

STATE OF MICHIGAN  
DEPARTMENT OF ATTORNEY GENERAL



**MIKE COX**  
ATTORNEY GENERAL

P.O. Box 30212  
LANSING, MICHIGAN 48909

March 29, 2004

Ms Mary Jo Kunkle  
Executive Secretary  
Michigan Public Service Commission  
6545 Mercantile Way  
Lansing, MI 48911

Dear Ms Kunkle:

**Re: MPSC Case No. U-13730**

I am enclosing for filing an original and 4 copies of the Attorney General's Replies to Exceptions to the Proposal for Decision. I am also enclosing a proof of service. In addition, a copy of this filing is being submitted electronically pursuant to the instructions in the Commission's notice of hearing.

Sincerely,

Donald E. Erickson  
Assistant Attorney General

c All Parties

**PROOF OF SERVICE - U-13730**

The undersigned certifies that a copy of the "Attorney General's Replies to Exceptions to the Proposal for Decision" was served upon the parties listed below by mailing the same to them at their respective addresses with first class postage fully prepaid thereon, or by State Interdepartmental mail as indicated, on the 29th day of March 2004.

---

Cindy Jakus

**Administrative Law Judge:**

Mr. James N. Rigas (P23155)  
MI Public Service Commission  
Administrative Law Judges Division  
PO Box 30221  
Lansing, MI 48909-8195      **[ID Mail]**

**MPSC Staff:**

Ms. Kristin M. Smith (P46323)  
Assistant Attorney General  
Public Service Division  
6545 Mercantile Way, Suite 15  
Lansing, MI 48911      **[I.D. Mail]**

**ABATE:**

Mr. Robert A. W. Strong (P27724)  
Clark Hill, P.L.C.  
255 S. Old Woodward Ave., Third Floor  
Birmingham, MI 48009

**Consumers Energy Company:**

Mr. Jon R. Robinson (P27953)  
Mr. H. Richard Chambers (P34139)  
Mr. Raymond E. McQuillan (P24100)  
Mr. John C. Shea (P36854)  
Consumers Energy Company  
One Energy Plaza  
Jackson, MI 49201

**Midland Cogeneration Venture  
Limited Partnership**

Mr. Michael J. Brown (P43015)  
Howard & Howard Attorneys, P.C.  
The Phoenix Building, Suite 500  
222 North Washington Square  
Lansing, MI 48933

Mr. Gary B. Pasek  
Midland Cogeneration Venture  
Limited Partnership  
100 Progress Place  
Midland, MI 48640

STATE OF MICHIGAN  
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

---

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

MPSC No. U-13730

---

**Attorney General's Replies to Exceptions to the Proposal for Decision**

Michael A. Cox  
Attorney General  
Paul F. Novak  
Assistant in Charge  
Special Litigation Division  
Donald E. Erickson  
Assistant Attorney General  
Sixth Floor G. Mennen Williams Bldg.  
525 W. Ottawa Street  
P. O. Box 30212  
Lansing, MI 48909

(517) 373-1123

March 29, 2004

**Table of Contents**

	<b><u>Page</u></b>
Introduction.....	1
Replies to CECo.....	1
I.    Overview .....	1
II.   Dismissal and Test Year Data .....	3
III.  Gas Depreciation.....	8
IV.  Conflict Between Dismissal and Alternative Recommendations .....	8
V.   SFAS 143 Asset Retirement Obligations.....	9
VI.  Specific Revenue Requirement Issues .....	9
Replies to ABATE .....	10
Replies to the MPSC’s Staff’ .....	11
Relief Requested .....	12

## **Introduction**

Pursuant to MCL 24.281, the Administrative Law Judge (ALJ) has issued a proposal for decision (PFD) in this case. Consumers Energy Company (CECo or the Company), the Association of Businesses Advocating Tariff Equity (ABATE), Attorney General Michael A. Cox (the Attorney General), and the Michigan Public Service Commission's (MPSC or the Commission) Staff filed written exceptions.

The deadline for filing replies to exceptions is March 29, 2004. In general, the Attorney General supports recommendations presented in the PFD. Pages 3-10 in the PFD conclude that the application for a rate increase by CECo should be dismissed. In the alternative, pages 10-49 in the PFD present recommended resolutions for specific issues that arise from the evidence and briefs filed by the parties.

## **Replies to CECo**

### **I. Overview**

Page 3 in CECo's exceptions argue that denying rate relief and dismissing this case would be unlawful and unreasonable as well as a recipe for disaster in violation of CECo's statutory and constitutional rights to just and reasonable rates.

This form of arguments commences a pattern followed by CECo throughout its written exceptions. CECo presents sound bites and maxims in response to the analysis presented in the PFD. In many places, CECo's exceptions present only cursory discussion of legal maxims, which beg the question being discussed. The real question is whether or not CECo has satisfied its burden of proof based upon the whole record. MCL 24.285.

CECo argues that the MPSC's grant of interim rate relief proves the Company has a revenue deficiency. In *Great Lakes Steel Div v PSC*, 416 Mich 166, 181; 330 NW2d 380 (1982), the Michigan Supreme Court said that a "partial and immediate" order is intended to be interlocutory, intermediate, and emergency relief, not required to be sustained by the same quality of procedural process and substantive proof as is required to support a final order. In that case, the Court specifically ruled that P & I orders are not final orders within the meaning of MCL 24.285. *Id.* at 176-177 & 180. The Court also ruled that the Commission may predicate the grant of immediate rate relief on a bond to insure refunds with interest if requested to do so, and if appropriate. *Id.* at 178. In other words, the Commission's order granting partial and immediate relief in this case was based upon a lesser burden of proof and is not precedent for not granting final rate relief.

CECo also begs the question by arguing (pp 2-3) that because the Company's witnesses and the Staff's witnesses supported a \$137.5 million and a \$84.8 million projected revenue deficiency, respectively, the proves that the ALJ's recommendation would result in a revenue deficiency of at least \$84.8 million. This argument fails to discuss the nature of the facts upon which CECo and the Staff relies. The projected increases in operation and maintenance (O&M) expense depend primarily upon dollars that are not included in current, MPSC-approved rates, that CECo is not currently spending, or that represent depreciation expense in dispute in Case No. U-12999. The projected increases in ratebase primarily reflect assets that are not currently in service. For example, Exhibit A-93 projects capital expenditures totaling \$545 million.

CECo summarizes (pp 3-7) arguments concerning why denying rate relief would be unreasonable and unjust, then CECo present several arguments concerning why the ALJ erred in

recommending dismissal (pp 8-32). Finally, CECo presents (pp 32-65) its responses to the ALJ's alternative revenue requirements recommendations in this case.

## **II. Dismissal and Test Year Data**

CECo's current, MPSC-approved gas rates, classifications, regulations, practices, and services are prima facie lawful and reasonable. MCL 462.25. Therefore, the burden of going forward and the burden of persuasion regarding any proposed changes falls on CECo by a preponderance of the evidence. *In re Michigan Gas Utilities Co*, MPSC Case No. U-7484, Opinion & Order dated 8-30-83, p 10; and *In re The Detroit Edison Co*, MPSC Case No. U-8020-R, Opinion & Order dated 7-8-87, pp 16-17. *Accord, BCBSM v Governor*, 422 Mich 1, 88-89; 367 NW2d 1 (1985). Furthermore, the MPSC may reject testimony even though testimony is uncontradicted. *Woodin v Durfee*, 46 Mich 424, 427 (1881), and *S C Gray, Inc v Ford Motor Co*, 92 Mich App 789, 804; 286 NW2d 134 (1929).

In each rate proceeding, the Commission must identify an appropriate test year as a basis for examining rate base, capital costs, revenues, and expenses to determine whether existing rates should be altered. The method the Commission generally employs begins with booked amounts for a historical period and adjusts those figures for known and projected changes in some future period. *In re Michigan Gas Utilities*, MPSC Case No. U-10960, Opinion and Order dated March 27, 1997. *Accord, In re Peninsular Gas Co*, MPSC Case No. U-11127, Opinion and Order dated July 31, 1997. The result should be a revenue and expense level representative of the future period thus providing a reasonable basis for establishing rates that will be in effect during that period. That future period is referred to as the test year.

In an Opinion and Order dated December 7, 1989, in MPSC Case No. U-8924<sup>1</sup> the MPSC addressed gas rates for Consumers Power Company and discussed the relationship between the concept of a test year and rate relief. In that case, Consumers Power proposed a fully projected test year. Pages 11-15 in the U-8678/U-8294/U-9197 Opinion and Order rejected CECO's exceptions, which requested the Commission to adopt a projected test year, and the Commission adopted a historical test year. In the course of its discussion, the Commission stated several important points regarding a test year.

First, there is no single correct answer to the selection of a test year. Second, a test year is a device employed to determine representative levels of revenues, expenses, rate base, and capital structure for use in the rate setting formula. Third, a test year may be historical, future, or a combination of historical and future data. Fourth, a historical test year employs actual operating data that is ordinarily adjusted for known and measurable changes. Fifth, a future test year uses projections to determine the levels of revenues, expenses, rate base, and capital structure for a future period of time. Sixth, Michigan does not have a statute that requires the use of any particular form of test year, so the selection of a test year is within the Commission's broad ratemaking power and expertise.

Seventh, in judging the validity of the test year data, the question to be asked is whether the methodology and the result are reasonable, not whether a more accurate or more complex method can be created. Eighth, it is the overall objective of fairness, rather than devotion to a particular methodology, that is of paramount importance. Ninth, the use of a historical test year simplifies the rate case proceeding because it relies upon data that is easily verifiable and because it lessens the reliance on projections, which, if erroneous, may adversely influence rates.

---

<sup>1</sup> This is one of three orders issued on the same date in MPSC Case Nos. U-8678, U-8294, and U-9197.

Although the Commission is not required to adopt an adjusted, historical test year, the historical method is reflected in the MPSC-approved settlement in Case No.U-10039, which establishes rate case filing requirements. Since those filing standards were adopted in the setting of a generic case, since those filing requirements apply to general rate cases for all gas companies, and since Case No. U-10039 was a settled case accepted by other gas companies as well as by CECo; the MPSC should not abandon the historical method in the context of this single-utility rate case even though the Commission has the power to adopt a different method. Also, the MPSC adopted an adjusted, historical test year method in CECo's last two gas rate cases (U-10755 and U-13000).

In this case, CECo proposes a projected 2004 test year (2 T 37-40). Instead of the \$263 million for annual operation and maintenance (O & M) expense approved by the MPSC in Case No. U-13000, CECo originally proposed to increase its O & M expense to \$312 million (2 T 43). In Case U-13000, the Commission approved capital expenditures of \$57.1 million for 2001 and \$58.5 million for 2002 approved by the Commission in U-13000. CECo originally proposed capital expenditures totaling \$135 million for 2003 and \$211 million for 2004, which represents a 199% increase over the levels approved in U-13000 (2 T 43). Mr. English described CECo's requested increases as amounts "we really need" (2 T 44).

Subject to the condition that CECo will voluntarily agree to limit its dividend payments to CMS Energy Company to no more than \$190 million annually, Staff witness William. Celio concluded that CECo needed \$80,466,000 per year as interim relief to maintain its financial health (2 T 549). For purpose of final rate relief, Mr. Celio did not change his recommended rate increase, and he testified that the use of a fully forecasted test year is consistent with Commission decisions (4 T 917).

On the other hand, CECo has opposed the Staff's proposed limit upon its dividends to its parent CMS Energy Company (4 T 695-697); therefore, Mr. Celio's testimony implies that the MPSC should approve no increase.

In any event, the PFD (pp 3-9) recommends dismissing CECo's application because the record fails to adequately support the adoption of a fully projected test year, because the Commission cannot adequately protect customers when a projection is not based upon historical information plus adjustments for known and measurable changes, because CECo's historical earnings have been higher than MPSC-authorized levels, and because financial woes of CMS Energy have not been caused by provision of gas utility service in Michigan.

CECo's arguments (Exceptions, pp 8-32) are essentially not responsive to the ALJ's analysis. First, CECo argues that the ALJ erroneously concluded that a future test year cannot be used, that the interim order did not reject use of a projected test year, that the evidence presented by CECo and the Staff adopt a projected test year, that there was no evidence showing that the projected levels are wrong, and that rejecting use of a projected test year would be arbitrary and capricious.

The PFD says that a projected test year should not be used because the MPSC supported use of a historical test year in Case No. U-13000, because the Staff performed an insufficient audit and review to actually justify the projected numbers, and because the MPSC cannot adequately protect customers given its inability to order refunds or to order CECo to actually make the projected capital investments and O&M expenses.

CECo's other arguments attempt to shift the burden of proof, which is discussed above. The fact that the MPSC can approve projected data does not refute the ALJ's conclusion that the MPSC should not approve the projections. Likewise, use of projections by witnesses for CECo

and the Staff does not require the Commission to adopt their testimony. In addition, rejecting the use of a projected test year is not arbitrary and capricious. See orders in Case Nos. U-8924 and U-13000.

CECo argues that there was competent, material, and substantial evidence to support use of projections. CECo's argument misses the point and mischaracterizes the ALJ's conclusions. On pages 6-7 in the PFD, the ALJ concluded that the evidence fails to adequately support adoption of a fully projected test year and that the MPSC cannot reasonably protest customers based upon this record.

CECo argues that the ALJ has erroneously chastised the Company for its dividend policy and that CECo will have a significant negative cash flow (pp 21-23). CECo's arguments are not responsive, and they are inconsistent. Pages 7-8 in the PFD address the cash flow crisis alleged by CECo and conclude that the crisis, if any, does not arise from the needs of CECo's gas operations. CECo is not publicly held and has no publicly held debt (4 T 794). CECo can pay \$166 million in dividends to its parent from retained earnings (4 T 795). Even after paying dividends totaling a projected \$175 million, CECo's cash flow is a positive \$87 million (Exhibit A-93, page 3, col. F, line 14). Exhibit A-93 does not support a conclusion that financing retirement activity requires cash flow in addition to funds received from new debt to retire old debt, and aside from \$545 million for projected 2004 capital expenditures not yet in-service, Exhibit A-93 still would show a positive cash flow. In other words, the PFD's conclusions are sound.

CECo argues (pp 25-29) that the ALJ erroneously relied upon historical returns on equity as a proxy for a future earned rate of return. Page 8 in the PFD notes that CECo's earned rates of return on common equity exceed its authorized rate of return. Those conclusions are based upon

record evidence, and those facts support the conclusion that any cash flow crisis does not stem from gas operations. Page 8 in the PFD does not rely upon CECo's historical rates of return to identify a future rate of return as CECo's exceptions attempt to claim.

### **III. Gas Depreciation**

Page 9 in the PFD notes that there is a pending gas depreciation rate case (U-12999) involving CECo, and page 9 notes that a resolution of that rate case may lead to offsets in any rate increase. Pages 30-31 in CECo's exceptions argue that the ALJ mistakenly concludes that the Commission needs to review depreciation expense before considering any rate increase. That argument mischaracterizes the ALJ's conclusion. The point is that the pending depreciation case is another circumstance to be considered when evaluating a fully projected test year. The record in Case U-12999 has been closed, and initial briefs will be submitted on April 2; therefore, that is a projected circumstance to be weighed even though the actual depreciation decision will be made in U-12999.

### **IV. Conflict Between Dismissal and Alternative Recommendations**

Pages 10-49 in the PFD present alternative recommendations concerning ratebase, adjusted net operating income, rate of return, revenue deficiency, and rate design and tariff changes. Page 31 in CECo's exceptions implies that the alternative recommendations support a conclusion contrary to the ALJ's dismissal recommendation. This argument creates a misleading impression. Pages 10-49 in the PFD assume only for the sake of argument that this case should not be dismissed.

**V. SFAS 143 Asset Retirement Obligations**

Page 32 in CECo's exceptions cites Mr. Barba testimony at 3 T 517, which requests authorization to book any timing differences related to SFAS 143. Mr. Barba's testimony (3 T 515-518) does discuss the booking of asset retirement obligations pursuant to SFAS 143, and he says that CECo will have two such obligations (3 T 516).

Mr. Barba does not attempt to quantify what tax timing differences may arise, and since this change in accounting may replace current depreciation practices, the Attorney General urges the MPSC to defer a decision regarding this issue to Case No. U-12999 in which the impact of SFAS 143 is directly at issue. Such action is consistent with CECo's position regarding depreciation.

**VI. Specific Revenue Requirement Issues**

Pages 10-49 in the PFD address alternative disputes regarding revenue requirement-related issues. Pages 32 in CECo's exceptions and CECo's Appendix 1 argue that the alternative requirements recommended in the PFD support a revenue deficiency of \$85 million. Pages 32-65 object to several of the specific recommendations.

Pages 10-14 in the Attorney General's initial brief address those issues, and those arguments support the adjustments proposed by the Staff and generally recommended by the ALJ. Therefore, the Attorney General opposes CECo's remaining exceptions for the reasons supported by the Staff's testimony and the analysis presented in the PFD.

## Replies to ABATE

ABATE's Exception No. 1 addresses the ALJ's recommendation to dismiss CECo's application. This exception is analogous to the Attorney General's exception, so the Attorney General offers no reply to that exception.

ABATE's Exception No. 2 address the rate of return discussion, which is presented in the PFD as an alternative to the ALJ's primary recommendation to dismiss CECo's application in this case. If the Commission adopts the ALJ's recommendation to dismiss CECo's application, then ABATE's Exception No. 2 becomes moot.

ABATE's Exception No. 3 addresses potential results from pending gas depreciation Case No. U-12999. The Attorney General will address relief related to U-12999 in the context of that case.

If the MPSC reaches the merits of CECo's proposed rate increase and CECo's arguments offered in support of a rate increase, then rate of return on common equity (ROE) becomes a relevant issue. The Attorney General has previously supported the 11.4% ROE proposed by the MPSC's Staff and recommended by the ALJ, but the MPSC should seriously consider ABATE's contention that 11.4% exceeds the Staff's recommended "reasonable range."

ABATE also requests the MPSC to take official notice of CECo's historical 14.5% rate of return on common equity over the last 12 months. The Attorney General agrees that this information is relevant to determining whether to dismiss this case. CECo's recently achieved rate of return reflects results from an event not fully reflected in CECo's or the Staff's calculations—namely the MPSC's approval of rate increases in Case No. U-13000.

### **Replies to the MPSC's Staff**

The Staff takes exception to one alternative recommendation made by the ALJ. Staff contends that the Commission should not continue to allow CECo to recover 50% of the costs for its Employee Incentive Compensation Plan (EICP) and its Supplemental Executive Retirement Plan (SERP). Based upon the testimony submitted by the Staff, the Attorney General supports the Staff's exception.

### **Relief Requested**

Attorney General Michael A. Cox requests the Michigan Public Service Commission to adopt the PFD's recommendation to dismiss CECo's application for a rate increase and to order CECo to refund revenues recovered via its interim rate surcharges. Interest at CECo's authorized rate of return compounded quarterly should be added to the refunds, and refunds should be allocated to customers based upon their consumption during the period that the surcharges were imposed.

Respectfully submitted,

Michael A. Cox  
Attorney General  
Paul F. Novak (P39524)  
Assistant in Charge

Donald E. Erickson (P13212)  
Assistant Attorney General

Special Litigation Division  
Sixth Floor, G. Mennen Williams Bldg.  
525 W. Ottawa Street  
P. O. Box 30212  
Lansing, MI 48909

(517) 373-1123

March 29, 2004