

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of) CONSUMERS ENERGY COMPANY) for approval to recover electric restructuring) implementation costs incurred during 2002) and 2003 and certain additional) implementation costs related to development of) a regional transmission system organization) <hr style="width: 100%; border: 0.5px solid black; margin-top: 5px;"/>)	Case No. U-14050
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NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on September 23, 2004.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before October 1, 2004, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before October 11, 2004. **An original and four paper copies and an electronic copy in the portable document format (PDF) of either document are necessary to meet proper filing requirements, as well as proof of service on all other parties of record.**

At the expiration of the period for filing of exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for Decision is reviewed by action of the Commission. To be seasonably filed, exceptions

must reach the Commission on or before they are due.

MICHIGAN PUBLIC SERVICE COMMISSION

James N. Rigas
Administrative Law Judge

September 23, 2004
Lansing, Michigan
dp

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PROPOSAL FOR DECISION

HISTORY OF PROCEEDINGS

On March 31, 2004 Consumers Energy Company (Consumers Energy) filed this application to recover electric restructuring implementation costs incurred during 2002 and 2003, along with certain additional implementation costs related to development of a regional transmission organization. Consumers Energy is asking that the Commission approve the recovery of \$2.221 million of implementation costs incurred in 2002 and \$0.890 million of implementation costs incurred in 2003. In addition, Consumers Energy is seeking recovery of \$4.855 million of implementation costs associated with funding for administrative and start-up expenses incurred in the development of an independent transmission system operator (Alliance BridgeCo costs). The total of these costs, with carrying costs through December 31, 2003, is \$8.461 million. Consumers Energy also asks for authority to recover the \$8.461 million, plus additional carrying costs at the rate of 7% until such amounts are recovered from customers.

Pursuant to due notice a prehearing conference in this matter took place on May 4, 2004. The Association of Businesses Advocating Tariff Equity (ABATE), Attorney General Michael A. Cox (Attorney General), Dow Corning Corporation, Hemlock Semiconductor Corporation and Mr. Phil Forner were recognized as Intervenors. The Commission Technical Staff (Staff) also entered an appearance and participated in the case. The intervention of the Midland Cogeneration Venture Limited Partnership was not allowed.

The hearings continued on July 1, 2004. At that time Consumers Energy presented two witnesses for cross-examination. In all three (3) exhibits were marked and received into evidence.

Consumers Energy's first witness was Mr. Charles F. Belknap, Jr., Supervisor of Planning and Financial Analysis in the Rates Department. Mr. Belknap identified expenditures incurred in 2002 and 2003 to implement retail open access and addressed the prudence of those expenditures. Exhibit A-1, page 1, summarizes electric implementation costs by year and by category:

Line No	Category	2003		Total
		2002	Carrying Costs	Recoverable Costs
		(\$000)	(\$000)	(\$000)
1	2002 Implementation Costs	2,221	155	2,376
2	BridgeCo Costs	4,855	340	5,195
3	2003 Implementation Costs			890
4				<u>8,461</u>

Year 2002 and 2003 implementation costs (not including Alliance BridgeCo costs) are shown by major process on page 2 of Exhibit A-1. Mr. Belknap divided 2002

and 2003 implementation costs (not including the Alliance BridgeCo costs) among five categories: (i) customer education/information programs, (ii) customer and retailer billing systems, (iii) metering information, (iv) regional transmission organization (RTO) costs, and (v) carrying costs. The witness testified that these costs were reasonably and prudently incurred, were incurred in addition to normal electric operating costs, were reasonable costs for the activities they represent, and furthered Consumers Energy's ability to conduct a retail open access program in a manner that promotes customer choice.

Consumers Energy's second witness was Mr. Steven L. Gaarde, Director of Transmission and Regulatory Strategies in the Electric and Gas Supply Department. Mr. Gaarde addressed the costs incurred in connection with the development of an independent transmission system operator. Exhibits A-2 and A-3 provide detail regarding these costs. The witness represented that the need to develop an independent transmission system operator is a direct result of electric industry restructuring.

Mr. Gaarde stated that in the process of the development of the Alliance RTO, it was necessary for Consumers Energy and other participating utilities to provide funding for administrative and start-up expenses. Consumers Energy's share was \$4.893 million, which was subsequently reduced to \$4.855 million.¹ Mr. Gaarde represented that these costs were directly related to the formation of an independent transmission system operator; were necessary in order to proceed with development of a regional independent transmission system operator; would not have been incurred in the

¹ The Alliance BridgeCo costs were in addition to the \$131,000 of RTO development costs incurred in 2002 for expenses and outside services. See Exhibit A-2.

absence of electric industry restructuring; and relate to activities that would not have been performed if not for restructuring.

Mr. Gaarde also testified that Consumers Energy has not previously been reimbursed for the Alliance BridgeCo costs. The witness stated that if the Federal Energy Regulatory Commission (FERC) were, at some point in time, to authorize the Midwest ISO to reimburse Consumers Energy for any RTO related costs, Consumers Energy would remove any costs recovered at the Federal level so as to not recover the same costs twice.

No other witnesses were presented.

Initial Briefs have been filed by Consumers Energy, Staff, the Attorney General, and ABATE. Reply Briefs have been filed by Consumers Energy, ABATE and Mr. Phil Forner.

POSITIONS OF THE PARTIES

Consumers Energy states that Public Act 141 of 2000 (Act 141) establishes a right to recover implementation costs that are prudently incurred. MCL 460.10(a). Consumers Energy takes the position that the record evidence in this case establishes that the costs at issue here are incremental and were reasonably and prudently incurred. Consumers Energy states no evidence was offered to the contrary.

Consumers Energy states that in response to the April 1, 2004, Michigan Court of Appeals decision in *Consumers Energy Company v Michigan Public Service Commission*, 261 Mich App 455; ___ NW2d ___ (2004), the Commission issued orders on April 28, 2004 and June 3, 2004 identifying additional information needed and

addressing the expedited procedure that would be followed pursuant to the remand. The April 28, 2004 order directed Consumers Energy to make a filing by May 7, 2004 for the purpose of exercising the option of recovering its approved implementation costs either (i) in Case No. U-13715 through securitization or (ii) through a surcharge mechanism. Consumers Energy elected to recover its approved implementation costs through use of surcharges.

On May 7, 2004 Consumers Energy filed with the Commission the information requested in the April 28 order. The May 7 filing included proposed surcharges that would provide for recovery of the 1997-2001 implementation costs and documentation showing their derivation.

The June 3, 2004 Order and Notice of Hearing set forth Consumers Energy's proposal for recovery of the 1997-2001 implementation costs and established an expedited schedule to address that proposal. The order and notice of hearing was issued in Case Nos. U-11955 (1997-1998 implementation costs), U-12358 (1999 implementation costs), U-12891 (2000 implementation costs), and U-13340 (2001 implementation costs).

On June 29, 2004 the Commission issued its order in Case Nos. U-11955, *et al*, authorizing Consumers Energy to collect \$87.633 million of implementation costs through use of per kilowatt-hour (kWh) surcharges on all customer classes (both full service and ROA customers), along with additional carrying costs until amounts are recovered from customers. The approved per kWh surcharges began for large commercial and industrial customers effective for service rendered on and after June 30, 2004. Surcharges for small commercial and industrial customers will be

effective for service rendered on and after January 1, 2005 and for residential customers for service rendered on and after January 1, 2006, so as to correspond with the expiration of applicable rate caps.

Consumers Energy states that the Commission concluded in its June 29, 2004 order in Case Nos. U-11955, *et al*, that implementation by Consumers Energy had been effective and had produced results. The Commission went on to find that all prerequisites for recovery of implementation costs that had previously been reviewed had been met. Consumers Energy states the Commission reached these conclusions in 2004, after the costs at issue in this proceeding had been incurred. Consumers Energy argues these conclusions are equally applicable with respect to the implementation costs at issue in this proceeding. Consumers Energy maintains that full and unconditional recovery of the \$8.461 million of implementation costs should be approved.

Finally, Consumers Energy notes that at the time this case was filed, the Commission had not yet determined what methodology would be used for recovery of implementation costs. The June 29, 2004 order in Case Nos. U-11955, *et al*, resolved many of the outstanding cost recovery issues. Consumers Energy states the \$8.461 million of additional implementation costs at issue in this proceeding are equal to approximately 10% of the \$87.633 million approved for recovery in the June 29, 2004 order. Consumers Energy represents that extending the 36-month collection period for the previously approved costs by an additional four months (*i.e.* 40 months rather than 36 months) would provide a means to recover the additional amounts at issue in this proceeding using the same surcharge levels approved by the Commission in its

June 29, 2004 order. Consumers Energy contends that this is a reasonable approach for recovery of the costs at issue in this proceeding and would avoid the need to add an additional surcharge or to recalculate the previously approved surcharge amounts. Given that there will be reconciliation at the end of the recovery period, Consumers Energy maintains both it and customers are protected against over- or under-recoveries.

Similar to the procedure provided for in the June 3, 2004 order in Case No. U-11955, *et al*, Consumers Energy proposes that the Commission in this case provide parties an opportunity to request a hearing on the limited issue of the recovery mechanism for costs at issue in this proceeding. If any party seeks an additional hearing on this issue, then the Commission can reopen the record in this case for the limited purpose of holding an expedited hearing to review the recovery mechanism proposal. If there are no objections or requests for a hearing, then Consumers Energy requests that the Commission approve the recovery mechanism as described on Attachment A to Consumers Energy's Brief.

Staff states that after reviewing the testimony and exhibits presented in this case and after making its own independent review, it has no objection to the approval of Consumers Energy's application.

The Attorney General notes that in Case No. U-13715, the Commission rejected Consumers Energy's request for authority to securitize its 2001, 2002, and 2003 implementation costs along with the \$4,893,000 spent in an effort to form the Alliance RTO. The Attorney General states that in this case Mr. Gaarde testified that an action is currently pending at FERC to recover the RTO development costs. Because

Consumers Energy's request for reimbursement of these RTO development costs is still pending before FERC, the Attorney General asserts there is a potential for double recovery.

The Attorney General therefore contends the Commission should dismiss, without prejudice, Consumers Energy's request for the RTO development costs until FERC provides a final ruling on the action. Once a final resolution is obtained from FERC, and assuming Consumers Energy does not get reimbursed from MISO, Consumers Energy can submit an application seeking reimbursement of these costs from this Commission. The Attorney General states the Commission would then have the benefit of FERC's review of this issue when deciding whether to grant Consumers Energy's application for the RTO development costs. The Attorney General maintains this would avoid the problem of having to track the FERC proceeding in order to assure Consumers Energy refunds any RTO development costs it obtains from FERC.

ABATE takes the position in its brief that recovery by Consumers Energy in this case of the Alliance BridgeCo costs (\$4.855 million) and 2002 RTO development costs (\$131,000) should be denied. ABATE asserts that the Alliance RTO never commenced operation, never led to anything that was used and useful for utility service in Michigan and are not reasonable and prudent costs.

ABATE argues that on December 20, 2001 FERC found the Alliance RTO lacked sufficient scope to exist as a stand alone RTO. *The Alliance Companies, et al.*, 97 FERC ¶61, 327 (2001). ABATE states that in a subsequent order in response to a petition for declaratory order seeking guidance on various outstanding issues, FERC stated that it intended to allow recovery of all costs prudently incurred by any Alliance

Grid Co. participant to establish an RTO which is a member of an RTO. *Alliance Companies, et al.*, 99 FERC ¶61, 105 at 61, 442 (2002). ABATE states further that on November 13, 2001, Consumers Energy filed an application requesting authorization to sell and transfer its transmission facilities to a newly formed subsidiary of Trans-Elect, Michigan Electric Company, LLC. ABATE maintains that Consumers Energy was on notice prior to the time of the sale that only those companies with transmission assets that were part of an RTO were eligible for collection of costs related to the Alliance RTO. ABATE concludes that those costs should have been included in any sale to Michigan Transco and, as such, should have been collected from all members of the Midwest ISO. ABATE notes that FERC denied the Midwest ISO's request to reimburse Consumers Energy in 2003. *Re Midwest ISO*, 103 FERC ¶61,219 (2003), reh den 104 FERC ¶61,298 (2003).

Finally ABATE contends Consumers Energy was adequately compensated for Alliance BridgeCo and RTO development costs. *Midwest Independent Transmission System Operator, Inc.*, 104 FERC ¶61, 298 (2003).

ABATE concludes that these costs could have been included in the purchase price or may in fact have been included in the purchase price, with the knowledge that the owner of the transmission assets could receive recovery of those costs once it became a member of an RTO. At the very least, Consumers was negligent in the structure of its deal with Michigan Transco. ABATE asks the Commission to find that the start-up costs Consumers seeks to recover in this proceeding should be disallowed for the reason they were not reasonably and prudently incurred.

In its Reply Brief ABATE responds to Consumers Energy's cost recovery proposal. ABATE takes the position that the use of an equal mills per kWh surcharge is unlawful because it reallocates costs among various customers in violation of Act 141, Section 10d(2). ABATE states that an equal mills per kWh surcharge, by definition, reallocates costs from low load factor customers to high load factor customers.

As an alternative to the Consumers Energy's proposal, ABATE asks that the Commission provide that any costs approved in this case be collected from customers using a class specific surcharge using the methodology based upon the average of the twelve coincident peaks with 75% on demand and 25% on energy. ABATE maintains this is a fair method which avoids any issues related to Section 10d(2) of Act 141.

Mr. Forner, in his Reply Brief, states his support for the Attorney General's proposal to dismiss, without prejudice, Consumers Energy's request to recover the \$5.195 million of RTO development costs. Mr. Forner also recommends that the Commission establish carrying costs at something less than 7%.

DISCUSSION AND FINDINGS

The Administrative Law Judge finds that the evidence presented here supports the determination that the costs Consumers Energy seeks recovery of in this case are incremental costs and were reasonably and prudently incurred. The Commission held in its June 29, 2004 order in Case Nos. U-11955, *et al*, that all prerequisites for recovery of the 1997-2001 implementation costs that were at issue in those cases had been met. The same conclusion is appropriate for the \$8.461 million of implementation costs at issue in this case.

ABATE has argued that the costs associated with the Alliance BridgeCo costs and 2002 RTO development costs should not be approved. The Administrative Law Judge agrees with Consumers Energy that ABATE has incorrectly applied the standard for review. The Michigan Court of Appeals in *ABATE v Public Service Commission*, 208 Mich App 248; 527 NW 2d 533 (1994) recognized that prudent costs can include unsuccessful investments. 208 Mich App at 262. Furthermore, in *Detroit Edison Company v Michigan Public Service Commission*, 261 Mich App 448; ___ NW2d ___ (2004), the Court stated “the PSC must review the utility’s expenses in light of the knowledge that was available at the time the expenditures were made.” 261 Mich App at 452. A used and useful criterion is consequently inappropriate.

The testimony offered by Consumers Energy’s witness, Mr. Gaarde established that the Alliance BridgeCo costs and \$131,000 of 2002 RTO development costs were incurred in furtherance of the development of an independent transmission system operator. No evidence was offered to the contrary.

Consumers Energy has shown that the Alliance BridgeCo costs are implementation costs that have not been recovered. The Administrative Law Judge finds that Consumers Energy is entitled to recovery of these costs pursuant to prior Commission determinations and Act 141. Section 10w(1) of Act 141 requires that investor-owned electric utilities in Michigan join a FERC-approved transmission organization or divest their transmission assets. In addition, implementation costs that the Commission approved for recovery by Consumers Energy in Case Nos. U-11955, et al, included costs of participating in the formation of an independent transmission system operator.

The Administrative Law Judge finds that the Alliance BridgeCo costs were incurred in furtherance of the goal of developing an independent transmission system operator. Exhibit A-3 shows the notes for the Alliance BridgeCo loans predate the December 20, 2001 FERC order cited by ABATE. Prudence requires consideration of whether decisions were reasonable at the time the decisions were made. ABATE has not offered any evidence that the promissory notes were not reasonable when the notes were entered into. Information available at the time indicated that the Alliance RTO was a viable option.

ABATE has also argued that the Alliance BridgeCo costs should have been included in any sale of the transmission system and, as such, collected from members of the Midwest ISO. Consumers Energy has shown, however, that the Alliance BridgeCo notes were not part of the transmission plant assets. When Consumers Energy sold the transmission assets it obtained an agreement from the purchaser, METC LLC that METC LLC would repay to Consumers Energy any of Consumers Energy's start-up costs that METC LLC ultimately recovered. Consumers Energy was thus assured that it would receive any reimbursement that occurred at the Federal level after the sale of the transmission system. The writer agrees with Consumers Energy that attempts to recover costs from the Midwest ISO do not mean that the costs are not properly recoverable from customers pursuant to prior Commission orders and Act 141.

Participation by Consumers Energy in development of an independent transmission operator was necessary for ongoing compliance with the provisions of PA 141. The costs would not have been incurred in the absence of electric industry restructuring and relate to activities that would not have been performed if not for

restructuring. Consumers Energy's decisions to incur the Alliance BridgeCo costs as well as the \$131,000 RTO development costs were consistent with the strategy that the Commission found complied with Act 141. See Case No. U-12726 order, p. 6.

Regarding the Attorney General's proposal to defer consideration of the request for recovery of the Alliance BridgeCo costs in this case, Consumers Energy points out that FERC has now denied all of the previously pending requests for recovery of these costs. FERC denied the Midwest ISO's request to reimburse Consumers Energy in *Re Midwest ISO*, 103 FERC ¶61,219 (2003), reh den 104 FERC ¶61,298 (2003). FERC denied the Midwest ISO's request to reimburse METC in *Re Midwest ISO*, 107 FERC ¶61,131 (2004), reh den 108 FERC ¶61,010 (2004).

In Case No. U-13715 the Commission found that implementation costs which had not been previously reviewed would not be approved for securitization. This determination does not provide a basis to defer the review and approval of the \$4.855 million in this case. In addition, the Attorney General's argument that the Commission should defer review of the Alliance BridgeCo costs is contrary to the holdings of the Michigan Court of Appeals. *Consumers Energy Company v the Michigan Public Service Commission, supra*. Recovery of the Alliance BridgeCo costs and the RTO development costs should be authorized in this proceeding.

With regard to the issue of implementation cost recovery, the June 29, 2004 order in Case Nos. U-11955, *et al*, resolved many of the outstanding cost recovery issues. The Administrative Law Judge recommends that the Commission provided a notice and opportunity for hearing on the issue of cost recovery in this case.

Finally, the Commission has in the past found that Consumers Energy should use 7% to compute carrying costs. No evidence has been offered to support a different determination in this case. The writer therefore recommends that the Commission authorize 7% carrying costs in this case.

CONCLUSION

Based upon the foregoing discussion and findings, the Administrative Law Judge recommends that the Commission issue its order adopting the findings and conclusions set forth above and grant the application of Consumers Energy Company to recover electric restructuring implementation costs incurred during 2002 and 2003, along with certain additional implementation costs related to development of a regional transmission organization.

MICHIGAN PUBLIC SERVICE COMMISSION

James N. Rigas
Administrative Law Judge

September 23, 2004
Lansing, Michigan
dmp

ISSUED AND SERVED: September 23, 2004

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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STATE OF MICHIGAN)
) SS. Case No. U-14050
County of Ingham)
_____)

PROOF OF SERVICE

Dawn M. Prawdzik deposes and says that on the 23rd day of September 2004, she served a copy of the attached Proposal for Decision, upon those persons shown on Attachment A, by enclosing same in a sealed envelope addressed as indicated above and delivering the envelope to the Commission's mail courier for (1) postage prepayment and deposit with the United States Postal Service, or (2) delivery through interdepartmental mail (I.D.M.).

Subscribed to before me this 23rd
day of September, A.D. 2004.

Notary Public, Ingham County, Michigan

My Commission expires 8-16-2011.

ATTACHMENT A

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