incentive mechanism provides substantial rewards for results that may be within the margin of error for the statutory targets for energy savings. However, the Commission believes that the Staff's incentive mechanism would be more effective if it enhanced the incentive to invest more in cost-effective energy optimization programs. Therefore, the Commission directs that within 30 days, the parties to this case may file new proposed financial incentive mechanisms. The parties may propose something new or may use the mechanisms proposed by either Mich Con or the Staff, with modifications to achieve the aforementioned objectives.

The Commission also agrees with the Staff, the Attorney General, and ABATE that uncollectibles should not be included in the EOP, because all uncollectibles are already included in the UETM and subject to reconciliation. The Commission further agrees with the Staff that Mich Con's proposed 10-year weather normalization should be accepted. 2 Tr 323-324.

ABATE's objection to the inclusion of natural gas transportation customers in the EOP has been addressed, as ABATE demonstrates, in Case No. U-15800, and will not be addressed again here.

THEREFORE, IT IS ORDERED that:

- A. The energy optimization plan filed by Michigan Consolidated Gas Company is approved.
- B. The proposed surcharges for Michigan Consolidated Gas Company's energy optimization plan are approved for implementation for bills rendered on and after June 3, 2009, subject to the exclusion of the uncollectibles and financial incentive mechanism portions of the proposed surcharges, as set forth in this order.
- C. Uncollectibles associated with the energy optimization plan shall be addressed through the uncollectibles expense tracking mechanism in Michigan Consolidated Gas Company's next

general rate case, and will be monitored by the Commission Staff in the energy optimization plan reconciliation proceeding.

D. Within 30 days, interested parties shall file new proposals for a financial incentive mechanism. The parties may propose a new mechanism or may use one of the mechanisms proposed by either Michigan Consolidated Gas Company or the Commission Staff, with modifications to achieve the objectives set forth in the order.

E. Michigan Consolidated Gas Company shall file its first reconciliation on or before March 31, 2010.

F. Michigan Consolidated Gas Company shall file with the Commission, within 30 days, tariff sheets that reflect the approvals set forth in this order.

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

Orjiakor N. Isiogu, Chairman

By its action of June 2, 2009.

Monica Martinez, Commissioner

Mary Jo Kunkle, Executive Secretary

Steven A. Transeth, Commissioner