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

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **CONSUMERS ENERGY COMPANY** for authority to increase its rates for the distribution of natural gas and for other relief.	)))))	Case No. U-13000

At the December 20, 2001 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. Laura Chappelle, Chairman
Hon. David A. Svanda, Commissioner
Hon. Robert B. Nelson, Commissioner

OPINION AND ORDER

I.

History of Proceedings

On June 29, 2001, Consumers Energy Company (Consumers) filed an application seeking authority to increase its rates for the transportation, storage, and distribution of natural gas in the annual amount of not less than $140,011,000 and for other relief. At the same time, Consumers submitted a motion pursuant to MCL 460.6a for partial and immediate rate relief in the annual amount of not less than $34,465,000, which it proposed to collect through imposition of interim surcharges on all customer classes.

A prehearing conference was conducted by Administrative Law Judge Daniel E. Nickerson, Jr., (ALJ) on August 16, 2001 at which petitions for leave to intervene filed by the Association of Businesses Advocating Tariff Equity (ABATE), Attorney General Jennifer M. Granholm

(Attorney General), the Midland Cogeneration Venture Limited Partnership (MCV), Metro Bureau Group Services, Inc., (MBGS), the National Energy Marketers Association (NEMA), and Thomas C. DeWard were granted. The Commission Staff (Staff) also participated in the proceedings. The ALJ also established a schedule.

On September 19, 2001, Consumers filed revised testimony decreasing the amount of partial and immediate rate relief sought to $32,817,000.

On October 16 and 17, 2001, the ALJ conducted the evidentiary hearing on Consumers' motion for partial and immediate rate relief. During the course of the hearing, 10 witnesses testified and 32 exhibits were received into evidence. On October 31, 2001, briefs were filed by Consumers, the Staff, the Attorney General, ABATE, and Mr. DeWard.

II.

Positions of the Parties

Consumers

Consumers presented 5 witnesses and 23 exhibits in support of its motion. For the purposes of interim relief, Consumers relies upon historical 2000 test year data. Because Consumers is currently authorized to earn a rate of return on common equity of 11.6%, Consumers experienced a revenue deficiency of $52,497,000 based on unadjusted data from 2000. However, Consumers points out that a significant part of the revenue deficiency is attributable to warmer than normal weather and commodity losses incurred in the third year of its experimental gas customer choice program.[1] Nevertheless, Consumers maintains that even after actual results for 2000 are properly

[1] Consumers' experimental gas customer choice program was approved by the Commission's December 19, 1997 order in Case No. U-11599.

normalized for these and other factors, its evidence indicates a substantial revenue deficiency for interim relief purposes.

The largest adjustment proposed by Consumers involves a revision to its rate base. Consumers' historical 2000 test year rate base is $1,147,507,000. Exhibit A-1. Consumers proposes to value its rate base at $1,294,835,000 for interim purposes. Exhibit A-19. The increased rate base reflects two changes. First, Consumers proposes to decrease its average net utility plant balance by $36,502,000 to reflect the full effect of the accounting change approved by the Commission's October 24, 2000 order in Case No. U-12679, wherein the Commission authorized Consumers to reclassify 75.5 billion cubic feet (Bcf) of recoverable base gas stored underground from Account 358 to Account 164.1 and to transfer the cost of that gas on the company's books and records to Account 164.1. Second, Consumers proposes increasing its working capital by $183,829,000 due to the change in its natural gas inventory associated with the accounting change and increases in natural gas prices. Consumers maintains that these revisions are necessary to ensure that the rates in effect as a result of the Commission's order on partial and immediate rate relief will be reasonably related to its actual rate base.

Consumers also proposes a number of additional normalizing adjustments to the historical test year data for revenues and expenses, which are summarized on Exhibits A-20 and A-21. The revenue adjustments include increasing sales revenues to normalize for weather conditions, to remove a commodity loss, and to eliminate an amount remaining in its gas customer choice reserve. Transportation revenues were increased due to weather conditions. Miscellaneous revenues were decreased to adjust for unauthorized gas usage charges.

Consumers' expense adjustments include a reduction associated with lost and unaccounted for gas, an increase in the cost of gas related to normalized weather conditions, five "true-up" adjustments of expenses related to federal income taxes (FIT), Michigan single business taxes (MSBT), an executive incentive compensation plan (EICP), its “Save & Share” program, and its public utility assessments. Additional adjustments relate to changes in other operation and maintenance (O&M) expenses due to a change in accounting for paid personal absence liability and to remove the effects of a life insurance refund.

Consumers’ current gas rates were established by the March 11, 1996 order in Case No. U-10755, which approved use of the overall rate of return of 7.83%. In this proceeding, Consumers proposes an overall rate of return of 8.0871% based on the capital structure and cost rates described on Exhibit A-4, which adopts the same rate of return on common equity of 11.6% that was approved in Case No. U-10755. Consumers bases its proposed cost of long-term debt of 7.3085% on historical 2000 test year data. Its proposed cost of short-term debt of 7.6972% is the company’s actual rate for December 2000. The proposed cost of preferred stock is 4.4557%, and is based on the weighted average preferred stock cost for the test year.

At the conclusion of the evidentiary hearing, Consumers’ position reflected a desire to obtain partial and immediate rate relief in the amount of $32,817,000. However, as more fully indicated in the discussion of the Staff’s position, in its October 31, 2001 brief, Consumers chose not to contest several of the Staff’s adjustments, which lowers the amount of partial and immediate rate relief sought by Consumers to $26,335,000.

Finally, it is Consumers’ position that interim relief should be collected through imposition of interim rate surcharges on all customer classes.

<u>The Staff</u>

The Staff presented 2 witnesses and 2 exhibits in support of its contention that Consumers’ motion for partial and immediate rate relief should be denied in its entirety. According to the

Staff, although Consumers' case for interim relief satisfies all of the procedural requirements set forth in MCL 460.6a, the utility failed to demonstrate that its proposed increase should be granted because the level of its probable revenue deficiency is "insignificant." 3 Tr. 246.

The Staff report required by MCL 460.6a, which was admitted as Exhibit S-30, contains a summary of prior precedent regarding the standards for acting on motions for partial and immediate rate relief. According to the Staff, such precedent indicates that the Commission will not entertain controversial adjustments or any adjustments viewed as clear departures from past ratemaking policies. Guided by those principles, the Staff indicated its agreement with only three major types of adjustments to Consumers' historical 2000 test year data.

First, the Staff agrees with Consumers that there should be an adjustment for the actual changes to the value of gas in underground storage that result from the company's use of projected 13-month averages for the period ending December 31, 2001. The Staff explained that it determined the amount of this adjustment by utilizing Consumers' projection of the volumes and cost of gas in its underground storage fields and then adjusting for the effect of the October 24, 2000 order. The Staff calculated that the increase in working capital attributable to higher gas costs is $53,217,000.

Second, the Staff indicated that certain revenue and expense adjustments affecting net operating income (NOI) that appear on page 4 of Exhibit S-31 should be made. It is the Staff's position that Consumers' NOI for the test year should be $93,174,000. Among the Staff's revenue adjustments are changes in sales and transportation levels to normalize for the effects of weather. However, in so doing, the Staff expressly disapproved Consumers' approach, which included a leap-year adjustment in its calculations. (At page 19 of its October 31, 2001 brief, Consumers accepted this adjustment.) The Staff's adjustments also included the annualization of Consumers' sales and transportation rates, which the Staff stated would eliminate the need to reflect certain revenue adjustments included by Consumers. (At page 19 of its October 31, 2001 brief, Consumers accepted these adjustments.)

Third, the Staff concluded that it would agree with Consumers' adjustments to historical 2000 test year data for non-recurring expense adjustments associated with two changes in accounting for vacation expense accrual ($2,634,000 and $1,993,000) and a life insurance refund ($1,585,000). 4 Tr. 274.

Additionally, the Staff expressly disagreed with several of the adjustments proposed by Consumers. Specifically, the Staff indicated that it would be "premature and unreasonable" to include the effects of the October 24, 2000 order in Case No. U-12679 in rates at this time because the adjustment would effectively deprive customers of the anticipated benefits. In so doing, the Staff reasoned that because Case No. U-12679 involved a controversial accounting adjustment that was approved without a hearing, the Commission should not address Consumers' proposed working capital adjustment attributable to that order without the benefit of a full and complete hearing. The effect of the Staff's adjustment is a $13,845,000 decrease in Consumers' revenue deficiency. 4 Tr. 271.

The Staff also proposed elimination of the effect of discounts provided to transportation customers, which decreased the company's revenue deficiency by $4,252,000. Additionally, the Staff opposed all five of the "true-up" adjustments proposed by Consumers. According to the Staff, these adjustments are inconsistent with prior Commission orders and should not be considered for interim purposes.

Finally, the Staff opposed Consumers' inclusion of $414,000 in expenses associated with its payment of executive bonuses. (Although maintaining the appropriateness of including these costs in its test year expenses, Consumers stated in its October 31, 2001 brief that it would concede this issue for interim purposes.)

After all of its revisions, the Staff calculated a revenue deficiency in the amount of $1,535,000.

Attorney General

The Attorney General presented the testimony of one witness and six exhibits in contending that Consumers' motion for partial and immediate rate relief should be denied. The Attorney General's case focuses on two aspects of Consumers' presentation. The Attorney General maintains that $15,616,000 of the $32,817,000 interim rate relief requested by Consumers is attributable solely to the base gas adjustment approved in Case No. U-12679. According to her, there are five reasons for the Commission to deny interim relief with regard to the base gas adjustment. First, the Attorney General insists that interim relief should not include highly controversial items. Because the October 24, 2000 order was issued without the benefit of notice or an opportunity for a hearing, the Attorney General argues that the effects of the base gas transfer are more appropriately considered in the context of the Commission's final order in this proceeding.

Second, the Attorney General stresses that Consumers was the sole beneficiary of the gas cost reduction attributable to the base gas transfer from October 25, 2000 to March 31, 2001, when the three-year suspension of Consumers' gas cost recovery (GCR) clause expired. According to the Attorney General, during the subsequent five months, the residual effects of the base gas transfer resulted in only a $11,824,961 gas cost reduction for ratepayers. Therefore, the Attorney General reasons that 92% of the expense reduction benefits of the base gas transfer accrued directly to

Consumers. For this reason, she insists that it would be unfair to assign 100% of the resulting rate base increase to ratepayers.

Third, the Attorney General states that one of Consumers' witnesses argued for inclusion of the rate base adjustments in the interim case because their magnitude could drive down Consumers' rate of return on common equity during 2001. Citing the fact that Consumers' actual gas return on equity has been trending up during 2001, not down, the Attorney General contends that Consumers' argument lacks merit.

Fourth, the Attorney General argues that, in the application in Case No. U-11599, which involved Consumers' request for approval of the three-year experimental gas customer choice program, Consumers expressly assumed the risk of losses associated with gas commodity cost increases. The Attorney General maintains that when Consumers actually faced the prospect of incurring such losses, it managed to avoid them because the base gas transfer eliminated Consumers' $115 million net gas commodity loss and turned it into a permanent rate base increase. Therefore, the Attorney General contends that it would be patently unfair for Consumers to not shoulder any of the gas commodity loss.

Fifth, the Attorney General states that the possibility that mismanagement contributed to the 2000-2001 year $161 million gas commodity loss experienced by Consumers has not been addressed. The Attorney General suggests that the issue of whether Consumers could have eliminated or greatly reduced that loss as well as the question of the reasonableness of the utility's planning and response to the situation should be addressed in the final rate phase of this case.

With regard to the $17,201,000 of interim relief that is not related to the base gas transfer, the Attorney General states that the capital structure underlying Consumers' interim relief request is flawed and should be replaced by the capital structure used in Case No. U-10755. According to the Attorney General, any expense increases resulting from Consumers' modifications to its capital structure are self-inflicted and should be disallowed for interim relief.

The Attorney General also insists that the overall rate of return of 8.0871% proposed by Consumers is excessive. Given the recent decline in interest rates, the Attorney General maintains that a more appropriate overall rate of return would be 7.68% as calculated on Exhibit I-27. According to the Attorney General, use of the overall rate of return of 7.68% would reduce the non-base gas transfer portion of interim relief from $17,201,000 to $8,900,000, which the Attorney General insists is insufficient to justify emergency rate relief.

ABATE

ABATE presented the testimony of one witness in support of its contention that transportation customers should be spared from paying any portion of the interim relief. According to ABATE, Consumers has completely abandoned the principle of basing rates on cost of service with respect to its proposed interim rate design. ABATE argues that, while Consumers is proposing a final rate decrease to total transportation service, it proposes a significant interim increase for transportation customers due to the use of equal percentage surcharges to all customer classes. ABATE maintains that Consumers' cost of service study shows that transportation customers are currently providing Consumers with twice the rate of return it is requesting for interim relief. ABATE stresses that the principal reason for Consumers' need for interim relief is the increase in its gas in inventory. Because transportation customers purchase their own gas and only utilize Consumers' transportation service to deliver customer-owned gas, ABATE insists that transportation customers are not responsible for any increased revenue deficiency associated with the increased cost of gas in inventory. Citing Exhibit A-6, ABATE also stresses that transportation customers are already providing Consumers with revenues in excess of those required to ensure Consumers a rate of return of 8.09%.

Mr. DeWard

Mr. DeWard presented one exhibit and personally testified in support of his contention that Consumers' request for interim relief should be denied. Mr. DeWard's primary position, which consists of 15 adjustments to Consumers' case, calls for the Commission to immediately reduce Consumers' rates by $15,438,919. Mr. DeWard's secondary position, which consists of 17 adjustments to Consumers' case, calls for the Commission to immediately reduce Consumers' rates by $8,168,392.

Fourteen of the adjustments embodied in his primary and secondary positions are redundant.[2] Both positions call for removal of undistributed earnings of Michigan Gas Storage Company from common equity, removal of earnings (less federal income taxes) due to a change in recording of property tax expense, removal of prepaid taxes resulted from a change in recording property taxes, a deferred tax adjustment, an increase in working capital to remove reserves and receivables, removal of deferred federal income taxes on contributions in aid of construction (CIAC) from rate base, reduction of amortization expense associated with the CIAC adjustment, removal of 1999 and 2000 gains on the sale of property from rate base, increasing income due to revenues from unauthorized gas use fees, removal of negative income from gas loan revenue, moving income from non-utility to operating income, reduction of labor for leap year adjustment, removal of non-recurring and inappropriate expense, and adjustment of federal income tax expense.

[2] Although the intent of the adjustments is identical, the amounts of the adjustments sometimes vary due to differences in the amount of rate base or other factors.

In addition to the 14 redundant adjustments, Mr. DeWard's primary position calls for removal of $147,327,000 from rate base due to rejection of the base gas adjustment.

Mr. DeWard's secondary position has three unique adjustments, including a proposal to finance gas stored underground with short-term debt, increasing accounts payable to offset gas stored underground, and reducing financing costs on receivables.

III.

Discussion

Standards for Partial and Immediate Rate Relief

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

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

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

The statute does not specify any substantive standards for the granting of a motion for partial and immediate rate relief. Over the years, the Commission has adopted various standards through the issuance of interpretive statements, guidelines, and case-by-case determinations. Having reviewed the Commission's prior statements and considered current circumstances, the

Commission concludes that the primary purpose of interim relief is to provide additional revenues on an expedited basis when the utility is experiencing a significant revenue deficiency and the revenue deficiency is likely to be experienced for a prolonged period of time.

Consumers is alleging an immediate revenue deficiency of more than $26 million. It is undisputed that Consumers is about to enter its peak revenue months, which exacerbates the company's potential revenue shortfall if any appropriate rate relief is delayed. It is also well established that the schedule set for the hearing of this case will not permit issuance of a final order until the end of the heating season. Consequently, the failure to consider interim relief at this time will cause a hardship to the utility due to the loss of revenues that can never be recouped. It is well established that the Commission cannot set a future rate to permit a utility to recover revenue lost during the pendency of a permanent increase request. Michigan Consolidated Gas Co v Public Service Comm, 389 Mich 624; 209 NW2d 210 (1973), General Telephone Co v Public Service Comm, 341 Mich 620; 67 NW2d 882 (1954), and Michigan Bell Telephone Co v Public Service Comm, 315 Mich 533; 24 NW2d 200 (1946). Therefore, the Commission turns to the issue of whether, in light of all of the evidence, the Commission should exercise its discretion to grant any or all of the relief sought in Consumers' motion.

Revenue Deficiency

Reduced to its essence, Consumers' request for interim relief in the amount of $26,335,000 consists of five elements. Only four of these elements remain in dispute.

1. Cost of Capital

The Commission is aware of the Attorney General's concern that the overall rate of return of 8.0871% proposed by Consumers and supported by the Staff for interim purposes is excessive in light of the recent decline in interest rates. The Commission is also aware of concerns expressed by the Attorney General with regard to Consumers' proposed capital structure, which is based upon the actual capital structure as of December 31, 2000.

The Attorney General supports the use of a 7.68% rate of return. The Attorney General's position is based on use of Consumers' capital structure from Case No. U-10755, which employed data from a 1996 test year and updated cost rates.

Consumers maintains that the Attorney General's overall rate of return is unreasonable because her proposal to use its 1996 capital structure in this proceeding is flawed. Consumers stresses that there are considerable differences between Consumers' 1996 and 2000 capital structures. Indeed, both Consumers and the Staff supported use of the 2000 capital structure data because Consumers' 2000 capital structure is much closer to the capital structure that will actually exist while the interim rates will be in effect.

After considering the merits of the arguments, the Commission finds that the Attorney General's proposal should not be adopted. The Commission is not persuaded that it would be reasonable to use an overall rate of return established through use of a projected 1996 capital structure that is now antiquated. Rather, the Commission agrees with Consumers and the Staff that Consumers' historical 2000 test year capital structure will produce results that are more reasonable than the projected 1996 test year data.

2. Base Gas Adjustment

The Commission's October 24, 2000 order in Case No. U-12679 authorized Consumers to reclassify 75.5 Bcf of recoverable base gas from Account 358 to Account 164.1 and to transfer the cost of that gas on the company's books and records to Account 164.1. Consumers made these adjustments on October 25, 2000. Consumers argues that the Commission should recognize these accounting adjustments for purposes of establishing its interim rates because the company has demonstrated a massive increase in investment necessary to fund its gas purchases. Further, Consumers stresses that the Staff agreed that Consumers' projected 13-month average gas in storage balance of $383 million for the year ending December 31, 2001 is more representative than the historical balance of $200 million. In any event, Consumers maintains that the failure to recognize the effects of the base gas reclassification in rates at this time is inconsistent with the October 24, 2000 order in Case No. U-12679 and is confiscatory because it accepts the effect of reducing the cost of gas paid by GCR customers while rejecting the increase to the company's working capital requirement.

The Staff maintains that the ratemaking effect of the October 24, 2000 order in Case No. U-12679 is controversial and is therefore more properly a matter for the final phase of this proceeding. Indeed, the Staff states that the Commission should not place the effect of the accounting adjustment into rates prior to "a full and complete hearing." Staff's brief, p. 8. Moreover, the Staff contends that recognition of the base gas reclassification at this time deprives ratepayers of the benefits that were anticipated by the Commission when it approved Consumers' application in Case No. U-12679.

The Attorney General contends that recognition of the base gas reclassification for interim purposes is controversial and unnecessary given the significant benefits that flowed to Consumers by virtue of the October 24, 2000 order. According to the Attorney General, absent approval of Consumers' application in Case No. U-12679, the company would have had a $115,800,000 loss during the three-year experimental gas customer choice program. Additionally, the Attorney General cites the Staff's concern that recognition of the base gas reclassification at this time would prevent ratepayers from realizing much of the benefits expected as a result of the October 24, 2000 order.

It its brief, ABATE indicates that it generally supports the positions taken by the Staff and the Attorney General.

Mr. DeWard insists that the base gas reclassification issue is unprecedented, highly controversial, and inappropriate for interim relief. According to him, Consumers has already received a $115,800,000 benefit due to the ability to avoid a loss during the three-year experimental gas customer choice program. He believes that any additional benefits are not necessary at this time. Indeed, Mr. DeWard maintains that the fact that Consumers' borrowing costs were significantly reduced by avoiding the $115,800,000 loss should be sufficient justification to deny interim relief.

The Commission finds that the effects of the base gas adjustment approved by the Commission's October 24, 2000 order in Case No. U-12679 should be recognized for the purposes of determining interim relief. Pursuant to the Commission's authorization, Consumers made adjustments to its books and records that had an immediate effect on its rate base and its cost of gas. No one has questioned the accuracy of the adjustments or the fact the Consumers was required to make them. The adjustments reduced Consumers' plant in service balance and increased its working capital requirement balance. The adjustments also changed Consumers' cost of gas, reducing Consumers' GCR cost of gas after the March 31, 2001 expiration of the three-year price freeze approved by the December 19, 1997 order in Case No. U-11599.

These adjustments have been applied consistently to all of Consumers' gas transactions. While the rationale underlying the recoverable base gas adjustment may be debated, there is no reason to question the effect of the adjustment on the level of Consumers' working capital and its cost of gas. The increase in Consumers' working capital requirement attributable to the recoverable base gas adjustment is significant and readily determinable. The record clearly indicates that

Consumers' 13-month average natural gas inventory for the period ending December 31, 2001 will exceed $383 million. It is equally undisputed that working capital in rate base in current rates reflects $170 million in natural gas inventory.

Further, the Commission finds that the Staff's concern over the need to wait until the final phase of this case for a full and complete hearing on the issue is misplaced. MCL 460.6a(1) requires the Commission to afford interested parties an opportunity for a full and complete hearing as a prerequisite to issuance of an order granting interim relief. That hearing has taken place. The Staff and the intervenors have had the opportunity to cross-examine Consumers' witnesses, to present their own witnesses and exhibits, and to file briefs on all of the issues related to the base gas reclassification. Therefore, the procedural requirement of a full and complete hearing has been compiled with and the Commission may address the issue at this time. Of course, the Commission's resolution of an issue in connection with a request for interim relief does not preclude further litigation of the same issue during the final phase of this proceeding. As explained in Great Lakes Steel Div v Public Service Comm, 416 Mich 166; 330 NW2d 380 (1982), Section 6a(1) expressly provides that the Commission's decision on interim relief is to be made "pending submission of all proofs" and, therefore, must be rendered before the whole record exists.

Finally, the Commission rejects the characterization of the base gas adjustment as "controversial." The adjustment clearly benefited GCR customers by substantially reducing the cost of gas. The record indicates that the savings to GCR customers for the period April 2001 to March 2002 will approximate $77 million. 3 Tr. 99. There is nothing controversial about the need to recognize the ratemaking effects of such an adjustment, particularly when there have been benefits for ratepayers. Moreover, the Commission has broad discretion to set the boundaries of its inquiry into the appropriateness of granting or denying interim relief. Attorney General v Public Service Comm, 63 Mich App 69; 234 NW2d 437 (1975).

For the above reasons, the Commission finds that the arguments raised by the Staff, the Attorney General, ABATE, and Mr. DeWard lack merit.

3. True-up Adjustments

Each year Consumers accrues and books an estimated amount for certain expenses. The following year, when the actual amount of the expenses is determined, a true-up adjustment is made. For these expenses, the company's 2000 books included both an accrual of expense for 2000 and a true-up adjustment to the accrual that had been booked in 1999.

In its filing, Consumers eliminated the true-up adjustments for its FIT, its MSBT, its EICP, its "Save & Share" program, and its public utility assessments because these adjustments were all related to a period outside of the historical test year. In all five cases, elimination of the true-up adjustments had the effect of increasing the amount of expense reflected on Consumers' 2000 books.

Consumers and the Staff differ with regard to whether Consumers' NOI should reflect these true-up adjustments, which were proposed by Michael A. Torrey, Consumers' Director of Revenue Requirements, Cost Analysis, and Planning. Consumers maintains that the true-up adjustments are appropriate because they do not deviate from past Commission practice and are consistent with prior Commission orders. According to Consumers, on cross-examination of the Staff, it was shown that, in Case No. U-10755, the company made the same type of out-of-period adjustment with respect to FIT expense and that adjustment was accepted by the Staff. 4 Tr. 293-299. Additionally, citing the March 11, 1996 order in Case No. U-10755, Consumers maintains that the Commission also accepted that adjustment. Thus, Consumers submits that its true-up adjustments are appropriate.

The Staff rejected Consumers' proposed expense adjustments associated with true-up of 1999 expense accruals. According to Susan Crimmins Devon, Supervisor of the Auditing and Tariff Section of the Commission's Gas Division, Consumers' adjustment of the historical test year data is simply incomplete. The Staff states that by eliminating the 1999 true-up adjustments, the historical test year is left with only the estimated 2000 accruals, which will be adjusted sometime in 2001. It explains that Consumers' methodology does not include the subsequent year 2001 true-ups of the 2000 accrual as part of its true-up of its expense accruals. Thus, in the Staff's opinion, the historical test year is no longer reflective of normal 2000 expense levels. Finally, the Staff argues that nothing in Consumers' last rate proceeding is inconsistent with its position in this proceeding.

The Commission finds that the true-up adjustments proposed by Consumers should not be considered for interim purposes. As explained by Ms. Devon, Consumers' true-up adjustments appear to be incomplete because they do not account for related adjustments that are routinely made. Further, deferring consideration of these issues until the final phase of this proceeding provides the parties with an opportunity to sort through the adjustments and clarify their positions.

4. <u>Transportation Discounts</u>

Staff witness Devon imputed additional revenues to the historical test year in an amount equal to the discounts negotiated by Consumers with certain T-2 transportation service customers, which reduced Consumers' revenue deficiency by $4.2 million. The Staff reasons that Ms. Devon's imputation of additional revenues is required because the Commission approved a similar adjustment in Case No. U-10755.

Consumers objects. According to Consumers, the Commission should not base its rates on phantom revenues. Moreover, Consumers argues that the Staff's adjustment should be rejected for purposes of granting interim relief because it represents poor regulatory policy, because the Commission has not followed this policy consistently, and because it is unlawful. Consumers states that it makes no sense to adopt ratemaking policies that create a disincentive for it to attempt to attract or retain marginal load. Further, Consumers stresses that the Commission followed a different policy with respect to Mich Con's coal displacement customers when it approved the allocation of the revenue effect of those discounts to other transportation customers in the October 28, 1993 order in Cases Nos. U-10149 and U-10150. Finally, Consumers argues that other states have recognized the unlawfulness associated with imputing revenues to a utility in the context of discounted rates. Indeed, citing Cincinnati Gas & Electric Co v Public Utilities Comm, 86 Ohio St 3d 53; 711 NE2d 670 (1999), Consumers insists that the Staff's position should be rejected because it lacks any connection to reality.

The Commission finds that the imputation of additional revenues in the amount of the discounts negotiated by Consumers with its T-2 transportation service customers is reasonable and should be followed for interim purposes. In the March 11, 1996 order in Case No. U-10755, the Commission ordered that the discounted Rate T-2 transportation volumes be priced at the current T-1 rate, which is based on the cost of service. Order, Case No. U-10755, pp. 36 and 64. In its interim rate request, Consumers did not price out the discounted volumes at the T-1 rate and simply included the historical test year revenues derived from the discounted rate. Accordingly, Consumers' approach represents a departure from established Commission ratemaking policy and is inappropriate for purposes of interim rate relief. On the other hand, the Staff's adjustment is consistent with the ratemaking policy utilized in Case No. U-10755.

5. Staff's Interim Revenue Deficiency

Without considering the effect of the base gas adjustment, the Staff determined that Consumers would be likely to experience a revenue deficiency of $1.535 million. No one directly challenged the Staff's determination. Therefore, the Commission finds that the revenue deficiency determined by the Staff should be included in determining the level of interim relief. It should also be recognized that the Attorney General supported a revenue deficiency of $8,900,000, an amount in excess of the $4,928,000 relief granted to Consumers in the March 21, 1977 order in Case No. U-4717, and, therefore, not insignificant as the Attorney General contends.

Rate Design

Consumers and ABATE are the only parties to address rate design issues. Consumers proposed that the interim rate increase be apportioned to all sales and transportation customer classes based on historical 2000 test year revenues with each class being assessed a commodity surcharge to recover the class's assigned increase.

ABATE criticized two aspects of Consumers' approach to rate design. First, ABATE opposed assigning any portion of the interim increase to transportation customers. According to ABATE, Consumers' transportation customers are currently compensating Consumers at a level that far exceeds the amount necessary for Consumers to earn an overall rate of return of 8.0871%. ABATE stresses that Consumers is not seeking to increase the rates of transportation customers in the final order. Therefore, ABATE insists that increasing the rates of transportation customers for interim purposes is clearly inconsistent with Consumers' 2000 cost of service study. Second, ABATE maintains that Consumers' removal of certain premium and market-based volumes from the calculation of the interim surcharges is improper.

Consumers responds that rate design is a ratemaking function over which the Commission has great discretion. According to Consumers, there is no legal requirement that the Commission design rates strictly based upon the cost of serving each class of customers. Because its interim rates will be in place temporarily, pending a final order, Consumers urges the Commission to use a simplified rate design to avoid the necessity of considering the cost of service study and permanent rate design issues as part of the interim phase. In any event, Consumers states that further rate design adjustments can and will be made as part of the final phase of the case.

The Commission finds that ABATE's objections to Consumers' proposed interim rate design have merit and should be adopted for interim proposes. Given that Consumers is not seeking to increase the rates of transportation customers in the final phase of this proceeding, it is difficult to understand why it would be equitable to increase the rates of those customers for interim purposes.

IV.

Summary

The following summarizes the calculation of Consumers' interim revenue deficiency:

Description	Amount
Rate Base	$1,294,835,000
Overall Rate of Return	8.0871%
Income Required	$104,715,000
Adjusted Net Operating Income	$94,918,000
Income Deficiency	$9,797,000
Revenue Multiplier	1.5699
Revenue Deficiency	$15,380,000

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCL 462.2 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACS, R 460.17101 et seq.

b. There is a substantial probability that Consumers is experiencing a revenue deficiency of $15,380,000 on an annual basis.

c. An award of partial and immediate rate relief in the annual amount of $15,380,000 is warranted.

d. Consumers' rate base for partial and immediate rate relief purposes is $1,294,835,000. Its rate of return on common equity should remain at 11.6%, but its overall rate of return should be increased to 8.0871% to reflect changes in its capital structure and borrowing rates. Its adjusted NOI is $94,918,000.

e. The partial and immediate rate relief increase should be implemented through use of a commodity surcharge applicable to all sales customer classes, calculated and assessed on the basis of historical 2000 test year rate revenues.

f. Consumers should be required to file with the Commission a bond suitable to ensure that appropriate refunds will be made to its customers in the event that the final rate order in this proceeding provides for an annual rate increase of less than $15,380,000.

THEREFORE, IT IS ORDERED that:

A. Consumers Energy Company is authorized to increase its annual gas revenues by $15,380,000 and to place into effect the interim surcharges that are attached to this order as Exhibit A for service rendered on and after December 21, 2001.

B. Consumers Energy Company shall file with the Commission a bond suitable to ensure that appropriate refunds will be made to its customers in the event that the final rate order in this proceeding provides for an annual rate increase of less than $15,380,000.

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

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

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

MICHIGAN PUBLIC SERVICE COMMISSION

(S E A L)

/s/ Laura Chappelle
Chairman

/s/ David A. Svanda
Commissioner

By its action of December 20, 2001.

/s/ Dorothy Wideman
Its Executive Secretary

/s/ Robert B. Nelson
Commissioner

THEREFORE, IT IS ORDERED that:

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MICHIGAN PUBLIC SERVICE COMMISSION

____
Chairman

By its action of December 20, 2001.

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Commissioner

____
Its Executive Secretary

____
Commissioner

In the matter of the application of)
CONSUMERS ENERGY COMPANY for authority)
to increase its rates for the distribution of natural) Case No. U-13000
gas and for other relief.)
____)

Suggested Minute:

"Adopt and issue order dated December 20, 2001 granting, in part, Consumers Energy Company's motion for partial and immediate rate relief in the annual amount of $15,380,000, as set forth in the order."