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October 9, 2015

Ms. Mary Jo Kunkle
Executive Secretary
Michigan Public Service Commission
7109 West Saginaw Highway
Post Office Box 30221
Lansing, MI 48909

Re: Case No. U-17735 - In the matter of the application of Consumers Energy Company for authority to increase its rates for the generation and distribution of electricity and for other relief

Dear Ms. Kunkle:

Enclosed for filing please find the **"Exceptions of Consumers Energy Company."** This is a paperless filing and is therefore being filed only in a PDF format. I have enclosed a Proof of Service showing electronic service upon the parties.

Sincerely,

Bret Totoraitis
Digitally signed by Bret A. Totoraitis
Date: 2015.10.09 14:30:16 -04'00'

Bret A. Totoraitis

cc: Hon. Mark E. Cummins, Administrative Law Judge
Parties per Attachment 1 to Proof of Service

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

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of CONSUMERS ENERGY COMPANY for authority to increase its rates for the generation and distribution of electricity and for other relief.	))))))	Case No. U-17735

EXCEPTIONS OF CONSUMERS ENERGY COMPANY

October 9, 2015

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BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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EXCEPTIONS OF CONSUMERS ENERGY COMPANY

I. INTRODUCTION

On September 16, 2015, Administrative Law Judge Mark E. Cummins ("ALJ") issued his Proposal for Decision ("PFD") in Case No. U-17735. In general, the PFD was thorough and well-reasoned. The ALJ should be commended for his careful and thoughtful consideration of the numerous complex issues presented in this case. Without detracting from the overall quality of the PFD, Consumers Energy Company ("Consumers Energy" or the "Company") disagrees with some of the conclusions reached in the PFD. Accordingly, Consumers Energy is filing these Exceptions pursuant to the schedule established by the ALJ in this matter.

II. EXCEPTIONS REGARDING THE TEST YEAR (PFD Section II)

There is no dispute regarding use of a projected June 1, 2015 to May 31, 2016 test year for purposes of this case, and the Company agrees with the ALJ's adoption of that test year for purposes of the PFD. Consumers Energy does note, however, that the Company disagrees with the ALJ's observation in footnote 5 of the PFD (page 12) that a general reconsideration regarding the efficacy and the reasonableness of the use of projected test years may be warranted in the future. Consumers Energy asserts that Public Act 286 of 2008, MCL 460.6a(1), grants utilities the right to use projected test years to develop revenue requirements in general rate cases in order to partially relieve the regulatory lag inherent in the ratemaking process. Projected test years help to better assure that rates reflect costs incurred during the time those rates are in effect and reflect a reasoned accommodation to public utilities in the context of the significant social burdens that utilities bear in the course of providing the public, safely and reliably, with vital utility services. The Michigan Legislature rightfully and appropriately weighed and balanced the competing concerns of all stakeholders in enacting the projected test year provision of Public Act 286, and its policy decision in that matter is not, and should not be, subject to revision in this forum.

III. EXCEPTIONS REGARDING RATE BASE (PFD Section III)

A. Environmental Contingency Costs

At page 22 of the PFD, the ALJ recommends that the Michigan Public Service Commission ("MPSC" or the "Commission") exclude from rate base Air Quality Control Systems ("AQCS") contingency costs in the amount of $24,360,000. In support of this recommendation, the ALJ offers "four factors" which are based predominantly on Michigan Environmental Council ("MEC")/Natural Resources Defense Council's ("NRDC") Initial Brief arguments and the testimony of Staff witness Nicholas Evans. PFD at 19-22. For its part, MEC/NRDC failed to present any record evidence which demonstrates that the Company's AQCS contingency costs are unreasonable. Staff, on the other hand, relied on numerous flawed assumptions in the presentation of its position. As a result of these inadequacies, the ALJ's recommendation to reject the Company's AQCS contingency costs should be rejected by the Commission.

The ALJ's first factor is the conclusion that standard project management practices do not provide a justification to recover project contingency amounts. PFD at 19. The Company disagrees. Standard project management practices overwhelmingly establish the reasonableness of contingency costs. These standards were extensively explained in the testimony of Company witnesses Linda M. Hilbert and David B. Kehoe. 7 TR 1258-1259; 6 TR 718-719.

Including contingency in project costs is well-established, standard project management methodology and is consistent with industry practice. 7 TR 1258. Company witness Hilbert explained on rebuttal:

> "According to the Association for the Advancement of Cost Engineering International ('AACE'), contingency is 'An amount added to an estimate to allow for items, conditions, or events for which the state, occurrence, or effect is uncertain and that experience shows <u>will likely result, in aggregate, in additional costs</u>.' [Emphasis added.] Contingency is generally included in most estimates, and is **expected to be expended.** It is a real item in a project estimate like any other cost, and should be included in every estimate of projects of this size. Regarding the Company's performance in this area, the total installed cost of nearly all completed projects has finished very near the approved amount all while delivering the expected results. Those total costs, which include contingency, are consistent with benchmarking data as show[n] in my Exhibit A-43 . . ." 7 TR 1258-1259 (emphasis in the original; footnote omitted).

As AQCS contingency costs are real costs, it would be inappropriate to exclude them from the project budgets for purposes of determining rate base in this proceeding.

The ALJ's reliance on the "Indiana Michigan Certificate of Need" case is also misplaced. In *In re Application of Indiana Michigan Power Company for a Certificate of Necessity*, 307 Mich App 272; 859 NW2d 253 (2014) ("*I&M Opinion*"), the Court of Appeals interpreted the requirements of MCL 460.6s, which applies to Certificate of Necessity filings. There are numerous differences between the proceedings before the Commission and that case. First, filings made pursuant to MCL 460.6s are subject to the requirements of that statute and not the statute under which the Company has filed this electric rate case proceeding, MCL 460.6a. Among other distinguishing provisions, MCL 460.6s specifically mandates that the Commission "specify the costs approved for the construction of or significant investment in the electric generating facility" (See MCL 460.6s(6)) and contains a statutorily-based 10% contingency provision. See MCL 460.6s(9). These provisions, which are specific to MCL 460.6s filings, were at the heart of the Court's determination and are inapplicable to the Commission's ultimate finding in this case.

Next, the findings of the Court, and the Commission below, were specific to the record in MPSC Case No. U-17026 and are not overarching determinations regarding the recovery of contingency costs.[1] In MPSC Case No. U-17026, Indiana Michigan Power Company requested recovery of two separate categories of contingency costs and the Commission ultimately found that one category of contingency costs was not supported by substantial evidence but still approved a certain level of those costs. *I&M Opinion* at 297. Here, the Company has requested recovery of AQCS costs and has extensively supported the reasonableness of those costs in the record. The Company has established that AQCS contingency costs are based on industry-accepted methods of projecting such costs and are consistent with industry benchmarking data. 7 TR 1258-1262; 6 TR 718-719. The Company has also established that its contingency costs are subject to a thorough and continuous review process which removes low-risk contingencies from the Company's project costs. 6 TR 720-721. Contingency costs are real costs, just as the other projected costs in the project budgets, and these costs are a reasonable and prudent component of the total costs of the AQCS projects. 7 TR 1261-1262.

The ALJ's second factor is based on the erroneous finding that the Company's witnesses were unable "to provide specific details for any of the projects to which those requested contingency expenditure [sic] relate." PFD at 19-20. Company witness Hilbert explained that the Company's contingency amounts are not simplistic ranges of possible spending, but instead

[1] As discussed in more detail *infra*, the Commission has an established precedent of approving contingency costs for recovery in rates.

are project-specific, specifically-analyzed and projected cost amounts similar to any other cost item in the projects' budgets. 7 TR 1259-1260. Each project has a very specific forecasted contingency that is constantly evaluated and adjusted based on actual risk. Ms. Hilbert testified:

> "[O]ur project 'contingency cost' is a risk-based estimated monetary value based on the Project Management Institute's ('PMI') quantitative analysis of the project's risks and opportunities. Our risk-based contingency value reflects a probabilistic approach tailored to the project and periodic review ensures its relevancy for the phase. We are not using a simple percentage-based approach. To calculate our risk-based contingency, we take the probability of occurrence multiplied by the potential impact. For example, if we have $15 million associated with the procurement of commodities, we may determine that the estimated monetary value of the risk-based contingency to have a 40% probability that prices will rise 10%. We would thus carry $600,000 in risk-based contingency. We could have opted for a simple percentage-based contingency application in the early stages of the project. However, that approach ties up too much capital and requires little analysis of the likelihood of the contingency occurring or the impact of the occurrence of the contingency. Each project has a different percent of contingency which could change over the life of the project depending on what stage the project is in and certainly which will be different between projects. This could result in the perceived assumption that our contingency is a 'range of possible spending' which creates a higher degree of uncertainty regarding future expenditures than is found with other cost categories, as Mr. Evans indicated. In reality, each project has very specific forecasted contingency that is constantly being evaluated and adjusted based on actual risk. We perform routine risk reviews that identify items available for review and audit. This provides greater transparency than a simple percentage-base method and the periodic evaluation throughout the project lifecycle drives continued risk and cost mitigation ideas to help achieve predictable results." 7 TR 1259-1260. See also Exhibit A-95 (LMH-11).

The above record evidence, in addition to Company Exhibit A-95 (LMH-11), refute the ALJ's conclusion by providing specific details about the Company's requested contingency costs.

The third factor relied on by the ALJ essentially finds that utilities, like Consumers Energy, are different from other companies and, thus, should not be afforded the opportunity to recover all project costs. PFD at 21. This conclusion is unreasonable and based on a statement in the Initial Brief of MEC/NRDC which has no evidentiary support. MEC/NRDC's Initial Brief, page 11. Contrary to the ALJ's assumption, contingency costs are real costs that are recognized throughout the utility industry and standard project management practices. 7 TR 1258-1259. The Commission has previously confirmed the validity of contingency costs from a rate recovery standpoint and has also approved the recovery of such costs in rates. See MPSC Case No. U-9493, May 7, 1991 Order, page 14 ("The Commission agrees with Consumers that inclusion of a contingency factor is not a hypothetical cost but, rather, it is an attempt to reflect probable costs that are not specifically quantifiable at the time the cost estimate is made."); see also MPSC Case No. U-11724, March 3, 2000 Order, page 14 ("The Commission therefore concludes that it should adopt the ALJ's recommendation as it pertains to (1) treating all Ludington Plant assets as scrap following the close of the plant's useful life and (2) **authorizing use of the 10% contingency factor** proposed by Mr. Johnson.") (emphasis added).

In addition to the above, the record before the Commission in this matter overwhelmingly supports the reasonableness of the AQCS contingency costs. The Company's record evidence establishes that contingency amounts are project-specific, specifically-analyzed and projected cost amounts similar to any other cost item in the projects' budgets. 7 TR 1259-1260. In contrast, Staff and the Attorney General, the only parties which contested the contingency costs in the record, were unable to adequately support their positions.

Staff witness Evans conceded the unsupported nature of his recommendation in cross-examination by admitting that his recommendation was not based on any analysis of the likelihood that any of the contingency costs would, in fact, be incurred by the Company.

Mr. Evans did not rely on any type of project management resource, authority, consultation, or study of industry standards regarding project management and budget setting. 8 TR 1622-1623. Mr. Evans' recommendation with respect to the recovery of contingency costs is also in conflict with the Staff's position with respect to AQCS contingency costs in Case No. U-17087. In that case, Staff recommended the inclusion of projected AQCS contingency costs in rate base. 8 TR 1626. With respect to the Attorney General's position, Sebastian Coppola argued that the Company's AQCS contingency values should be modified so that they are capped at 15% of the project's cost. 7 TR 1265; Exhibit AG-12. Mr. Coppola, however, failed to provide a sufficient rationale or reason for his position. Thus, no party in this case has established in the record that the Company will not incur the requested contingency costs. It is inappropriate for the ALJ to conclude that the Company will somehow earn a rate of return on expenditures that are not ultimately spent.

Finally, the ALJ's criticisms of the Company's "Blackbox" process, which continuously reviews and evaluates contingency costs, lack merit. Company witness Kehoe explicitly explained that the Blackbox process removes a portion of projected contingency amounts and applies an off-setting credit, which corresponds to those removed costs and this process was applied to the Company's Fossil and Hydro Generation capital request in this case. 6 TR 720-721; see also Exhibits A-97 (DBK-7) and A-98 (DBK-8). Because of the forward-looking nature of contingency costs, the Company uses the Blackbox process to regularly review projects and their associated contingency costs as follows:

> "Q. What is the Blackbox and what is included in that number?
>
> "A. The Blackbox is the difference between the estimated cost of the projects the business has requested during the identified time, and the amount of funding authorized by senior management. The Blackbox also recognizes that

> individual project contingency dollars, when combined, may represent more contingency dollars than are required.
>
> ***
>
> "Q. Please explain how the Company, specifically the Fossil & Hydro Generation Department, manages the Blackbox to mitigate the uncertainty that Mr. Evans discusses at page 6, line 3 of his direct testimony.
>
> "A. The Fossil & Hydro Generation Department regularly reviews and evaluates all projects and their contingencies. Contingencies that are determined to have a high degree of probability or risk are left in the project estimate, while contingencies that are found to have a lower probability or risk are credited to the Blackbox." 6 TR 720-721.

Exhibits A-97 (DBK-7) and A-98 (DBK-8) further demonstrate that this process eliminates costs in the aggregate to remove contingencies that have a low probability of risk. 6 TR 720. The ALJ's criticisms of the Company's Blackbox process are unfounded.

Based on the above, and for the reasons presented in the Company's record evidence, it would be unreasonable and unlawful to disallow the AQCS contingency costs in their entirety as recommended by the ALJ. Consumers Energy's record evidence establishes that AQCS contingency costs are based on industry-accepted methods of projecting such costs, are consistent with industry benchmarking data, are real costs just as the other projected costs in the project budgets, and are a reasonable and prudent component of the total costs of the AQCS projects. Furthermore, the Commission has an established precedent of treating contingency costs as recoverable and there is no rational basis to depart from that precedent here. The Commission should approve the inclusion of AQCS contingency costs in rate base in this case.

IV. EXCEPTIONS REGARDING RATE OF RETURN (PFD Section IV)

A. Equity Cost (Return on Equity)

1. Overview of Company Position — the ALJ Erred in Recommending that the Return on Equity be Set at 10.00% Rather than at a Level of Not Less than 10.30%

The authorized return on equity is a key consideration for investors. This is reflected in the excerpts from analyst reports which are quoted or summarized by Dhenuvakonda Rao at 5 TR 234-235; 246-247. In selecting a return on equity in this case, the Commission needs to consider what message it wishes to send to the investment community. An outcome viewed as non-constructive by investors would have negative ramifications not only for Consumers Energy, but also for the Company's customers and the State of Michigan.

Evidence in the case indicates that investors and analysts currently view the Michigan regulatory environment as generally constructive. Consumers Energy witness Rao presented evidence that lowering the return on equity below 10.30% in this case would send the wrong message to investors and analysts as they consider investment decisions in this State given the risk profile for Consumers Energy and taking into consideration alternative investments of similar risk. 5 TR 243, 248-250. He testified that investors are looking for confirmation that the Commission understands the investment community and the importance of authorized returns in attracting capital to Michigan. 5 TR 234.

Consumers Energy's currently authorized return on equity for its electric business is 10.30%. This return was last set for Consumers Energy by the Commission in its June 7, 2012, Case No. U-16794 Order and continue in the Commission's May 15, 2013 Order Approving Settlement Agreement in Case No. U-17087. The ALJ in his PFD correctly rejected arguments by the Association of Business Advocating Tariff Equity ("ABATE") and the Municipal Coalition that the return on equity should be set at 9.60% and arguments by the Attorney General that the return on equity for Consumers Energy should be set at 9.75%. However, as discussed below, the ALJ incorrectly concluded that the return should be reduced from 10.30% to 10.00%, rather than set at a level of not less than 10.30%, based on five factors that he viewed as determinative: (1) the use of Staff's proposed proxy group for the cost of equity analyses; (2) the effect of Consumers Energy's improved credit rating; (3) the ALJ's view that some of the assumptions used in Consumers Energy's model-based analyses were not appropriate; (4) comparison of Consumers Energy's proposed return on equity to authorized returns on equity granted for other regulated utilities in the United States; and (5) the effect of Public Act 286 on the utility's risk profile. Unfortunately, the ALJ's analysis failed to place the proper weight and emphasis on countervailing factors related to each of his concerns, which support the Company's position that the return on equity should be set no lower than 10.30%.

Consumers Energy presented evidence in this case that it is planning major investments in Michigan, which will benefit both utility customers and the economy, as well as create a significant number of Michigan-based jobs. 5 TR 145, 170, 194. In order to make these investments, the Company will need to be able to raise capital on reasonable terms and conditions. Consumers Energy requests that the Commission find that the record evidence in this case and established principles and criteria support establishing a return on equity for Consumers Energy's electric business in this case of not less than 10.30%.

a. The ALJ Erred in Placing Undue Emphasis on Only One of the Three Legally Required Criteria for Establishing a Fair and Appropriate Rate of Return and Failing to Give Appropriate Consideration to Evidence Pertaining to the Other Criteria and Supporting a Higher Return on Equity

As noted above, the ALJ's recommendation that the Commission should use a 10.00% return on equity in calculating the Company's revenue deficiency in this case was based on five factors that the ALJ found determinative. Each of the factors identified by the ALJ relates in some manner to the issue of the amount of risk associated with investment in Consumers Energy. For example, the ALJ concludes that certain features of Public Act 286 reduce the risk of investing in Consumers Energy. Similarly, the ALJ's conclusions regarding the appropriate proxy group and his interest in comparing other recent authorized returns on equity from other jurisdictions serve as an indirect means of comparing the risk associated with investment in Consumers Energy to other comparable investment risks.

However, in reaching this recommended return on equity in this case, the ALJ loses sight of the legal standard governing the determination of a fair and reasonable rate of return in utility ratemaking cases. The ALJ places undue emphasis on only one of the three legally required criteria for establishing a fair rate of return.[2] At the same time, the ALJ overlooks important record evidence offered by Consumers Energy pertaining to the other legal criteria that supports establishing a return on equity no lower than the Company's existing 10.30% return on equity.

The United States Supreme Court set forth the legal standard for a constitutionally sufficient rate of return in two seminal cases: *Bluefield Waterworks & Imp Co v Pub Serv Comm of W Va*, 262 US 679; 43 S Ct 675; 67 L Ed 1176 (1923) and *Fed Power Comm v Hope Natural Gas Co*, 320 US 591; 64 S Ct 281; 88 L Ed 333 (1944). These cases are widely cited throughout the utility industry in ratemaking cases, including by four of the witnesses in this case. 5 TR 213; 10 TR 2111-2112, 2157, and 2331. In the first case, the Supreme Court held:

> "A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public <u>equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by</u>

[2] Even with respect to that one criterion, the ALJ's analysis is not properly tailored to the legal standard and overlooks record evidence that undermines the ALJ's rationale for lowering the Company's current 10.30% return on equity, as will be discussed in response to each of the ALJ's five factors in the sections below.

> corresponding, risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." *Bluefield Waterworks*, 262 US at 692-93 (emphasis added).

Similarly, in the second case, the Supreme Court stated:

> "[T]he return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital." *Fed Power Comm v Hope Natural Gas Co*, 320 US at 603 (emphasis added).

Both landmark Supreme Court decisions identify the same three criteria that a legally sufficient rate of return must satisfy in order to meet constitutional muster: (1) compensation for risk which is comparable to certain other companies of like risk; (2) adequate return to ensure the financial soundness of the business; and (3) sufficient return to maintain credit and attract capital.

As noted above, the ALJ's five factors are all directed at an analysis of the Company's risk, in general and relative to other utilities; however, they overlook entirely the second and third criteria identified by the Supreme Court for a constitutionally sufficient rate of return. In contrast, Consumers Energy presented testimony which considered and factored in all of the Supreme Court's criteria in making its recommendation that the Commission should adopt a return on equity for ratemaking purposes that is no lower than the Company's existing 10.30% return on equity. The Company disagrees with the ALJ's risk analysis, as will be discussed further in response to each of the ALJ's five factors in the sections that follow. But for purposes of this section, Consumers Energy notes that the ALJ's analysis does not acknowledge any of the

Company's evidence on the other factors supporting a return on equity no lower than 10.30% or appropriately incorporate that evidence into his recommendation.

One of the most significant considerations requiring a higher return on equity in this case is the Company's large capital investment program. Mr. Rao explained:

> "[E]vidence presented by Consumers Energy in this case indicates that the Company plans to make significant capital expenditures in Michigan in the infrastructure necessary to ensure adequate generation capacity and provide safe and reliable service to customers in compliance with federal and state requirements. The Company plans to invest more than $7 billion from 2015 to 2019 to improve system reliability, meet environmental standards, and expand and upgrade generating capacity. This significant capital investment increases the risk profile of the Company with respect to investors and rating agencies. Authorizing a ROE in this case at a level that investors view as adequately compensating for risk is important in keeping Consumers Energy healthy <u>and in attracting large amounts of capital to Michigan</u>. Authorizing a return that investors consider to be below expectations could lead to increases in the cost of capital or <u>hinder the Company's access to new capital</u>, neither of which is in the best interest of customers." 5 TR 237 (emphasis added).

Mr. Rao further testified:

> "When evaluating where to invest capital, investors will assess the Company's relative attractiveness to other utility investments. Given the Company's need to invest more capital in comparison to its peers, it is critical that the Company's ROE be set at a competitive level which would suggest a range in the top quartile or even above of the ranges shown here [i.e. in Mr. Rao's quantitative ROE analyses]." 5 TR 212.

The Company's large capital investment program implicates both the risk criteria for determining an appropriate return on equity and the capital attraction criteria. However, the ALJ does not appear to consider the Company's large capital investment program in the course of identifying or discussing the five factors that he found determinative in recommending a reduction to the Company's existing 10.30% return on equity. Nor does the ALJ discuss or give any weight to the capital attraction needs of Consumers Energy generally in the course of making his recommendation.

Another significant consideration requiring a higher return on equity in this case is the expectation of rising interest rates in the near future. Mr. Rao testified that "[t]here is a consensus among economists that interest rates will continue to rise and revert to normal levels soon as indicated by various interest rate forecasts." 5 TR 233. See also, Exhibit A-9 (DVR-1), Schedule D5, page 13. Mr. Rao testified that uncertainty around the economy and the potential for abrupt changes in the level of interest rates increases general business risk also. 5 TR 233. But, he also testified:

> "From an investor standpoint, U.S. Treasuries and utility stocks are similar, competing investment alternatives. Both securities offer a relatively lower-risk profile and a stable return compared to other investment options. As treasury yields rise from their historically low levels, U.S. Treasuries will become more attractive to investors relative to utility stocks. This shift causes the required return on utility equity to push higher. This phenomenon has already occurred in 2013. As shown in the chart on page 10 of Exhibit A-9 (DVR-1), Schedule D5, starting in April 2013, the ten-year U.S. Treasury has made a steep climb to 3% at the end of 2013. However, the Philadelphia Stock Exchange Utility Sector Index, a stock index composed of public utility stocks, during the same time period, shows a general downward trend. Also, through 2013, the Utility Sector Index, which was up 7%, has underperformed versus the stock market as a whole, as measured by the S&P 500 Index, which was up 30% for the same time period." 5 TR 232-233.

So, just as with the Company's large capital investment program, projections for increasing interest rates implicates both the risk criteria for determining an appropriate return on equity and the capital attraction criteria. Once again, the ALJ does not appear to consider rising interest rates in the course of identifying or discussing the five factors that he found determinative in recommending a reduction to the Company's existing 10.30% return on equity. Nor does the ALJ discuss or give any weight to the capital attraction needs of Consumers Energy generally in the course of making his recommendation. Notably, no other party to this case offered any evidence showing that these considerations – a large capital investment program and rising interest rates – do not create additional capital attraction challenges as the Company demonstrated in its case.

Because the ALJ's recommendation failed to acknowledge, or give any weight to, the capital attraction needs of Consumers Energy in this case, his recommended return on equity was not based on an adequate consideration of the correct legal standard. The Commission should credit the uncontested testimony offered by Company witness Rao demonstrating that there are significant capital attraction considerations that should bear on the determination of the return on equity used in this case and that support the use of a return on equity that is at least no lower than the Company's existing 10.30% return on equity.

b. <u>The ALJ Erred By Adopting Staff's Proxy Group Instead of the Small Proxy Group Proposed by Consumers Energy</u>

On page 85 of the PFD, the ALJ concludes that the proxy group proposed by Consumers Energy in this case for purposes of the Company's quantitative return on equity analyses was "overly broad." The ALJ concludes instead that the proxy group proposed by Staff would be more "closely aligned" with Consumers Energy's actual size and credit rating. PFD at 85. However, in the ALJ's description of the proxy group proposed by the Company, see PFD at 73, the ALJ overlooks the fact that Consumers Energy actually proposed *two* proxy groups in this case. 5 TR 215. The ALJ's analysis only reflects and discusses the larger group of 23 companies. PFD at 85.

In fact, Consumers Energy witness Rao recognized in his testimony that "[m]any of the companies selected in my [large] proxy group are significantly larger than Consumers Energy." 5 TR 215. As a result, Mr. Rao proposed to narrow that original proxy group further by adding the additional criterion that the proxy utilities must also have less than $10 billion of Net Plant. 5 TR 215. Consumers Energy, by way of comparison, has Net Plant of approximately $7.6 billion. Exhibit A-2 (NNB-3), Schedule B1. That additional criterion resulted in a smaller second proxy group of six utilities. 5 TR 215. As discussed below, Mr. Rao's smaller group is more closely aligned to Consumers Energy than Staff's group for size and is comparably aligned for credit rating.

The ALJ's expressed concern about the size (in terms of Net Plant) of the utilities in the proxy group being appropriately matched to the size of Consumers Energy's electric utility, does not support his conclusions. Comparison of the Staff proxy group and the Company's smaller proxy group supports a conclusion that the Company's small proxy group is actually more "closely aligned" to the size of Consumers Energy than Staff's proxy group. Staff's proxy group includes utilities ranging in size up to $20 billion in Net Plant, which is still significantly larger than Consumers Energy. 10 TR 2112-2113. All of the utilities that are in the Staff proxy group but not in the Company's smaller proxy group are above $10 billion in Net Plant. And, all of the utilities in Consumers Energy's smaller proxy group are also included in Staff's proxy group. Compare Exhibit A-9 (DVR-1), Schedule D5, page 1 with Exhibit S-4, Schedule D-5, page 2. Further, to the extent that the ALJ was concerned that proxy utilities that share a similar credit rating to Consumers Energy, the Company's smaller proxy group satisfies the ALJ's concerns exactly as well as Staff's proxy group, which the ALJ favored in his PFD.

The ALJ also expressed agreement with the Attorney General's criticism of three utilities included in Consumers Energy's larger proxy group. One of those utilities, FirstEnergy, is not included in the Company's smaller proxy group. Exhibit A-9 (DVR-1), Schedule D5, page 1. The other two utilities, Portland General Electric and TECO Energy, are both included in the

Company's smaller proxy group. However, the criticism offered by the Attorney General was that those two utilities are "far smaller than CECo's parent Company (CMS Energy) on a market capitalization basis." 10 TR 2332 (emphasis added). But, a proxy group of utilities is not intended to approximate the utility's *parent* company. The goal is to choose a proxy group of utilities that approximates the *regulated utility itself*. Both Portland General Electric and TECO Energy do that with Net Plant of $5.3 billion and $6.3 billion, respectively. Exhibit A-9 (DVR-1), Schedule D5, page 1. Furthermore, both Portland General Electric and TECO Energy were included in Staff's proxy group as well, which the ALJ adopted for purposes of his analysis. Staff's proxy group would still not be superior to Consumers Energy's more carefully tailored small proxy group. Therefore, none of the reasons that the ALJ provided in the PFD for preferring Staff's proxy group over the small proxy group offered by Consumers Energy withstand scrutiny of the record evidence in this case.

Company witness Rao performed all of the same quantitative analyses using the smaller proxy group that he performed using the Company's larger proxy group, except the Risk Premium analysis. See Exhibit A-9 (DVR-1), Schedule D5, pages 3, 4, 8, 9, and 14. In every case, the smaller proxy group returned return on equity results ***higher*** than the average for the larger proxy group. See Exhibit A-9 (DVR-1), Schedule D5, page 14. For example, the smaller proxy group returned Capital Asset Pricing Model ("CAPM") results of 9.98% for the traditional risk-free rate and 10.72% for the historical risk-free rate, Exhibit A-9 (DVR-1), Schedule D5, page 3, and it returned Empirical Capital Asset Pricing Model ("ECAPM") results of 10.27% for the traditional risk-free rate and 11.01% for the historical risk-free rate, Exhibit A-9 (DVR-1), Schedule D5, page 3. The results of Mr. Rao's analysis, particularly in light of other considerations discussed in these Exceptions, do not support the ALJ's conclusion that the

Commission should reduce the Company's existing 10.30% return on equity as proposed in the PFD.

c. <u>The ALJ Erred by Reducing the Company's Return on Equity Based on Recent Changes to Consumers Energy's Credit Rating</u>

On page 86 of the PFD, the ALJ cites recent improvements in Consumers Energy's credit ratings as one reason why he recommended a return on equity lower than the Company's proposed minimum level of 10.30%. In explaining his conclusion, the ALJ cites testimony from Staff that improved credit ratings improve "cash flow stability, debt coverage, liquidity, etc." PFD at 86 (citing 10 TR 2122). In other words, the ALJ's focus, once again, was exclusively on his perception that improved credit ratings lower business risk, and hence, support a lower return on equity when considering the risk criteria for a constitutionally appropriate rate of return.

However, as noted earlier in these Exceptions, the ALJ placed undue and inappropriate emphasis on the risk criterion for determining an appropriate return on equity while failing to appropriately consider other criteria identified by the United States Supreme Court as necessary for a constitutionally sufficient return on equity. Among those other criteria is the requirement that an appropriate return on equity must be one that is adequate for a utility to, among other things, "maintain and support its credit." *Bluefield Waterworks*, 262 US at 693. The PFD did not appropriately consider and factor in rebuttal testimony offered by Mr. Rao explaining the connection between the *existing* level of return on equity and the very credit rating improvements that the ALJ believes should now result in a reduction in return on equity. In his rebuttal testimony, Mr. Rao explained:

> "The ROE authorized by the Commission and the ability of Consumers Energy to earn the authorized return are important factors considered by rating agencies. This is reflected in the December 2014 research update by Standard & Poor's ('S&P'). This assessment raised Consumers Energy's issuer credit rating

> from 'BBB' to 'BBB+' with a stable outlook. The rating on Consumers Energy's first mortgage bonds was also raised from 'A-' to 'A.' While generally supportive of Consumers Energy's credit worthiness, the assessment also identified the following:
>
>> 'The rating outlooks are stable based on our expectation that CMS Energy Corp. will continue to effectively manage its regulatory risk, thereby supporting consistent operating results and a financial profile in line with expectations at the current ratings.'
>
> "Downside:
>
>> '<u>We could lower ratings if...rate case outcomes are consistently weaker than expected</u>, there is greater regulatory lag, or if capital spending increases and is primarily debt financed.'
>
> "<u>A utility's authorized ROE and a consistent, constructive track record in this regard, is a key component in credit ratings assessments</u>. The regulated electric and gas utility methodology for Moody's, for example, includes the following factors:
>
> - Legislative & Judicial Underpinnings;
> - Consistency & Predictability; and
> - Sufficiency of Rates & Returns.
>
> "These credit rating assessments provide confirmation that the ROE that is authorized in this case is an important signal that the Commission sends to the investment community. <u>Setting the ROE at 10.00% would be seen as a regression in each of these factors, having a negative impact on credit rating agencies' assessments</u>." 5 TR 247-248 (emphasis added).

In other words, Consumers Energy experienced recent credit rating improvements at least in part *because of* its existing 10.30% return on equity and the signal that it sends to the financing community about the supportive regulatory environment in Michigan. This conclusion is not based on mere speculation, but on the statements of the credit rating agencies themselves explaining why they concluded that Consumers Energy's credit ratings should be upgraded. It would be inappropriate, and analytically incorrect, therefore, to use the Company's upgraded credit ratings as a rationale for reducing the Company's existing return on equity below the level that supported the credit ratings increase in the first place. Such a determination risks deterioration of the Company's credit rating, rather than "maintaining and supporting" the Company's credit ratings as is identified as one of the appropriate objectives for a constitutionally sufficient rate of return.

Mr. Rao testified that "the Company's credit rating goes hand-in-hand with fair and timely regulatory decisions." 5 TR 248. He further testified:

> "The constructive regulatory environment has been a key factor in the Company's progression to having credit ratings more in line with its peer utility companies. Lowering the return below the currently authorized rate of 10.30% would create a significant risk of having a negative impact on the rating agencies assessment that the Michigan regulatory environment is supportive and of undermining the belief that the authorized return reasonably compensates investors. Lowering the return to 10.00% is not in the best interest of Consumers Energy, its customers, or the State of Michigan.
>
> * * *
>
> "It should also be noted that the investors and credit rating agencies look for a long and consistent track record. Due to the constructive regulatory environment in Michigan and strong internal financial discipline, the Company has started to develop a good track record of financial performance which will be jeopardized if ROE is not set at an attractive level." 5 TR 248-249.

The ALJ did not acknowledge this uncontested testimony; nor did he properly account for the interdependent nature of Consumers Energy's existing authorized return on equity and the Company's recent credit ratings improvements in making his recommendation to set a 10.00% return on equity in this case. Furthermore, the ALJ did not consider the credit maintaining criteria required under United States Supreme Court precedents for determining an appropriate rate of return. Contrary to the ALJ's recommendation, the return on equity should be set no lower than the Company's existing 10.30% authorized return on equity in order to preserve the underpinnings of the Company's improved credit ratings and ensure a return adequate to maintain those improved credit ratings.

d. <u>The ALJ Erred in His Analysis of the Company's Assumptions Used in Consumers Energy's Quantitative Return on Equity Analyses</u>

On pages 86-87 of the PFD, the ALJ concludes that three of the quantitative analyses used by Consumers Energy to calculate a range of potential returns on equity "appear to be based, in part, on questionable assumptions." In particular, the ALJ criticized the Company's use of: (1) a historical risk-free rate in the calculation of its CAPM; (2) "outdated" projected United States Treasury bond yield rates in connection with its Risk Premium analysis; and (3) an adjusted beta rather than a "raw beta" when performing its ECAPM analysis. PFD at 86. In each case, however, the ALJ cites reasoning from other parties that the Company refuted in the record, but fails to appropriately consider and weigh the Company's response.

With respect to the ALJ's first point about the use of the historical risk-free rate for the CAPM calculation, Mr. Rao offered extensive testimony supporting the rationale for using that risk-free rate instead of the traditional published outlook for yields on 30-year United States Treasury Bonds. Mr. Rao testified:

> "The historical average provides a more accurate representation of the long-term risk faced by investors. Recent Federal Reserve monetary policy actions have depressed interest rates below normal levels and the CAPM methodology oversimplifies the risk-return relationship. One of the shortcomings of the CAPM methodology in the present economic environment is that it applies the risk premium calculated using 'historical' data to the 'present' level of risk-free rates. As I mention later in my testimony, the artificially low interest rates are about 1-2% below historical levels and future expectations of the interest rate have considerable uncertainty. Utility stocks are particularly sensitive to interest rates and utilizing the projected interest rates which have considerable variability would underestimate the required equity returns. Throughout the rest of my testimony I will focus on the

> results using the average risk-free rate but have provided the results using both methodologies in my exhibits." 5 TR 218-219.

Thus, Mr. Rao's use of the historical risk-free rate in his calculations corrects for the effect of artificially low interest rates that result in many of the traditional quantitative analyses producing misleading results.

Only three other witnesses in this case provided any comment on Mr. Rao's use of the historical risk-free rate in his analyses. Staff's witness Kirk D. Megginson and the Attorney General's witness Coppola dismissed the use of the historical risk-free rate as inappropriate without offering any response to Mr. Rao's explanation about why it is necessary under the current unique market circumstances or any explanation about why the traditional models remain theoretically sound in the current environment. See 10 TR 2118 and 10 TR 2333, respectively. Neither of these witnesses offer any response or answer to Mr. Rao's observation that "[t]he models are based on the assumption that economic conditions are relatively stable and that current market inputs are reflective of their long-term outlook. That assumption is not currently being met." 5 TR 214. ABATE's witness Christopher C. Walters, on the other hand, testified, "I do agree that this Federal Reserve program introduced risk or uncertainty in long-term interest rate markets. Because of this uncertainty, caution should be taken in estimating Consumers' current return on common equity in this case." 10 TR 2168. Nevertheless, Mr. Walters discounted Mr. Rao's use of the historical risk-free rate based principally on his comparison to returns on equity recently authorized in other jurisdictions (see Section IV.A.1.e of these Exceptions below).

In reaching his conclusion that the Company's proposed historical risk-free rate is inappropriate, the ALJ credits a later observation offered by Mr. Walters, in which he claims that use of the historical risk-free rate "would require one to unreasonably assume that 'Treasury yields are going to increase by approximately 250 basis points in the near term' and then 'revert to the historical mean.'" PFD at 86 (citing 10 TR 2171). However, the ALJ did not consider rebuttal testimony on that point offered by Mr. Rao. After disagreeing that his testimony makes such an assumption, Mr. Rao testified:

> "Mr. Walters has failed to understand the inherent assumptions that he is making by using the CAPM and risk-premium analyses. By using a historic equity risk premium, Mr. Walters is understating the risk-premium investors would seek in a low interest rate environment. Utility investors in particular are sensitive to interest rates and therefore current Federal Reserve intervention in the markets is exposing investors to uncertainty. This uncertainty is not captured in the historical equity risk premium used by Mr. Walters. To correct for this incorrect assumption made by the models, I used the average historical rate <u>as a proxy for the future</u>. I could have alternatively used the current risk-free rate and a higher risk premium but estimating the appropriate risk premium has challenges, as I have previously discussed." 5 TR 270-271 (emphasis added).

Mr. Walters' analysis mischaracterizes Mr. Rao's testimony to the extent that he believes Mr. Rao intends the use of a historical risk-free rate as a prediction of actual near-future expectations for Treasury rates. It is merely a proxy based on sound logic, with which even Mr. Walters agreed, that there is more risk in the market than current United States Treasury rates indicate.

With respect to the ALJ's second point that Consumers Energy's United States Treasury yields used in its Risk Premium analysis were "outdated" in comparison with the United States Treasury yields offered by ABATE witness Walters, Mr. Rao offered no direct rebuttal testimony on that point. As noted in Mr. Walters' testimony, Mr. Rao used Treasury yields from September 2014, 10 TR 2176, which were still reasonably current at the time of the Company's filing in this case in early December 2014. Mr. Walters filed his testimony nearly four and a half months later in late April 2015 and used Treasury yields from April 1, 2015. 10 TR 2176.

Nevertheless, the observation that Mr. Walters used more current forecasts of United States Treasury yields is neither remarkable nor, in this case, meaningful.[3] Mr. Rao's testimony argued repeatedly and strenuously against the use of current forecasts of United States Treasury yields as providing a relevant and useful measure of risk-free rates in any of the CAPM, ECAPM, or Risk Premium models. See generally, 5 TR 216-222, 258-260, 269-271, 273-274. As discussed above, no other party ever offered evidence effectively refuting Mr. Rao's concerns about the use of these current forecasts of United States Treasury yields to represent the risk-free rate of return in the current economic environment, and Mr. Walters actually agreed that such concerns were reasonable. 10 TR 2168. Therefore, the observation that Mr. Walters used a more current version of the current United States Treasury yields forecast cannot support the conclusion that the Company's return on equity should be reduced below its current level of 10.30%.

With respect to the ALJ's third point about the Company's use of an adjusted beta in calculating its ECAPM results, the ALJ once again overlooked uncontested testimony by Consumers Energy witness Rao responding to that criticism by ABATE. In rebuttal testimony, Mr. Rao responded to ABATE's criticism as follows:

> "My ECAPM analysis, as well as Roger Morin's studies, relies on a Value Line adjusted beta. This is appropriate, as explained in Dr. Morin's book, *The New Regulatory Finance*:
>
> > 'Some have argued that the use of the ECAPM is inconsistent with the use of adjusted betas, such as those supplied by Value Line and Bloomberg. This is because the reason for using the ECAPM is to allow for the tendency of betas to regress toward the mean value of 1.00 over time, and, since Value Line betas are already adjusted for such trend, an ECAPM analysis results in double-counting. This argument is erroneous. Fundamentally, the ECAPM is not an adjustment, increase or decrease,

[3] Making decisions based on which witness filed testimony last would create an unreasonable criterion that would place Consumers Energy at a disadvantage and deny Consumers Energy due process.

> in beta. This is obvious from the fact that the expected return on high beta securities is actually lower than that produced by the CAPM estimate. The ECAPM is a formal recognition that the observed risk-return tradeoff is flatter than predicted by the CAPM based on myriad empirical evidence. The ECAPM and the use of adjusted betas comprised two separate features of asset pricing. Even if a company's beta is estimated accurately, the CAPM still understates the return for low-beta stocks. Even if the ECAPM is used, the return for low-beta securities is understated if the betas are understated….Both adjustments are necessary.'

> "The ECAPM has been utilized in several rate case proceedings and is included among the models relied upon by some regulatory witnesses and decision makers. My use of the ECAPM and Value Line betas is appropriate and is well supported by a leading industry expert." 5 TR 271.

Although no party contested Mr. Rao's testimony on the appropriateness of the use of adjusted betas in the ECAPM calculation, the ALJ fails to acknowledge Mr. Rao's testimony on this point or to incorporate this additional information into his analysis.

Each of the ALJ's reasons for rejecting the results of the Company's quantitative return on equity analyses overlooks critical and uncontested evidence in the record demonstrating that the other parties' criticisms of the Company's methodology are misplaced. There is no support in the record for a finding that the Company's existing 10.30% return on equity should be reduced based on any defects or shortcomings in the assumptions utilized in performing the Company's quantitative analyses.

e. <u>The ALJ Erred in Reducing Consumers Energy's Return on Equity Based on His Comparison to Other Recently-Approved Utility Returns on Equity</u>

On page 87 of the PFD, the ALJ concludes that Consumers Energy's existing 10.30% return on equity is "significantly above the national average" when compared against the authorized returns on equity granted for other regulated utilities throughout the country. The

PFD cites Exhibits S-4 (Schedule D-5), AG-16, and SWC-4 in support of that conclusion, as well as testimony by Staff, the Attorney General, ABATE, and Wal-Mart Stores East, LP and Sam's East, Inc. ("Wal-Mart"). PFD at 87. The ALJ concludes that this observation provides another reason for reducing the Company's existing return on equity and adopting the lower 10.00% return on equity proposed by Staff. However, as discussed earlier in these Exceptions, the ALJ continues to place undue emphasis on only the comparative risk criterion for establishing an appropriate rate of return in this case. But, even with respect to that one criterion, his analysis of recently approved returns on equity in other states is not properly tailored to the legal standard and overlooks record evidence supporting a return on equity no lower than 10.30%.

As noted above, in *Bluefield Waterworks*, the Supreme Court held:

> "A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made <u>at the same time and in the same general part of the country</u> on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." 262 US at 692-93 (emphasis added).

Properly applied, the *Bluefield Waterworks* holding calls for returns to reflect comparability in both time and location to utilities that are subject to a rate proceeding.

In Michigan cases governed by Public Act 286, utilities typically use a fully projected future test year, as Consumers Energy has proposed in this case. So, there will be no historical referent that accurately captures a comparable utility return on equity in terms of time. Use of recent utility authorized returns on equity as a proxy for near-future comparability in terms of time may serve as a *partial* solution to that problem, but cannot meet the constitutionally required threshold unless they are also considered in light of reasonable forecasts of circumstance that are likely to affect those returns on equity in the appropriate future period of time. In this case, the ALJ and several of the other parties insist that recent past approved returns on equity in other jurisdictions should be largely determinative of the return on equity used for calculating the revenue deficiency in this case, but neither the ALJ or those other parties makes any adjustment or accommodation for circumstances that indicate that returns on equity are likely to rise during the future test period. Therefore, none of the other parties' recommendations, nor the ALJ's conclusion that relies on them, are comparable in time as required by the *Bluefield Waterworks* holding.

Company witness Rao provided considerable testimony in this case demonstrating that economic outlooks for the near future exhibit signs of instability and uncertainty that are expected to drive increasing interest rates and rising return expectations among investors in the near term. See generally 5 TR 228-234. No party offered contrary evidence in this case tending to show a different expectation for near-future periods. For this reason, recent past approved returns on equity cannot be taken at face value for comparability to an appropriate return on equity for Consumers Energy in this case based on a future test year. If recent past returns on equity indicate a 10.00% return on equity as the ALJ found in this case, any future return on equity, under the circumstances forecasted by Mr. Rao, would need to be set at a level somewhat higher than 10.00% in order to be comparable in time as required by *Bluefield Waterworks*. In fact, the most recent information in the record of this case supports that conclusion. The Attorney General offered Exhibit AG-20, which, like exhibits offered by Staff and Wal-Mart, shows recently authorized returns on equity around the United States dating back two to three years. However, Exhibit AG-20 also includes information on authorized returns on equity as recently as the first quarter of 2015. While the parties' exhibits show a downward trend in authorized returns on equity over the past two to three years (through the end of 2014) on a national basis, the first quarter of 2015 showed a marked upward movement of returns on equity back to 10.37%. Exhibit AG-20. This is consistent with Mr. Rao's forecast of investor expectations and supports the conclusion that Consumers Energy's return on equity in this case should be set no lower than 10.30%.

Under cross-examination about the trend shown on Exhibit AG-20, Mr. Rao provided the following testimony:

> "Q. This is confirming something you have already discussed with ABATE's counsel. The ROE percentage as indicated in the column (2), it's 10.02 percent for 2013 and 9.91 percent in 2014, so it's going on a downward trend. Is that correct, as indicated by those two numbers?
>
> "A. That is correct. But if you continue to look at that 2015 first quarter, the direction changes, it starts to increase.
>
> "And that brings me to the point I wanted to remind all of us when we are looking at the histories, while history provides a reasonable data point, you should also look at what is happening in the environment either this year or what is projected to happen. And as all of you know, one of the major things that is likely to happen this year is Federal Reserve starting to raise interest rates. So that's probably the biggest issue on the top of all investors' minds. And even on the forecasters minds, for that matter. No one can predict when or how much, but everybody knows the rates are going up. And different forecasters have different estimates. Any time, any amount ranging from 100 to 200 basis points within the next year or two and –
>
> "Q. I appreciate –
>
> "A. So I would like us to remember that. And that's been one of the considerations I used in arriving at my recommendation." 5 TR 294-295.

In making his recommendation in this case, the ALJ did not acknowledge this recent reversal in the national trend of declining returns on equity or incorporate it into his 10.00% return on equity proposal.

The recently authorized return on equity comparisons offered by several other parties to this case are also not comparable in terms of location as required by *Bluefield Waterworks*. Rather than comparing recently authorized returns on equity for utilities "in the same general part of the country" as directed by the Supreme Court in *Bluefield Waterworks*, Staff and other intervenors offered comparisons showing the recently authorized returns on equity of all utilities nationally, which included significant numbers of utility decisions in states far remote from Consumers Energy's service territory in Michigan. In fact, using data shown on Staff's Exhibit S-4, Schedule D-5, page 13 (cited by the ALJ in making his determination to recommend a 10.00% return on equity in this case), the average return on equity resulting from recently decided cases in the states "in the same general part of the country" as Consumers Energy, i.e. Indiana, Michigan, Ohio, Pennsylvania, and Wisconsin,[4] is actually 10.26%. When adjusted for comparability of time as discussed above, that recent average of authorized returns on equity "in the same general part of the country" as Consumers Energy is easily well above the Company's current return on equity of 10.30%. This is further support for the fact that the Commission should not use any return on equity in this case for setting rates lower than 10.30%. The ALJ failed to tailor his analysis of the comparability of recently approved returns on equity in terms of location as required by *Bluefield Waterworks*.

[4] The Company does not include recently authorized returns on equity from the State of Illinois in this analysis because Illinois operates under a formula ratemaking paradigm, which, according to Illinois state statute, simply adds 580 basis points to the monthly average yields of 30-year Unites States Treasury bonds for the applicable calendar years. 220 ILCS 5/16-108.5(c)(3). Because Michigan does not utilize formula ratemaking, results from recent Illinois cases are not comparable to the individualized ratemaking requirements applicable to Michigan utilities.

One last point bears discussion with respect to the issue of comparing recently authorized returns on equity for other utilities for purposes of determining an appropriate return on equity for Consumers Energy in this case. As discussed further above, the ALJ emphasized the risk criterion for determining an appropriate return on equity to the complete exclusion of the other constitutionally required criteria throughout his analysis. On pages 79 and 80 of the PFD, footnotes 30 and 31 respectively, the ALJ notes that some of the parties to the case argued that return on equity results from Virginia should be excluded from any comparison for recently approved returns on equity in other states. The ALJ appears to have accepted those arguments by citing return on equity averages offered by other parties that exclude Virginia. If recent Virginia return on equity decisions were being analyzed from the perspective of comparability of risk, that might arguably be appropriate, since *Bluefield Waterworks* indicates that risk comparisons should be comparable in time and location. However, in this case, the recent Virginia return on equity decisions provide an example of the appropriate rationale related to the capital attraction goal of an appropriate return on equity. Consumers Energy explained that rationale in its Reply Brief in this case, but the ALJ never discusses Consumers Energy's analysis or considers its meaning for the capital attraction criterion of a constitutionally sufficient return on equity.

During cross-examination of Mr. Rao, ABATE's counsel asked Mr. Rao to read a portion of two analyses from Regulatory Research Associates into the record. 5 TR 288-290. Those analyses stated that they excluded Virginia results from their return on equity calculations due to the fact that Virginia statutes authorize the Virginia State Corporations Commission to approve enhanced returns on equity of up to 200 basis points for utilities' investments in certain generation projects. 5 TR 288-290. A review of the Virginia statutes in question confirms the

Regulatory Research Associates' description of the program. Va. Code Ann. 56-585.1.A.6. However, the program appears to be part of a deliberate state program in Virginia designed to incent utilities to make large investments in certain types of electric generating plants.

In other words, the State of Virginia has recognized that large capital investment programs require a higher authorized return on equity in order to attract the capital necessary to undertake those projects. Virginia, then, represents an apt parallel to Consumers Energy's situation in this rate case. As discussed earlier in these Exceptions, Mr. Rao testified about the need for an attractive return on equity in this case as a result of the Company's large capital investment program. Again, he testified:

> "[E]vidence presented by Consumers Energy in this case indicates that the Company plans to make significant capital expenditures in Michigan in the infrastructure necessary to ensure adequate generation capacity and provide safe and reliable service to customers in compliance with federal and state requirements. The Company plans to invest more than $7 billion from 2015 to 2019 to improve system reliability, meet environmental standards, and expand and upgrade generating capacity. This significant capital investment increases the risk profile of the Company with respect to investors and rating agencies. Authorizing a ROE in this case at a level that investors view as adequately compensating for risk is important in keeping Consumers Energy healthy and in attracting large amounts of capital to Michigan. Authorizing a return that investors consider to be below expectations could lead to increases in the cost of capital or hinder the Company's access to new capital, neither of which is in the best interest of customers. A return of 10.70% is within the range of reasonable returns and adopting a 10.70% return in this case will help assure that Consumers Energy continues to have reasonable access to capital on reasonable terms and conditions." 5 TR 237.

Rather than excluding Virginia from any cross-state analysis of recently authorized returns on equity, the Commission should look to Virginia, in particular, as an example of the kind of returns on equity that should be granted in the current environment to support Consumers Energy's large capital investment program. In other words, Virginia returns on equity should be given specific weight in determining Consumers Energy's return on equity in this case as they pertain to the capital attraction objective of setting appropriate returns. The ALJ failed to consider this aspect of the Virginia returns on equity even though it is further support for the conclusion that the Commission should not use any return on equity lower than 10.30% in this case for calculating the Company's revenue requirement.

f. **The ALJ Erred in Concluding that Certain Provisions of Public Act 286 Reduce Consumers Energy's Business Risk and Require a Reduction in the Company's Return on Equity**

On page 88 of the PFD, the ALJ cites several features of Public Act 286 that, in the ALJ's perception, "reduc[e] the risk borne by [Michigan utilities] in the past . . . ." The ALJ found that such features as projected test years, self-implementation, and final orders within one year "necessitate taking a conservative approach with regard to the specific ROE authorized in rate cases like this." The ALJ appears to perceive Michigan's existing regulatory paradigm as providing more advantages to Michigan utilities than exist in other states, and hence, reducing investors' relative risk. However, the ALJ's analysis is not in line with the record evidence in this case. Responding to similar claims by ABATE witness Walters, Mr. Rao testified:

> "The reports referenced by Mr. Walters in his testimony often refer to the Michigan energy legislation passed in 2008 and the Commission orders issued subsequent to the law . . . . While the energy legislation has reduced the regulatory lag, it needs to be noted that prior to the 2008 law, Michigan utilities faced long and uncertain processing times compared to other states. By requiring an order in 12 months, the energy law has brought Michigan more in line with other states." 5 TR 268-269.

Contrary to the analysis implicit in the PFD, Michigan utilities such as Consumers Energy do not enjoy unique regulatory advantages that make the utility business in this state less risky.

This conclusion is further supported by an excerpt from one of the analyst reports cited in Mr. Rao's rebuttal testimony. It stated:

> "Michigan's regulatory environment <u>has made great progress</u> since the 2008 energy legislation passed. While most provisions have stuck, an electric decoupling mechanism that helped smooth earnings was knocked down by the courts. Regardless, a string of generally positive rate cases suggests that <u>the regulatory atmosphere in Michigan has improved</u>. If CMS can keep rate increases at or near its targets, the prospect of regulatory pushback will be less daunting, but the latter is always a concern given uncertainty around the resilience of Michigan's economy. *Morningstar Equity Analyst Report, April 24, 2015.*" 5 TR 246 (emphasis added).

Rather than indicating that Michigan enjoys some kind of premium regulatory atmosphere in the wake of Public Act 286, the Morningstar analysis indicates that Public Act 286 helped make "progress" and "improvement" in Michigan's regulatory environment, which suggests a previously deficient regulatory paradigm. It is also worth noting that the Morningstar analysis places particular importance on those regulatory improvements in the context of the State of Michigan due to the "uncertainty around the resilience of Michigan's economy." In other words, Morningstar's analysis indicates that they view Michigan's economy as more risky than other states, and that places special importance on Michigan having a utility regulatory environment at least as constructive as most other states. Mr. Rao's testimony made a similar observation. He testified:

> "From an investor standpoint, while PA 286 reduces regulatory lag, it does not put Consumers Energy in a more favorable position than other states, some of which require regulatory approval in less than 12 months. This is shown on Exhibit A-9 (DVR-1), Schedule D5, pages 11 through 12, a compilation of rate case time requirements for select companies in the proxy group. A more significant consideration to investors is whether the MPSC's authorized returns support a conclusion that the MPSC understands the importance of authorizing returns that investors will view as reasonable." 5 TR 235.

These are the opposite of the kind of conclusions reached by the ALJ, who decided that Public Act 286 makes Michigan less risky than other jurisdictions.

Furthermore, it should be noted that the Company's existing 10.30% return on equity was established by the Commission's June 7, 2012 Order in Case No. U-16794 and maintained in the Commission's May 15, 2013 Order Approving Settlement Agreement in Case No. U-17087, both of which were decided well after the enactment of Public Act 286. So, any risk-reducing effect that Public Act 286 may have had on the appropriate level of utility returns on equity in Michigan has already necessarily been factored into the Company's existing 10.30% return on equity. There have been no amendments to the features of Public Act 286 cited in the PFD as requiring a lower return on equity in this case, so there appears to be no discernable rationale why Public Act 286 now requires further reduction in the Company's existing return on equity as proposed by the ALJ.

At best, Michigan utilities are only recently beginning to come on par with the kind of supportive regulatory environment previously more common throughout the industry and, hence, do not enjoy any lower risk than other utilities (and, because of unique characteristics of Michigan's economy, likely are perceived by investors to be higher risk). Mr. Rao testified repeatedly that investors look for a "long and consistent track record" when evaluating the regulatory environment and making investment decisions. 5 TR 249. Again, Mr. Rao noted in his rebuttal testimony that "the Company has *started* to develop a good track record of financial performance . . . ." 5 TR 249 (emphasis added). But, he also noted that the Company's developing track record "will be jeopardized if ROE is not set at an attractive level." 5 TR 249. Mr. Rao testified:

> "Investors look for continued confirmation that the Commission understands the investment community and the importance of returns in attracting capital to Michigan. When evaluating an investment opportunity, investors look at not only the authorized ROE but also other regulatory/legislative mechanisms that are in place to ensure adequate and timely recovery of costs. These

> include file-and-implement provisions of 2008 Public Act 286 ('PA 286'), which I mentioned in my direct testimony. I believe that investors would consider an authorized return of 10.00% to be at a level lower than appropriate to adequately compensate for perceived risks." 5 TR 245-246.

Thus, the Commission should reject the ALJ's conclusion that features of Public Act 286 support a reduction of the Company's existing 10.30% return on equity. The Commission should instead use a return on equity in calculating the Company's revenue requirement in this case that is set no lower than the Company's existing 10.30% authorized return on equity.

g. The ALJ Erred in Observing that the Company's Reliance on the Brattle Group Report Provides "Limited Assistance" in Evaluating the Impact of Decoupling Mechanisms on Return on Equity

In footnote 36, on page 90 of the PFD, the ALJ observes that the Brattle Group Report admitted in evidence as Exhibit A-117 (DVR-2) in this case is "of limited assistance" in evaluating whether a utility's return on equity should be reduced if a regulatory body also implements a revenue decoupling mechanism or other similar mechanism as part of the utility's rate structure. The ALJ bases his observation on his understanding that "the report in question deals with a mechanism that appears to be much broader in scope" than the revenue mechanisms proposed by Consumers Energy. PFD at 90, note 36. This conclusion is not correct. Contrary to the ALJ's interpretation, the Brattle Group Report does not analyze only a single broad decoupling mechanism or even a group of like broad mechanisms. Rather, the Brattle Group Report indicates that the researchers used a "broad definition" of a decoupling mechanism in order to capture a wide variety of decoupling mechanisms around the country with the basic attributes that fit the definition. Exhibit A-117 (DVR-2), page 6. One of the broad classes of decoupling mechanisms included was any mechanism that involves "decoupling with general revenue true-up mechanisms." Exhibit A-117 (DVR-2), page 3, note 5. The mechanism proposed by Consumers Energy in this case fits that broad definition.

In any case, the Brattle Group Report describes a systematic and statistically based review of a wide variety of decoupling mechanisms for the purposes of determining whether utilities that have decoupling mechanisms are, statistically speaking, more or less likely to have a lower cost of capital than utilities without. After performing statistical analysis of a wide variety of utilities with and without broadly defined decoupling mechanisms, the Brattle Group Report determined that:

> "[t]he findings of our analysis do <u>not</u> support the belief that utilities <u>with</u> decoupling have a lower cost of capital than utilities <u>without</u> decoupling. Contrary to what some might expect to find, at least on the basis of the opinions of certain intervenors and the (minority set of) judgments where commissions reduced allowed rates of return because of decoupling, we found that the estimated cost of capital for decoupled utilities was <u>higher</u> by a <u>small but statistically significant</u> amount." Exhibit A-117 (DVR-2), page 2 (all emphasis in original).

To the extent that the ALJ proposed that the Brattle Group Report offered into evidence by the Company should not be given any weight in determining that approval of such a mechanism should <u>not</u> result in a reduction to return on equity, the ALJ's understanding is not supported by a correct reading of Exhibit A-117 (DVR-2).

2. <u>Return on Equity Conclusion</u>

As discussed in more detail above, the ALJ did not adequately consider and afford the appropriate weight to substantial testimony and other record evidence offered by Consumers Energy witness Rao, which undermines the ALJ's conclusion that the Company's return on equity should be reduced to 10.00%. The ALJ also placed too much emphasis on only one of three legally required factors for determining a constitutionally sufficient return on equity while overlooking the other factors. And the ALJ did not correctly analyze the one factor that he considered throughout his analysis. The Company put forth substantial evidence, in the form of Mr. Rao's expert testimony and exhibits, supporting an increase in the Company's return on equity for ratemaking purposes to 10.70% and explaining why a return on equity at that level is appropriate in light of the legally required criteria for determining a constitutionally sufficient return. However, Mr. Rao also noted in his rebuttal testimony that, at the very least, the return should remain at not less than 10.30% and that reducing the Company's return on equity to "less than the presently authorized level of 10.30%" would:

> "send a wrong signal to the investor community at a time Consumers Energy is implementing a large infrastructure improvement program and put the Company at a disadvantage in raising capital from the investor community. Lowering the authorized ROE would negatively impact the value of their investment in the Company and jeopardize the progress that the Company and the State of Michigan have made during the last several years in promoting Michigan as a place to invest. Once lost, it will be difficult to regain investors' confidence." 5 TR 243.

Reducing the return below the currently authorized level of 10.30% is something the Commission should not do. The Commission should reject the ALJ's recommendation to reduce the Company's return on equity for ratemaking purposes to 10.00% and should instead use a return on equity no lower than the Company's existing return on equity of 10.30% in calculating the Company's revenue deficiency in this case.

B. <u>Overall Rate of Return Summary</u>

Consumers Energy requests that the Commission authorize a return on equity in this case for Consumers Energy's electric business of not less than 10.30%. If the Commission authorizes a 10.70% return on equity in combination with the capital structure recommended by the Company, and in the PFD, in combination with the other cost rates recommended by the Company, and in the PFD, then the resulting overall rate of return is 6.38% on an after-tax basis and 9.22% on a pre-tax basis. The capital structure, cost rates, and determination of overall rate of return are shown on Appendix E to the Company's Initial Brief. The result if the currently authorized return on equity of 10.30% is maintained would be 6.21% on an after-tax basis and 8.95% on a pre-tax basis.

V. EXCEPTIONS REGARDING ADJUSTED NET OPERATING INCOME (PFD Section V)

A. Operation and Maintenance ("O&M") Expenses

1. Electric Distribution – Vegetation Management/Line Clearing

At page 108 in the PFD, the ALJ recommends that the Company's line-clearing expense level be set at $43,950,000. This determination is based on the ALJ's acceptance of the Staff's proposal of an expense level of $3,950,000 to address hazardous trees outside of the right-of-way and the Attorney General's proposed line-clearing expense amount of $40,000,000. Although the Company agrees with the ALJ's adoption of the Staff's proposed funding for hazardous trees outside of the right-of-way (8 TR 1355), it does not agree with the adoption of the Attorney General's proposed line-clearing expense. By adopting the Attorney General's proposed line-clearing amount, the ALJ fails to provide Consumers Energy with a reasonable line-clearing expense level and discounts the fact that the Company's projected expense amount is designed to increase customer satisfaction and benefit customers through improved reliability. 8 TR 1321.

As an initial matter, the ALJ improperly characterized the Company's commitment to line clearing. Citing the Company's reinvestment in other O&M programs during 2014, the ALJ criticized Consumers Energy for previously spending less that its MPSC-authorized amount on vegetation management. PFD at 107. This assertion is an inaccurate portrayal of the Company's actions. Exhibit S-11.10 shows that the Company has historically spent more than the amount of Electric Distribution O&M expenses that have been approved in rate filings. See also 8 TR 1362. However, the Company must manage its spending across the utility portfolio, and funding for line clearing, service restoration, and other Electric Distribution O&M expenses must be balanced. 8 TR 1352. Nevertheless, the Company has made efforts to mitigate the effect certain expenses, like service restoration, will have on overall Electric Distribution O&M expenses through projects like the pole-top capitalization. 8 TR 1354. As Company witness Mary P. Palkovich testified:

> "By reconfiguring its work order system to allow for the plant unitization of pole-top hardware, the Company will be able to capitalize some demand replacement pole-top hardware costs that are currently O&M expenses in service restoration, corrective maintenance, and HVD lines demand programs. It is estimated that approximately $19,700,000 per year can be reduced in direct O&M expenses in service restoration, corrective maintenance, and HVD lines demand once these new plant units are established. This movement of these O&M expenses to the capital Demand Failures Program is the reason the expenditures in that program are projected to increase but will mitigate the effects of the large increases in O&M expenses the Company may experience in periods of heavy storm activity." 8 TR 1354.

This will impact the Company's ability to direct more spending to its vegetation management program.

The ALJ's analysis further suggests that the Company's line-clearing expense amount should be based on historical spending. PFD at 107. This suggestion fails to consider the evidence provided by the Company demonstrating the basis for and benefit of the projected line-clearing expense amount. As Ms. Palkovich testified, "By increasing the amount of line-clearing spending from historical levels, Consumers Energy will be better equipped to reverse the growing trend of tree caused outages and reduce the time needed to restore service during outages." 8 TR 1351. Moreover, the use of the Company's projected line-clearing expense amount is consistent with the Commission's Order addressing the 2013 ice storm report, where the Commission encouraged Consumers Energy to continue with vegetation management improvements and to expand it vegetation management program to address trees outside of utility easements. See MPSC Case No. U-17542, May 2, 2014 Order, page 24; see also 8 TR 1351. The Company's proposal in this case is consistent with this direction.

In determining a reasonable line-clearing expense level, Consumers Energy projects a level of spending that is necessary to maintain electric distribution reliability and provides a reasonable expectation of meeting the Commission's Service Quality and Reliability standards. 8 TR 1302. While the Company has continued to work to improve its System Average Interruption Frequency Index ("SAIFI") levels (8 TR 1305), 21% of customer service interruptions are due to trees. 8 TR 1302. In order to further develop its line-clearing program, in 2013, Consumers Energy hired an outside consultant, Environmental Consultants Inc. ("ECI"), to perform an assessment of the Company's low voltage distribution ("LVD") line-clearing procedures, practices, and specifications and to conduct a workload study based on vegetation conditions existing along the LVD system. 8 TR 1317, 1365.

After a thorough analysis, ECI recommended that the Company adopt a seven-year average LVD line-clearing cycle and address hazardous trees that are outside of the right-or-way. 8 TR 1317. ECI based its recommendation on an evaluation of the following factors: "1) tree caused outage data trends by circuit; 2) the percentage of Consumers Energy's overhead primary system miles that operate at a 4.8/8.32 kV nominal voltage; 3) the common use of 50' poles in urban areas; and 4) the percentage of trees in the right-of-way contacting primary conductors." 8 TR 1317-1318. Consistent with ECI's recommendations, the Company is projecting $57,700,000 for its line-clearing spending for the test year. This requested line-clearing expense level consists of $53,300,000 for the LVD line clearing and $4,400,000 for the Company's high voltage distribution ("HVD") line-clearing program. 8 TR 1317. This funding level will permit clearing of approximately 25%, or 1,170 miles, of the HVD system, and approximately 14%, or 8,000 miles, of the primary LVD system annually. 8 TR 1318.

While recognizing that Consumers Energy hired ECI to perform an evaluation of its system, the ALJ dismisses the outside consultant's recommendation and concludes that the record supports a two-year average of projected spending resulting from ECI's analysis supporting an eight-year tree trimming cycle. PFD at 107. This claim misrepresents the ECI report and is unsupported by the record. The record demonstrates that increasing the amount of line-clearing spending and reducing the effective clearing cycle length from historical levels to a seven-year cycle will help to reverse outage trends. 8 TR 1319. As Company witness Palkovich testified:

> "A reduced cycle length means Consumers Energy has to remove less of the tree to meet clearance requirements when work is performed. Based on ECI's tree species and regrowth study of Consumers Energy's system, at historic funding levels Consumers Energy had to remove approximately 20 feet of a tree's canopy to achieve ten feet of clearance to conductors. When the effective cycle is ten years the amount of canopy removal drops to approximately 16 feet. At the projected seven-year clearing cycle the amount of tree canopy removal is approximately 12 feet to achieve ten feet of clearance to conductors." 8 TR 1319.

While the Company thoroughly discussed the use of a seven-year line-clearing cycle, the Staff did not comment on the specifics of the Company's proposed vegetation management program, and the Attorney General's discussion on line-clearing cycles was dependent on the ECI's report that rejected the use of an eight-year cycle. See 10 TR 2278, Exhibit AG-5.

Additionally, by accepting the Attorney General's recommendation to utilize a two-year average of projected spending based on the ECI's analysis for an eight-year tree trimming cycle, the ALJ adopted a flawed recommendation. To start, the ECI's proposed expense level for an eight-year clearing cycle did not take into consideration funding related to clearing the

Company's HVD system, as the ECI study only addressed the LVD system. 8 TR 1366. Moreover, this recommendation ignores the differences between an initial line clearing and the annual maintenance line clearing. As seen in the ECI report, see Exhibit AG-5, the initial line-clearing cycle would require $43 million in expenses and $34.4 million in the subsequent annual maintenance cycle. 10 TR 2278. By averaging the cost of the initial clearing cycle with the cost of the annual maintenance clearing cycles, the expense amount will not allow the Company to perform the first cycle of clearing. Due to the amount of vegetation present, the amount of money needed to clear the system through the first cycle is significantly higher than the funds needed for the maintenance clearing cycles. 8 TR 1366. The use of an average amount will not allow the Company to complete clearing in the cycle timeframe, and as the cycle time lengthens, the cost to clear a circuit mile increases. 8 TR 1366. Ms. Palkovich stated:

> "The ECI analysis used current density of vegetation on the Company's system to derive the first cycle line-clearing costs per year and predicted vegetation density to determine the second cycle line-clearing costs per year. Using an average cost for the two cycle periods would result in a ten-year timeframe to complete the first cycle line clearing. This is due to the higher cost associated with the first cycle line clearing based on vegetation density. Additionally, this assumes that all dollars would be used on the LVD system. Thus, there would be no funding to clear the HVD system." 8 TR 1366.

By adopting the Attorney General's line-clearing expense level, the ALJ failed to recommend a reasonable expense level for the vegetation management program, and therefore, the Company requests that the ALJ's recommendation be rejected.

2. <u>Uncollectible Expenses</u>

At pages 131-132 of the PFD, the ALJ recommends a reduction to the Company's Uncollectible Accounts expense in the amount of $5.5 million. This recommendation should be rejected as it is based on the Attorney General's position which fails to result in a reasonable projection of Uncollectible Accounts expense. The Commission should instead approve the Company's requested Uncollectible Accounts expense amount which is based on a reasonable methodology for projecting this expense.

Record evidence provided by the Company refutes the Attorney General's claims with respect to the appropriate calculation of Uncollectible Accounts expense. The Attorney General's recommended Uncollectible Accounts expense adjustment, which utilizes a five-year average of the ratio of net charge offs to revenue for the period 2010 through 2014, does not improve the estimate of uncollectible expense over the Company's three-year average approach. 6 TR 660. Company witness Daniel L. Harry explained that by using a five-year average approach, Mr. Coppola's calculation dilutes the recent trend of higher uncollectible expense by incorporating a lower 2010 historical year resulting in a lower ratio of net charge offs to revenue and a lower projection of Uncollectible Accounts expense. 6 TR 660. The Company's projection at $30.8 million is more reflective of the Company's recent uncollectible expense experience over the 2012 through 2014 timeframe, as shown in the trend of Uncollectible Accounts expense for those years ($23.2 million, $32.6 million, and $32.4 million, respectively). 6 TR 660.

Thus, the ALJ's recommendation, which adopts the Attorney General's position with respect to Uncollectible Accounts expense, should be rejected by the Commission. The Company's Uncollectible Accounts expense amount is reasonable and should be approved by the Commission.

3. Insurance Expense

At page 117 of the PFD, the ALJ recommends the disallowance of $2,504,000 in Insurance expense as proposed by Staff. Staff's recommendations in this regard, however, utilizes a five-year average of insurance premiums net of refunds, credits, and distributions and fails to capture the sporadic nature of insurance refunds and/or credits received by the Company.

Staff's understanding of the Company's Insurance expense is inaccurate. The receipt of insurance refunds and/or credits is not a "regular occurrence." Staff's Initial Brief, page 90. Company witness Harry explained that the receipt of insurance refunds and/or credits has historically been, and is expected to continue to be, very sporadic due to the volatility of investment markets and future claims experience. 6 TR 660-661. Due to the sporadic nature of these refunds and/or credits, the timing and amount of future refunds and credits cannot be relied on to occur with any certainty. 6 TR 661. These sporadically received amounts should be treated as non-recurring items and normalized out of ongoing expenses. 6 TR 661.

It should also be noted that Staff's recommendation for Insurance expense is in conflict with Staff's other O&M adjustments. For the projection of Uncollectible Accounts expense and Injuries and Damages expense, Staff claims that the Company's budget data is "more accurate" and a "better approach" to projecting those expenses when compared to historical averages. See Staff's Initial Brief, pages 77-79. However, when projecting Insurance expense Staff rejects the Company's budget data as apparently inaccurate and utilizes a historical average. Staff's Initial Brief, page 89; see also Exhibit S-11.22. While the Company does not support the use of budget data for the projection of any O&M expense, Staff appears to have selectively cherry-picked certain budget data which supports its desired result and rejected other budget data that is in conflict with Staff's desired result. Staff's fluctuation between budget data and the use of historical averages undercuts Staff's credibility with respect to the projection of O&M expenses and Staff's speculation that such budget data is more accurate than the Company's O&M expense projections in this case.

As a result of the above, the ALJ's recommendation to disallow $2,504,000 in Insurance expense should be rejected by the Commission. The Company's approach is reasonable and most accurately considers the sporadic receipt of insurance refunds and/or credits which may or may not continue in the future.

4. <u>Defined Benefit Supplemental Executive Retirement Plan ("DB SERP") and Defined Contribution Supplemental Executive Retirement Plan ("DC SERP")</u>

At pages 121-122 of the PFD, the ALJ recommends removing $4,747,000 in expenses related to the Company's DB SERP and DC SERP expenses. These expenses are related to common benefit offerings and are nothing more than retirement expenses for the Company's management personnel. 8 TR 1447, 1487. These expenses are reasonable, appropriate, and properly recoverable in rates.

In removing these expenses, the ALJ supports his recommendation by relying on recent regulatory history. PFD at 121. Citing to Commission Orders in MPSC Case Nos. U-14347, U-15244, U-15768, and U-16472; the ALJ indicates that recovery of these expenses have been consistently disallowed. *Id.* However, only one of the cited Orders is directly related to Consumers Energy's requested recovery of DB and DC SERP expenses.

In MPSC Case No. U-14347, the Commission addressed Consumers Energy's DB SERP expense, tying it to other expense categories such as stock options. MPSC Case No. U-14347, Opinion and Order, December 22, 2005, page 31. A review of this Order shows that the Staff witness argued that the Company should not recover DB SERP expenses during a time where the Company should be improving its financial position, service reliability, and safety. *Id.* It is under that framework that the Commission excluded the Company's DB SERB expenses indicating that the benefits of DB SERP accrues primarily to investors, but only tangentially benefit ratepayers. *Id.* at 34.

It is clear that the circumstances that led to the Commission's previous decision are no longer the case. The Company is in a different financial position than it was in 2003, and Consumers Energy continually invests in improving the reliability of its distribution system. As Exhibit A-115 (MPP-10) shows, improvements have been made in the recent five-year trends for SAIFI, Customer Average Interruption Duration Index, and System Average Interruption Duration Index (excluding major event days). 8 TR 1362-1363. And, the Staff has indicated its agreement with this fact. See Staff's Initial Brief, page 80. Consumers Energy is committed to providing safe and reliable service, and as Company witness Palkovich testified, "Consumers Energy is committed to allocating all resources possible to continue to improve reliability…" 8 TR 1352. It should be clear that the past factual scenario is not indicative of the Company's present management outlook.

The PFD fails to recognize the change in circumstances that have arisen since the Commission's Order, and instead, it reiterates the fact that the Company's shareholders benefit from recovery of these expenses. PFD at 121-122. The Company does not dispute this fact. The DB SERP and DC SERP plans can benefit shareholders, as a well-run company that serves its customers will benefit shareholders. However, the MPSC does not disallow recovery of reasonable expenses simply because shareholders are benefited. The Commission looks to whether the requested expenses are just and reasonable, and in this case, expenses related to retaining management are reasonable and provide benefits to ratepayers.

The Company's management has the task of providing excellent, cost-effective energy and service to customers, while optimizing the Company's resources to meet present day demands and future needs of the business and its customers. 8 TR 1486. While these individuals are aware of the Company's shareholders and the overall financial strength of the

Company, management is also intrinsically involved in the Company's day-to-day activities. This has a tremendous impact on customers. Management makes decisions regarding workforce and expense items. 8 TR 1486. Their decisions affect everything from system reliability, to customer service, to the ultimate presentation of information on the customer's bill. This directly benefits customers.

DB SERP and DC SERP provide a competitive benefit package for management personnel who focus on a number of operational areas of importance to the customer including safety, system reliability, improved productivity, competitive pricing, quality, and customer service. 8 TR 1488. The Commission should approve recovery of the DB SERP and DC SERP benefit plan expenses in rates as these expenses directly impact ratepayers.

5. Employee Incentive Compensation Plan ("EICP")

Consumers Energy excepts to the ALJ's recommendation to disallow recovery of the operating expense associated with the Company's two employee incentive compensation plans (hereafter collectively referred to as "EICP"). PFD at 122-127. The ALJ found that the Company did not meet the Commission's standards for the recovery of incentive compensation plans. As explained below, the Commission should reject this recommendation and approve cost recovery for the EICP.

In Case No. U-14347, the Commission established a standard for recovery of incentive compensation plans. In its December 22, 2005 Order in that case (page 34), the Commission stated:

> "In Case Nos. U-10149 and U-10150, the Commission determined that executive bonus and employee incentive plans require a showing that the plan will not result in excessive rates and that the benefits to ratepayers from the bonus and incentive plans will, at a minimum, be commensurate with the programs' costs."

As an initial matter, Consumers Energy notes that this standard is not entirely applicable to the Company's incentive compensation plan costs included in this case because they are not associated with a "bonus" plan. The ALJ's characterization of the EICP as "bonuses" is one defective component of his reasoning on the issue of the EICP. See PFD at 122 and 127. The EICP at issue in this proceeding are not bonus plans or profit-sharing plans. 7 TR 1176. To the contrary, they comprise a component part of the reasonable costs of market-based employee compensation. As a component of a reasonable, market-based employee compensation package, the incentive compensation costs are a reasonable cost of doing business to provide utility service. 7 TR 1176. The ALJ's characterization of the EICP as "bonuses" is incorrect. Consumers Energy's employees are not paid in excess of market rates when they receive incentive compensation under the EICP; rather, they are paid below market rates if they do not receive incentive compensation. 7 TR 1176. The ALJ's recommendation is thus a recommendation to approve cost recovery for less than a full amount of reasonable employee compensation.

The Company's overall compensation costs are reasonable, including the incentive costs, and benefit customers. Customers benefit if the Company is able to attract, retain, and motivate its employees. All of the incentive plan costs should be included in rates as part of reasonable, market-based pay. Consumers Energy presented <u>uncontradicted</u> evidence that its overall levels of compensation (of which the EICP are a component) are set at reasonable levels. 7 TR 1180. There is no reasonable basis to eliminate incentive compensation costs from the cost of service recovered in rates because they are a part of an incentive plan, rather than including the costs as part of base pay. 7 TR 1180. The costs of the incentive plans should be recovered in rates as part of the Company's reasonably incurred cost of providing utility service. The ALJ's recommendation to disallow the costs associated with the EICP amounts to a recommendation to disallow a portion of employee compensation which is reasonable, market-based and necessary to attract and retain a qualified workforce. 7 TR 1176.

Consumers Energy explained in detail the Company's employee compensation philosophy and structure, as well as the structure of the EICP, at pages 124-130 of the Company's Initial Brief. There was no evidence presented in this proceeding which contradicted the evidence presented by the Company which demonstrated that the Company's incentive compensation structure is supported by substantial and significant research, and is consistent with industry practice. 7 TR 1153-1154. The Company's incentive compensation plans are designed to emphasize and promote operational and performance objectives in four areas which are critical to the Company's utility service: safety, reliability, customer value, and financial performance. 7 TR 1160. Focusing employees on those goals provide qualitative and quantitative benefits for the Company's customers. With incentive compensation, the employees and the Company as a whole must re-earn the at-risk incentive compensation each year. If the targeted high levels of performance are not achieved, employees' incentive pay is reduced or eliminated. 7 TR 1156-1157. Customers benefit from incentive pay because the elimination of the variable at-risk incentive pay would mean that all compensation would be guaranteed and an important incentive to improve service would be eliminated. This result would be harmful to customers.

Shifting a portion of employees' reasonable, market-based compensation to an incentive-based component benefits customers without additional cost. The incentive-based "carve-out" of the Company's reasonable costs of employee compensation puts a portion of employees' pay at risk unless the performance targets are achieved. 7 TR 1177. The Company's performance-based incentives provide concrete incentives to accomplish specific goals that represent performance priorities for Consumers Energy and its customers. 7 TR 1177. The incentive plans help create a culture of performance, rather than entitlement. 7 TR 1177.

Additionally, an incentive program structured to focus on safety, reliability, and customer value results in the following customer benefits:

- Safety measures result in reduced number of lost days (less absenteeism) and reduced medical costs;
- Reliability measures result in reduced interruption costs; and
- Customer value measures result in reduced O&M costs and improved customer satisfaction from increased productivity and quality. 7 TR 1177.

Customers also benefit from a financially sound utility. Customers benefit when the Company is able to raise capital, at the best available rates. Financial health leads to reduced costs of capital and lower costs for customers. 7 TR 1178. In addition, customers benefit by having a portion of compensation structured in the form of equity-based, long-term incentive because there is no cash outflow as a result of providing that incentive. The absence of a long-term incentive plan would require additional cash outflows in the form of salaries to pay competitive levels of compensation. This would result in fewer available funds for utility investment, thus directly impacting the Company's ability to provide customer value and reliability. 7 TR 1178. Long-term incentive participants are rewarded only if good long-term decisions are made. Strong stock and earnings per share ("EPS") growth performance in comparison with peer companies provides a reliable measure of a well-run, high performing utility. Strong stock performance also helps provide access to capital, which the Company uses to invest in plant that supports safe and reliable utility service, thus benefiting customers and the State of Michigan. 7 TR 1179.

The Company's request for cost recovery of its incentive compensation plans meets the standard of proof articulated in Case No. U-14347. The costs of the incentive plans are reasonable components of the reasonable, market-based compensation package necessary for the Company to attract and retain a qualified workforce. 7 TR 1177. They are reasonable components of the cost of providing utility service to customers, and will not result in excessive rates.

The benefits provided to customers from the EICP outweigh the costs of those plans. The qualitative benefits of the incentive plans are described above. In addition, Company witness R. Michael Stuart provided a quantitative analysis of the benefits of the incremental portion of reasonable, market-based compensation that is incentive-based. Mr. Stuart testified that the design of the EICP leads to lower costs and improved service for the benefit of customers. 6 TR 913. Mr. Stuart explained that while it is not possible to specifically quantify the benefits for every metric included in the EICP, the Company has quantified the benefits associated with five of the metrics, which quantification is summarized as follows: (1) Employee safety: employee safety incidents decreased by 72% from 2006. The resulting reduction in lost work days and medical expenses provide approximately $2.2 million of annual savings which directly benefit customers. 6 TR 913-914. (2) Distribution reliability: Based on cost per outage minute estimates provided by the independent Berkeley Laboratories, Consumers Energy's seven-minute outage reduction in average outage minutes achieved since 2006 has resulted in annual savings to the Company's business customers in excess of $25 million. 6 TR 914. (3) Generation reliability: The Company improved in this area from an annual forced outage rate of 9% to an annual rate of 4%, which reduced fuel expenses by more than $4.6 million per year. 6 TR 914. (4) First time quality improvement: This metric was initiated in 2013. It is an equally-weighted index of process improvement measures across seven operating areas. The measures were established to quantify the Company's continuous process improvement efforts to reduce, rework, and eliminate waste. 6 TR 914. Annual improvement targets are established for each metric and for the index total. In the first year, the Company achieved a 24% improvement versus a 10% improvement target. 6 TR 914-915. This improvement resulted in savings to customers in excess of $1.4 million. 6 TR 914. (5) <u>Productivity improvement</u>: The Company improved its productivity by approximately 46% over the past seven years, which is a key reason the Company' O&M expenses compare very positively to its peers. The Company's productivity metric is based on the percent improvement across ten weighted department-level productivity metrics. 6 TR 915. During the seven-year period, Company employees per customer decreased at an average rate of 1.25% per year, which resulted in a savings to customers of $10.7 million. 6 TR 913-915.

The quantified benefits for five of the metrics included in the EICP described above greatly exceed the total costs of the incentive plans which are requested for recovery in this proceeding (the costs are $12.8 million for the test year, 7 TR 1179, Exhibit A-26 (AMC-3)). Mr. Stuart explained that electric customers' allocated portion of the quantified benefits associated with employee safety, quality, and productivity amounts to more than $9 million annually. 6 TR 916. When combined with the annual benefit of distribution ($25 million) and generation ($4.6 million), the total quantified annual benefit for electric customers is approximately $38.6 million. 6 TR 916. These quantified benefits are in addition to the qualitative benefits of the incentive compensation plans which are described above. Mr. Stuart testified that the incentive compensation plans are a primary reason why the significant benefits identified above were achieved for customers. 6 TR 917. The benefits for customers far exceed the expense for the incentive compensation plans which are included for cost recovery in this proceeding. 6 TR 917.

The ALJ criticized the structure of EICP because they include financial metrics. However, that criticism ignores the facts that: (1) customers benefit from a financially sound utility; and (2) the benefits which accrue to customers as a result of achievement of the financial metrics are in addition to the substantial, quantified benefits the non-financial metrics provide. The benefits of the non-financial metrics, identified and quantified above, far exceed the entire costs of the EICP. The ALJ did not address this important fact in his PFD.

The ALJ's reliance upon past Commission Orders in which the costs of employee bonus plans were disallowed (PFD at 126-127) ignores the facts that: (1) the Company's EICP are not bonus plans, but rather part of reasonable, market-based compensation structured consistently with industry standards; and (2) the Company's presentation in this proceeding clearly demonstrated that the costs of the EICP are outweighed by the quantified benefits the plans provide for customers.

The ALJ also (PFD at 127) agreed with an argument put forth by MEC that the operational metrics which are part of the short-term EICP are targeted at areas "where the [C]ompany already plans to expend a large amount of capital investment and/or O&M expense to achieve the same goals as offered in support of its EICP." The Commission should reject this reasoning and argument. The fact that some of the investments and O&M expenses described by the Company in this case are designed to result in improvements in the same categories of operational performance measures included in the EICP metrics does not undermine the importance of the incentive compensation programs to focus and motivate employees toward achievement of the performance goals. If the targeted high levels of performance are not achieved, employees' incentive pay is reduced or eliminated. 7 TR 1156-1157. Customers benefit from incentive pay because elimination of the variable at-risk incentive pay would mean that all compensation would be guaranteed and an important incentive to improve service eliminated. The incentive compensation plans are a primary component of the achievement of the significant benefits identified by Company witness Stuart. 6 TR 917. The incentive compensation plans serve to <u>complement</u>, not duplicate, improvements in the operational areas of safety, distribution reliability, and generation reliability which result from the investments in the Company's system identified by other Company witnesses. The Commission should reject the ALJ's conclusion to the contrary.

Consumers Energy urges the Commission to consider the standard articulated by the Indiana Utility Regulatory Commission ("IURC") in a 2011 case involving Southern Indiana Gas and Electric Company's request to recover incentive compensation. In an Order issued April 27, 2011 in IURC Case No. 43839, the IURC stated at page 50:

> "The Commission recognizes the value of incentive compensation plans as part of an overall compensation package to attract and retain qualified personnel. The criteria for the recovery of incentive compensation plan costs is [sic] well established. We will allow recovery in rates when: (1) the incentive compensation plan is not a pure profit-sharing plan, but rather incorporates operational as well as financial performance goals; (2) the incentive compensation plan does not result in excessive pay levels beyond what is reasonably necessary to attract a talented workforce; and (3) shareholders are allocated part of the cost of the incentive compensation programs."

The IURC recognized the value of incentive compensation plans as part of an overall compensation package to attract and retain qualified employees. Instead of requiring a quantification of customer benefits specifically related to the metrics of the incentive plan, which can be extremely difficult for measures that support undeniably desirable achievements (e.g., improved customer satisfaction and safety), the Indiana criteria require there be a combination of operating and financial metrics and a demonstration that there is no resultant excess compensation. This is a reasonable approach.

Consumers Energy's incentive compensation plans meet these standards articulated by the IURC. Consumers Energy's EICP includes operational and performance goals in addition to financial goals. The financial goals are not disproportionately weighted in the metrics of the EICP, and the entire costs of the incentive plans are more than covered by the benefits which accrue to customers from the non-financial metrics described by Company witness Stuart, as explained above. There is no excessive pay because incentive costs are a carve-out, rather than an add-on, to the reasonable competitive market level of compensation. The benefits which accrue to customers as a result of achievement of the financial metrics[5] are in addition to the substantial, quantified benefits the non-financial targets provide, which substantially exceed the costs of the incentive plans. The incentive compensation plans do not result in excessive pay and are part of a reasonable employee compensation package. Further, Consumers Energy's shareholders are allocated a part of the Company's incentive compensation costs. Shareholders bear the incentive compensation costs in years when the actual payouts are greater than the target level included in this proceeding. In addition, the incentive compensation for the top six officers has not been included in the Company's requested recovery in this case. Further, cash payments under the EICP reduce earnings and grants of equity under the long-term incentive increase outstanding shares, which are both reductions in value to shareholders. 7 TR 1175. Although the Company does not believe the IURC's third criterion of shareholder burden should be included in the Commission's analysis of cost recovery for the Company's incentive plans, the Company's plans nevertheless meet that standard.

[5] The use of earnings and cash flow measures in the EICP and officer annual incentive recognizes that the Company's financial health is important for the Company, it customers, and the State of Michigan. Financial health leads to reduced costs of capital, thus providing savings to the customer. 7 TR 1178.

Consumers Energy's incentive compensation plans also meet the criteria the MPSC used in Case No. U-14347, *supra*. The incentive plans do not result in excessive costs and provide benefits to customers. The measures used for the incentive plans are customer value, safety, reliability, and financial performance, all of which benefit customers, as explained in detail above. The Company presented evidence showing that the quantitative benefits of the incremental portion of employee compensation, which is incentive-based, well-exceed the total costs of the incentive compensation. In addition, there are qualitative benefits of the plans which also benefit customers. The compensation approach used by the Company is reasonable, consistent with industry practice and standards, and represents best practices for creating customer focus through compensation design, and does so without additional cost to the customer (because the incentive plans are part of the overall reasonable, market-based pay structure). 7 TR 1181. The overall compensation levels, including the incentive plans, are reasonable, and should be included in the Company's cost of service in this proceeding.

B. Adjusted Net Operating Income Summary

In calculating Adjusted Net Operating Income, the PFD understated expenses and as a result overstated the appropriate test year level of Adjusted Net Operating Income. Consumers Energy presented evidence and arguments supporting a jurisdictional Adjusted Net Operating Income of $466,390,000. The calculation of this amount and the differences between the Company's and Staff's calculations are summarized on Appendix C, page 1, of the Company's Initial Brief. The O&M expenditures used in developing the above Company and Staff positions are shown on Appendix D to the Company's Initial Brief. The Adjusted Net Operating Income recommended by the ALJ should be adjusted consistent with the above exceptions.

VI. EXCEPTIONS REGARDING OTHER REVENUE RELATED ISSUES (PFD Section VI)

A. Revenue Adjustment Mechanism

At pages 135-136 of the PFD, the ALJ found that the Commission cannot lawfully grant the Company's requested Revenue Adjustment Mechanism and, thus, recommends that it be rejected. Such a conclusion is inconsistent with the Company's request. The Company has explicitly made its request conditional on the enactment of legislation addressing revenue adjustment mechanisms for electric utilities during the pendency of this case. 5 TR 563. The Company submits that such legislation is before the Michigan Legislature and, if that legislation becomes law prior to the issuance of the Commission's final order in this case, the Company's proposal should be adopted by the Commission as the most reasonable and appropriate revenue decoupling mechanism. As a result of the nature of the Company's request, it is untrue that the Company is requesting that this mechanism be approved on a "contingent basis" or that the requested mechanism is beyond the scope of this proceeding. PFD at 136.

Furthermore, the ALJ's procedural fairness concerns, as provided in footnote 50, are not well-founded. The Company's proposed Revenue Adjustment Mechanism was explicitly described in the Company's testimony (see 5 TR 562-567) and all parties to this case have had opportunities to contest the Company's proposal. Company witness Laura M. Collins presented a detailed explanation of the Company's proposed Revenue Adjustment Mechanism as follows:

> "Q. Please describe the Revenue Adjustment Mechanism being proposed in this case.
>
> "A. The Company is proposing a symmetrical Revenue Adjustment Mechanism that compares the nonfuel rate revenues approved by the Commission in the most recent proceeding to the nonfuel revenue generated through actual sales for the period of time under evaluation. This comparison will be performed by rate class. The Company proposes to compare actual total delivery revenues (less

> customer charges) to the approved rate case delivery revenues (less customer charges), which would apply to all customers, and to compare actual nonfuel power supply revenues to the approved power supply revenues, which would apply only to Full Service customers. The difference in revenues would be deferred on the Company's books, pending an annual reconciliation process. The Company proposes that the revenues be reconciled on an annual basis, beginning with the end of test-year period in this case. If the Company collects more total delivery or total nonfuel power supply revenue during the 12-month period than was authorized by the Commission in this electric rate case, then following Commission review and approval, the Company would refund the amount of the over-collection to its customers on a prospective basis. Over-collected delivery revenues would be refunded to all customers, while the amount of over-collected nonfuel power supply revenues would be refunded to Full Service customers. If the Company did not collect its level of authorized delivery or nonfuel power supply revenues, then following Commission review and approval, the Company would collect the shortfall with approval of the Commission on a prospective basis." 5 TR 563-564.

Ms. Collins also extensively addressed the reconciliation procedures for the proposed Revenue Adjustment Mechanism. 5 TR 564-566.

The above record evidence constitutes substantial evidence which overwhelmingly supports the reasonableness of the Company's Revenue Adjustment Mechanism and which provides all parties to this case an opportunity to consider the Company's proposal. Should the Legislature enact legislation which provides for such a mechanism prior to the issuance of the Commission's final order in this case, it would be reasonable and lawful for the Commission to grant the Company's requested relief.

B. <u>Investment Recovery Mechanism ("IRM")</u>

At page 141 of the PFD, the ALJ recommends that the Commission reject the Company's proposed IRM. In forming this recommendation, the ALJ set aside "the potential legality of adopting the utility's proposed IRM,"[6] and found "that policy considerations alone necessitate ruling against Consumers' proposal, at least in its current form." PFD at 140. The ALJ's recommendation in this regard does not appropriately consider the record evidence provided by the Company and, thus, should be rejected by the Commission.

The ALJ's "policy considerations," which include the amount of expenditures included in the IRM and the IRM reconciliation process, do not form a reasonable basis to reject the Company's proposed IRM. First, it should be noted the Company's IRM proposal includes the opportunity for more reviews and Staff audits than capital expenditures that are approved through traditional ratemaking. 5 TR 344. Company witness Natalie N. Busack explained that the Company's proposed capital expenditures for the remainder of 2016, 2017, and 2018, as identified by Company witnesses David B. Kehoe, Mary P. Palkovich, Lincoln D. Warriner, and Christopher J. Varvatos in this case, are subjected to the same level of review in this case as all other proposed test year capital expenditures. 5 TR 344. Moreover, the remainder of 2016, 2017, and 2018 capital expenditures are subject to a second review in the IRM reconciliation case that is not afforded to capital expenditures that are not subject to the IRM. 5 TR 344.

Next, the ALJ's criticisms about commitment to spending fail to appropriately consider the Company's proposed reconciliation process. The Company's proposed IRM includes annual contested reconciliation cases which will review actual investments compared to capital expenditure amounts projected in the IRM surcharges. 5 TR 334-335; 5 TR 344. This process allows ratepayers the opportunity to only pay for those expenditures that are actually incurred by the Company. Beyond that reconciliation process, it would be inappropriate to further restrict

[6] While the ALJ did not offer any findings with respect to the legality of the Company's proposed IRM in the PFD, the Company submits that the IRM is both legal and within the Commission's legislative authority to approve. The legality of the IRM was extensively addressed by the Company at pages 114-122 of the Company's Reply Brief and the Company incorporates those arguments into these Exceptions by reference.

the Company's spending because: (1) such restrictions would conflict with the rate case paradigm where future costs are approved before they are realized and (2) because the Company must maintain the flexibility to respond to market forces as well as future safety and reliability concerns and maintain the ability to run its business and not be tied to individual, strictly defined spending plans. 5 TR 344-345.

Finally, the ALJ incorrectly concludes that the IRM will unfairly shift risks to ratepayers. The IRM actually reduces the risk that customer rates will reflect costs related to investments that did not ultimately come to fruition or provide a benefit. 5 TR 345. In contrast, general rate cases, without an IRM mechanism, establish rates based on a projected test year revenue requirement and provide no post-test year reconciliation of costs. 5 TR 345. The IRM reconciliation process will more closely align projected investment with actually incurred costs and thereby reduce regulatory lag and ratepayer risk. 5 TR 345.

Thus, for the reasons noted above, the ALJ's recommendation regarding the Company's proposed IRM should be rejected by the Commission. The Company's IRM is reasonable and should be approved by the Commission.

VII. EXCEPTIONS REGARDING REVENUE DEFICIENCY AND TIMING ISSUES (PFD Section VII)

As reflected in these Exceptions, it is the position of Consumers Energy that the recommendations in the PFD substantially understate the reasonable and appropriate revenue requirement for Consumers Energy's electric business. The Company calculated an annual revenue requirement for the test year in this case in the final net jurisdictional amount of $198,566,000 as shown on Appendix A to Consumers Energy's Initial Brief in this case. The Commission should adopt the Company's proposed revenue deficiency in its final order in this case.

It should also be noted that the ALJ acknowledges several times in the PFD that the Company has requested rate relief consisting of three distinct stages in this case to correspond with the timing of several significant events that will have a material impact on rates during the course of the test year. First, the Company is proposing that the Commission approve rates which include each of the cost items identified in the Company's case, including the costs of the Jackson Gas Plant. But because the Company does not currently expect to own the Jackson Gas Plant at the time rates go into effect, the first phase would simultaneously include a conditional offsetting credit that would be equal to the costs associated with the Jackson Gas Plant and remain in effect until the Company closes on the plant. 5 TR 164. Second, the Company requests that the Jackson Gas Plant credit would automatically shut off when the Company closes on the Jackson Gas Plant, and the rate increase described in the first stage would continue until the retirement of the Company's seven small "Classic 7" coal plants expected in April 2016. 5 TR 165. Third, Consumers Energy requests that the Commission authorize the Company to adjust its rates downward upon the retirement of the Classic 7 in order to reflect the removal of approximately $38 million of O&M costs associated with those plants from the Company's rates. 5 TR 165. Again, the net effect of those three stages would be approximately $198.6 million of incremental revenue for the Company annually.

Although the ALJ acknowledged the Company's proposal for a three-stage rate adjustment in this case and no party contested that proposal, the ALJ's PFD never made any explicit recommendation regarding approval of the Company's request. Since the matter is uncontested and there is no record evidence in this case opposing the Company's proposed three-stage rate adjustment, Consumers Energy requests that the Commission approve the three-stage request for rate relief proposed by the Company in this case.[7]

VIII. EXCEPTIONS REGARDING RATE DESIGN AND TARIFF ISSUES (PFD Section IX)

A. Residential Customer Charge

At page 158 of the PFD, the ALJ recommends that the Commission adopt Staff's Residential Customer Charge of $7.00. In support of that amount, Staff asserts that its cost-of-service study dictates that this charge remain at $7.00 instead of the $7.50 proposed by the Company. 9 TR 1781. The Company disagrees with Staff's position and the recommendation of the ALJ and notes that the Company's cost-of-service study supports an increase of the monthly customer charge to $7.50. 5 TR 571. However, to the extent that a different cost of service is adopted in the final rates decided by the Commission, the Company agrees that the customer charge should be adjusted accordingly, so long as the charge is not reduced below the current $7.00/month level. 5 TR 571.

B. Dynamic Peak Pricing Program ("DPPP") Changes

The ALJ addressed the Company's proposed changes to its DPPP at pages 154-157 of the PFD. The Commission should reject the ALJ's recommendation to adopt Staff's "compromise" proposal to increase the number of potential critical peak day events the Company can call from 8 to 12 per year. (PFD at 155-156.)

Consistent with the tariff change proposed by the Company for its Direct Load Management ("DLM") Program (described below), the Company's proposal to eliminate limits

[7] There are two additional issues that make timing of rate relief particularly important in this case. First, the Company's statutorily imposed E-1 rate is set to expire effective December 1, which will impact the distribution of costs to all of Consumers Energy's customers. Second, changes to Consumers Energy's cost of service and rate design resulting from the Commission's Order in Case No. U-17688 are also set to go into effect on December 1. The statutory one-year deadline for a final order in this case is December 7. However, the Company recognizes that the Commission may wish to make its order in this case effective December 1 in order to minimize the impact to customers associated with multiple rate changes occurring within a short period of time.

on the number of times it can declare a critical peak day event for purposes of its dynamic pricing program was also proposed so that that Company's DLM Program can qualify as a Load Modifying Resource with Midcontinent Independent System Operator, Inc. ("MISO"). 8 TR 1529. Company witness David F. Ronk, Jr. explained the importance of this change as follows:

> "**The change in tariff language** to remove the limitation on the number of critical peak events that can be called **is necessary for the program to qualify as a Load Modifying Resource in accordance with MISO's FERC-approved tariff.** While the Company has not had experience with qualifying the Dynamic Pricing Program we believe that the tariff requires the Company to have unlimited ability to call critical peak events to address emergency conditions and to effectively utilize the program as a Load Modifying Resource. **Adopting Staff's recommendation to maintain the existing limit on the number of occasions that a critical peak event could be declared** (or to establish a modest increase in the limit to 12 occasions), **would cause the benefits of the program to be lost.** While the Company shares Staff's concern about placing too much risk onto the customer, as a capacity product MISO and FERC have been clear that the resources need to be available to address capacity emergencies." 8 TR 1529. (Emphasis added.)

Thus, the ALJ's conclusion (PFD at 155) that the Company did not support its request for a removal of the tariff limitations on the number of times a critical peak event may be called is belied by Mr. Ronk's testimonial explanation. The ALJ's recommendation to adopt Staff's "compromises" would cause benefits of the DLM Program to be lost. The Company's proposed Dynamic Price rate tariff modifications should be approved by the Commission. The removal of the limitation of the number of critical peak event days is necessary for the reasons explained by Company witness Ronk, quoted above.

In addition, as explained at pages 167-168 of the Company's Initial Brief, the Company's proposed critical peak prices are reasonable, consistent with similar rates in other utility service areas, and necessary to incent enrolled customers to take actions that will achieve the desired customer demand reductions during peak events. 6 TR 951-952. However, if the Commission accepts the ALJ's recommendation to adopt Staff's proposed Dynamic Peak Pricing Rates, which are slightly lower than those proposed by the Company ($0.95/kWh as opposed to the Company's proposed $1.00/kWh), the claim that the lower price will increase customer acceptance of the program will need to be tested and validated.

C. <u>Educational Credit</u>

At page 159 of the PFD, the ALJ recommended that the Commission reject the General Educational Institution credit as requested by the Company and instead adopt a version consistent with the Company's initial filing that produces inequitable results when paired with Staff's proposed production cost methodology. As a result of the unintended consequences associated with the ALJ's recommendation, it should be rejected. The Commission should approve the Company's request as it produces the most equitable results.

As explained in the Company's Initial Brief in this matter, in order to meet the applicable requirements of Public Act 286,[8] the Company split educational institutions into their own cost class in order to determine their specific costs to serve. 5 TR 553. The Company then established credits (or charges) that are applied to the bills for educational institution customers (as they were billed at the standard rate) to get their billing at the cost-to-serve level. 5 TR 553. However, this approach resulted in inconsistent power supply and delivery charges to Education Institution customers which, in some cases, resulted in these customers paying more or less than the other general service customers served at the same voltage. 5 TR 553.

In order to alleviate the variances discussed above, the Company is proposing that, for rate design, Educational Institution customers be included in the cost study column with all other

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[8] Public Act 286 requires that public and private schools, universities, and community colleges are charged retail rates that reflect the actual cost of providing service to those customers. MCL 460.11(9).

general service customers served at similar voltage levels. 5 TR 553-554. The Company further proposes to provide all Educational Institution customers with a credit that removes the subsidies for Income Assistance and Senior Citizens, which these customers are not required to pay. 5 TR 554. These proposals, which are contingent on the approval of the Company's cost allocation proposals in this case, ensure that Educational Institution customers will not pay a cost-based rate higher than similarly situated customers and will receive a credit to remove any obligation to pay rate subsidies. 5 TR 553-554.

If the Company's cost allocation proposals in this case are not utilized by the Commission, additional modifications must be made to avoid inequitable results. These modifications are consistent with Commission's determination in Case No. U-17688 that rates should be evaluated based on the specific determinants and costs proposed or approved in a given case. Case No. U-17688, 2 TR 48; Case No. U-17688, June 30, 2015 Order, page 27. Staff's 75/0/25 production cost allocation methodology, if also approved in this case, would effectively negate the Company's above discussed Income Assistance and Senior Citizen subsidy credit which was based on the Company's initially filed determinants and costs. Thus, if the Commission adopts Staff's 75/0/25 production cost allocation methodology in this case, the Company proposes to continue the subsidy credit, as described above, and provide all Secondary and Primary Educational Institution customers a power supply credit that is consistent with the power supply credit approved for Primary Educational Institution customers in Case No. U-17688. Case No. U-17688, 2 TR 48. This approach would ensure cost-based rates for Educational Institution customers as required by 2008 Public Act 286.

D. **Substation Ownership Credit**

At page 169 of the PFD, the ALJ recommends that the Commission approve Hemlock Semiconductor Corporation's ("HSC") proposed methodology for calculating the substation ownership credit. HSC's recommended change to the calculation of the Joint Ownership Substation Credit should be rejected as it is not practicable and, if approved, would produce unreasonable results.

Although the ALJ concludes that the Company is capable of calculating the Joint Ownership Substation Credit on a monthly basis, as requested by HSC, it is important to note that the Company currently <u>does not have the functionality in place to perform the monthly calculation</u> as recommended by HSC. Company witness Collins explained that significant programing changes would be required to determine and store the monthly metered maximum demand on each substation which would be required by Michael P. Gorman's proposal. 5 TR 575-576. These programing changes would take time and resources to implement. 5 TR 575-576.

The Company's original proposal, which uses the previous calendar year's ratio of the customer's owned substation maximum demand to the Company's owned substation maximum demand, provides a more reasonable methodology. 5 TR 576. The use of a static ratio is further supported by the fact that the Company's and the customer's investment in a substation would not change monthly, and thus a monthly calculation would not necessarily reflect each party's total substation share in serving the load. 5 TR 576.

The Company's proposed joint substation ownership credit approach was also supported by Staff. In its Initial Brief, Staff specifically recommends as follows:

> "Staff recommends the ALJ and the Commission approve the Company's proposal to allow a partial substation ownership credit

> for customers served by more than one substation, where the customer owns one or more substations. If a customer owns one or more of the substations serving them, that customer should not be responsible for paying the same costs associated with substations as a customer who does not own any substations. These customers will receive the appropriate credit under the Company's proposal." Staff's Initial Brief, page 133.

On the basis of the above, HSC's position and the recommendation of the ALJ should be rejected by the Commission. The Company's proposal, which uses the previous calendar year's ratio of the customer's owned substation maximum demand to the Company's owned substation maximum demand, provides a more reasonable methodology for the calculation of this credit.

E. DLM Program Changes

Consumers Energy excepts to the ALJ's recommendation (PFD at 152-154) to reject the Company's proposal to remove the time-of-day and number of critical peak event limitations on its DLM Program. The ALJ, although accepting the Company's explanation that the proposed change is necessary to qualify the DLM Program with Federal Energy Regulatory Commission ("FERC") approved tariff provisions under which MISO operates its Load Modifying Resource Program (see 8 TR 1528-1529), agreed with Staff's position on this issue. The ALJ concluded that the Company could still obtain benefits from the program with the existing limitations in place, by reducing energy consumed and potentially lowering future load forecasts.

The ALJ's conclusions on this matter should be rejected. The ALJ's recommendation would prevent the Company from obtaining capacity reductions associated with having the DLM Program qualify as a MISO Load Modifying Resource Program. Further, the ALJ's statement at footnote 60 on page 153 of the PFD that "MISO and FERC seemingly want Consumers to use its DLM program to directly restrict its customers' use of air conditioning in order to make more capacity available to be shifted to other utilities within the MISO footprint that find themselves short of capacity" is wholly unsupported by any record evidence, and ignores the benefits of capacity savings the Company can obtain for itself and its customers if its changes to the DLM Program are adopted. Consumers Energy's proposed changes to the DLM Program should be adopted in order to ensure that the DLM Program qualifies as a MISO Load Modifying Resource, as explained in Company witness Ronk's rebuttal testimony in this proceeding. See 8 TR 1529.

In the alternative, if the Commission rejects the Company's proposed removal of the limitations on the time-of-day and number of critical peak events which may be called, it should adopt Staff witness Nicholas M. Revere's proposed alternative, which would increase the number of critical peak events which may be called from 8 to 12 per year. 9 TR 1857. Although this does not provide the maximum benefits of reduced capacity needs and participation in the MISO energy market, it would be preferable to the existing limitation of eight critical peak events per year. However, if the Commission adopts Mr. Revere's proposal it should recognize that it is also limiting the economic value of the DLM Program.

F. Threats of Violence Tariff

At page 174 of the PFD, the ALJ recommends that the Commission reject the Company's proposed Threats of Violence tariff. This is in spite of the fact that Consumers Energy has experienced over 500 incidents of threats of violence annually since 2010, and in 2014 alone 13 Consumers Energy employees were assaulted. 6 TR 808-809. The Company's proposed tariff is a step towards addressing threats or acts of violence by customers (6 TR 808), and absent MPSC approval of the proposed tariff, the Company is limited in its recourse to provide for the safety of its employees and contractors.

The ALJ provides four reasons to support his recommend rejection of the Threat of Violence tariff. First, the ALJ questions the Company's ability to determine what costs are recoverable prior to restoring electric service. PFD at 175-176. The proposed tariff shows that the Company is only seeking to recover the reasonable incremental costs that are directly associated with the customer's threat or act of violence. 6 TR 815. These costs are associated with the Company's investigation of the threat, the operating crews required to terminate service, and any other directly-related expenses incurred by the Company due to an injury as a result of a physical assault or related threat. 6 TR 810. The proposed expense recovery is similar to other tariffs in place with an expense recovery mechanism. As Company witness Michael J. Williams testified, "…in [tariff] C5 Customer Responsibilities, in C5.2 Bills and Payments, the Company reserves the right to recover all unbilled service revenue and reasonable actual costs associated with the theft of energy, stolen meters, or switched meters." 6 TR 815.

Second, the ALJ criticizes the tariff for not specifically providing for third-party involvement to assist in resolving the dispute. PFD at 175. This claim is inaccurate. While the tariff does not specifically discuss third-party involvement, this does not mean that third parties are not involved in the process. The Company involves local law enforcement if the threat or act of violence is an assault or involves the use of a weapon. 6 TR 820. And while the proposed tariff language does not require involvement of the Commission or Staff, customers always have the ability to file a complaint with the Commission. The ALJ failed to recognize that the Company does not have the option of turning to a third party for relief. Consumers Energy is unable to make a complaint to law enforcement when a threat or act of violence occurs. 6 TR 820. Only the employee or contractor who is the victim has the ability to file a police report. 6 TR 820.

Third, the ALJ expresses concern that the proposed tariff could further escalate the situation between the customer and the Company employee. PFD at 175. The Company disagrees. In his testimony, Company witness Williams directly responded to this claim. Mr. Williams testified that not disconnecting service of a violent customer does not alleviate the issue. 6 TR 814. Regardless of the proposed tariff provision, Mr. Williams testified that, "When the threat or act of violence occurs, a Company representative is often already onsite disconnecting service. These disconnections could be occurring for variety of reasons, such as nonpayment or theft on the account. If the Company representative was prevented from discontinuing service by the act of violence, the Company can still disconnect service regardless of this tariff modification." 6 TR 814.

Lastly, the ALJ contends that the Company's proposed tariff fails to provide customers with notice of termination of their utility service. PFD at 175. However, threats or acts of violence occur after customers have been notified of the Company's intent to disconnect service. 6 TR 823. Most often, the threat occurs when the Company is already onsite to shut off service. 6 TR 814. As Company witness Williams indicated, these customers are already eligible for disconnection and "these disconnections could be occurring for a variety of reasons, such as nonpayment or theft on the account. If the Company representative was prevented from discontinuing service by the act of violence, the Company can still disconnect service regardless of this tariff modification." 6 TR 814.

The Company's proposed Threats of Violence tariff is a reasonable means to protect Company employees and contractors from threats or acts of violence by customers, and Consumers Energy requests that the proposed tariff be approved.

IX. APPEAL OF ALJ'S RULING ON PROTECTIVE ORDER

On May 5, 2015, a hearing took place in this proceeding to consider Consumers Energy's Motion for a Protective Order regarding certain confidential materials provided to MEC/NRDC by the Company during the discovery phase of this case. While the parties agreed generally with the issuance of a protective order pertaining to those materials, MEC/NRDC proposed language in the protective order that would authorize them to retain the Company's confidential materials after the close of the proceedings in this case. At the May 5 hearing, the ALJ granted MEC/NRDC's request to retain the Company's confidential information, albeit with time restrictions linked to the filing of Consumers Energy's next electric general rate case and any Power Supply Cost Recovery ("PSCR") cases that commence before that time. 3 TR 65-67. Pursuant to R 792.10433, Rule 433(5), Consumers Energy appeals that decision.

On April 24, 2015, Consumers Energy filed a Motion for Protective Order pursuant to Rule 432 of the MPSC's Rules of Practice and Procedure, R 792.10432, for protection of certain confidential, commercially sensitive information ("Confidential Information"). The information for which the Company sought protection had been provided to MEC/NRDC pursuant to an Agreement of Confidentiality between MEC/NRDC and Consumers Energy, a copy of which is attached hereto as Attachment A. Consumers Energy moved for a protective order because MEC/NRDC had informed the Company that it desired to introduce Confidential Information into the record in this proceeding. In order to protect Confidential Information from disclosure which would harm Consumers Energy, but to also allow MEC/NRDC an opportunity to present Confidential Information in its evidentiary presentation in this proceeding in an unredacted format as part of a separate, confidential, sealed record, Consumers Energy requested the ALJ to enter a protective order which would allow use of Confidential Information in this proceeding but prevent the information from being disclosed to persons who had not entered into an Confidentiality Agreement with Consumers Energy.

Consumers Energy proposed a protective order which is attached to these Exceptions as Attachment B. The proposed protective order would appropriately allow the use of Confidential

Information in this proceeding, but protects the information from public disclosure and from use outside the context of this proceeding. The proposed protective order is essentially the same which was used in Case No. U-17429, Consumers Energy's recent Certificate of Necessity proceeding; Case No. U-17598, Consumers Energy's recent transmission reclassification proceeding; Case No. U-17678, a pending Consumers Energy PSCR Plan proceeding; and Case No. U-17643, Consumers Energy's most recently decided gas rate case.[9] MEC/NRDC supported the entry of a protective order for the Company's Confidential Information, but requested the ALJ to allow parties to retain a copy of the Confidential Information beyond the conclusion of this proceeding. 3 TR 60-65.

At the May 5, 2015 hearing, the ALJ granted Consumers Energy's Motion for the entry of a Protective Order, but ruled that counsel should be allowed to retain a copy the Confidential Information until the conclusion of the later of: (1) the Company's next general electric rate case; or (2) any PSCR Plan or Reconciliation proceedings which are filed before the conclusion of the Company's next general electric rate case. 3 TR 65-67. Pursuant to Rule R 792.10433, Rule 433(5), Consumers Energy appeals that decision.

The parties who have executed the Confidentiality Agreement with the Company should not be permitted to retain a copy of the Confidential Information beyond the issuance of a final order in this case. The ALJ's decision to allow such retention should be overruled by the Commission. As an initial matter, such retention <u>violates the express terms of the Confidentiality Agreement</u> which parties voluntarily signed in order to obtain the Confidential

[9] The Protective Order in Case No. U-17643 was requested by ABATE, and it included a provision that the confidential materials would be either returned to the producing party or destroyed upon request by the producing party.

Information.[10] Paragraph 1 of the Confidentiality Agreement provides that the Confidential Information may be used only for this proceeding and for no other purpose. In addition, Paragraph 5 of the Confidentiality Agreement states: "This Agreement shall be effective when signed and shall remain in effect until the issuance of a final order in . . . Case No. U-17735 <u>at which time the Confidential Information in the possession of [signing party] shall be returned to Consumers Energy</u>. The obligations of the parties under this Agreement will survive termination of this Agreement and will remain binding on the parties for a period of two (2) years from the last date of disclosure under this Agreement." See Attachment A hereto. MEC/NRDC's request for the ALJ to allow the parties to retain a copy of the Confidential Information beyond the conclusion of this case violates its agreement set forth in the Confidentiality Agreement. Any retention of the Confidential Information beyond the issuance of a final order in this case constitutes a breach of contract.

The Confidential Information subject to the Protective Order in this proceeding is Consumers Energy's confidential, commercially sensitive, proprietary information, the disclosure of which would harm the Company. Further, the regulatory process is not a single, never-ending proceeding. MEC/NRDC's apparent desire to use materials obtained in this proceeding <u>pursuant to a Confidentiality Agreement</u> in other, subsequent, undefined forums (including potentially forums other than the MPSC) does not justify allowing MEC/NRDC to retain the Company's Confidential Information. The ALJ's decision to attempt to reach a compromise and allow MEC/NRDC and the other signatories of the Confidentiality Agreement to retain the Confidential Information during the pendency of other future electric cases is expressly contradicted by the terms of the Confidentiality Agreement, and is unsupported by the

[10] The parties who signed the Confidentiality Agreement in this case are the Staff, the Attorney General, and MEC/NRDC.

Commission's Rules of Practice and Procedure. To the extent that MEC/NRDC or any other party seeks to discover Confidential Information in a future case, they are free to attempt to do so. The Commission should reject MEC/NRDC's attempt to retain Confidential Information for uses other than this proceeding, and should overturn the ALJ's ruling on the Protective Order which allows them to do so.

X. CONCLUSION

Consumers Energy requests that the Commission issue a final order consistent with these Exceptions and grant Consumers Energy such other and further relief consistent with the positions set forth in these Exceptions as is just and reasonable.

Respectfully submitted,

CONSUMERS ENERGY COMPANY

Dated: October 9, 2015

By: Bret Totoraitis

Digitally signed by Bret A. Totoraitis
Date: 2015.10.09 14:31:04 -04'00'

H Richard Chambers (P34139)
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Attachment A

AGREEMENT OF CONFIDENTIALITY

This Agreement is entered into as of the 25th day of February, 2015, by and between **Consumers Energy Company,** One Energy Plaza, Jackson, Michigan 49201, hereinafter called (**"Consumers Energy")** and **Michigan Environmental Council** and **Natural Resources Defense Council**, their attorneys, experts, and employees (collectively **"MEC/NRDC"**).

In consideration of the mutual promises contained herein, **Consumers Energy** and **MEC/NRDC** agree as follows:

1. This Confidentiality Agreement shall apply to certain confidential materials provided to **MEC/NRDC** in response to discovery requests served in MPSC Case No. U-17735 (hereinafter called "Confidential Information"). This data has been requested for the sole purpose of MPSC Case No. U-17735 and shall not be used by **MEC/NRDC** for any purpose other than the litigation of Case No. U-17735.

2. The Confidential Information shall be clearly marked by **Consumers Energy** as Confidential and subject to this Confidentiality Agreement. The parties agree that from time to time **Consumers Energy** may declare additional information as Confidential Information and subject to the terms and conditions of this Agreement. Any such additional information shall be identified as described in this paragraph and such information shall receive the full benefit of the protection afforded by this Confidentiality Agreement.

3. **MEC/NRDC** agrees to disclose such Confidential Information only to its employees, agents, licensees and contractors who have a need to know such Confidential Information and to use such Confidential Information only for the purpose stated above. **MEC/NRDC** represents that each party to who Confidential Information is disclosed shall abide by the terms of this Confidentiality Agreement.

4. In the event that **MEC/NRDC** is legally compelled to disclose any of the Confidential Information, it will provide **Consumers Energy** with prompt advance written notice, as soon as reasonably possible under the circumstances, so that **Consumers Energy** may seek a protective order or other appropriate remedy. **MEC/NRDC** will cooperate with **Consumers Energy** in any effort it undertakes to obtain a protective order or other remedy.

5. This Agreement shall be effective when signed and shall remain in effect until the issuance of a final order in the above-referenced MPSC Case No. U-17735 at which time the Confidential Information in the possession of **MEC/NRDC** shall be returned to **Consumers Energy.** The obligations of the parties under this Agreement will survive termination of this Agreement and will remain binding on the parties for a period of two (2) years from the last date of disclosure under this Agreement.

6. **MEC/NRDC** recognizes and agrees that nothing contained in this Agreement shall be construed as granting any intellectual property rights or other property rights, by license or otherwise, to any Confidential Information disclosed pursuant to this Agreement but that **MEC/NRDC** is being granted limited access only to the Confidential Information in accordance with this Agreement.

7. **MEC/NRDC** agrees that monetary damages may be an insufficient remedy for any actual or anticipatory breach of this Agreement and that **Consumers Energy** may seek an injunction as an appropriate remedy to prevent the unwarranted disclosure of any Confidential Information. However, **Consumers Energy** agrees that where injunctive relief will provide a full remedy for any actual or anticipatory breach of this Agreement, **Consumers Energy** will seek such injunctive relief instead of monetary relief. In any case, **Consumers Energy** will provide **MEC/NRDC** with notice and an opportunity to cure any actual or anticipatory breach of this Agreement, if doing so is reasonably possible under the circumstances.

8. This Agreement shall be governed by and construed in accordance with the laws of State of Michigan.

9. This Agreement may be executed and delivered in counterparts and duplicate originals, including by a facsimile and/or electronic transmission thereof, each of which shall be deemed an original. Any document

generated by the parties with respect to this Agreement, including this Agreement, may be imaged and stored electronically.

10. This Agreement is intended for the benefit of the parties hereto and does not grant any rights to third parties unless otherwise specifically granted herein.

11. No party may assign all or any part of this Agreement without the other party's prior written consent. This Agreement inures to the benefit of the parties hereto and their successors and permitted assigns and is binding on each other and each other's successors and permitted assigns.

12. With respect to the subject matter hereof, this Agreement supersedes all previous representations, understandings and negotiations, either written or oral, between and among the parties hereto or their representatives and constitutes the entire contract between the parties. This Agreement may be amended or modified only by a subsequent agreement in writing.

13. This Confidentiality Agreement does not authorize admission of the Confidential Information into the record, either public or confidential, of any proceeding, including MPSC Case No. U-17735. The Confidential Information that is the subject of this Agreement shall not be introduced into the record or referenced in MPSC Case No. U-17735 until a satisfactory protective order has been issued in that proceeding governing the information, applying existing law and Commission rules. This Confidentiality Agreement does not authorize admission or reference to the Confidential Information into any record by **MEC/NRDC**, either public or confidential, of any proceeding or permit renewal. This Agreement shall not prohibit **MEC/NRDC** from using information obtained from other sources in other proceedings on the basis that the same information was designated confidential in this case.

14. The undersigned parties (other than **Consumers Energy**) will provide **Consumers Energy** with advance notice, as soon as reasonably possible under the circumstances, of the intended use in testimony or exhibits of any material that **Consumers Energy** has designated Confidential Information. These parties will take reasonable steps to ensure that the advance notice includes information reasonably sufficient for **Consumers Energy** to (a) determine whether it wishes to file a motion for protective order, and (b) support any such motion with facts and argument. All of the undersigned parties agree to cooperate in the filing of such a motion and having it heard in accordance with the schedule adopted for this case.

The intent of this paragraph is for the parties to perform their obligations under this Agreement in a timely enough manner that if a motion for protective order is required, it may be filed and heard prior to the deadline for pre-filing Staff and Intervenor testimony.

IN WITNESS WHEREOF, this Agreement has been executed by duly authorized representatives of the parties as of the day and year first above written.

CONSUMERS ENERGY COMPANY

Bret Totoraitis
Digitally signed by Bret A. Totoraitis
Date: 2015.02.25 16:55:16 -05'00'

By:______________________________
H. Richard Chambers
Bret A. Totoraitis

Title: Attorneys for Consumers Energy Company

MICHIGAN ENVIRONMENTAL COUNCIL and NATURAL RESOURCES DEFENSE COUNCIL

Digitally signed by Christopher M. Bzdok
Date: 2015.02.25 16:49:53 -05'00'

By:______________________________
Christopher Bzdok

Title: Attorney for Michigan Environmental Council and Natural Resources Defense Council

Attachment B

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	)	Case No. U-17735
the generation and distribution of	)	
electricity and for other relief.	)	
	)	

PROTECTIVE ORDER

This Protective Order governs the use and disposition of Protected Material (as defined below) disclosed by Consumers Energy Company ("Applicant") to the Michigan Public Service Commission Staff ("Staff") and other Party (as defined below) in this case, as set forth herein. The intent of this Protective Order is to protect non-public confidential information and materials so designated by the Applicant, which information and materials contain confidential, proprietary, or commercially sensitive information, including confidential information provided in discovery, and any witness' related testimony and exhibits and arguments of counsel referring to such confidential information ("Protected Material"). This Protective Order describes the manner in which Protected Material is to be identified and treated, and governs its ultimate disposition. Accordingly, IT IS HEREBY ORDERED:

1. This Protective Order shall govern the use of all Protected Material, so identified and marked as required by Paragraph 11, made available for review, or produced, by or on behalf of the Applicant to any Party or Reviewing Representative. Protected Material shall be used and disclosed by the recipient thereof solely in accordance with the terms and conditions of this Protective Order.

2. This Protective Order protects: (1) the Protected Material; (2) any copy or reproduction of the Protected Material made by any person; and (3) any memorandum,

handwritten notes, or any other form of information that copies, contains or discloses Protected Material.

3. The information subject to this Protective Order does not include:

a. Information lawfully known by the Party or Reviewing Representative at the time of disclosure; and

b. Information that is or becomes available to the general public through no fault of a Party or Reviewing Representative.

4. "Party" shall mean any party to this proceeding who requests or receives access to the Protected Material, subject to the requirement that each Reviewing Representative must sign a Nondisclosure Certificate.

5. "Reviewing Representative" shall mean a person who has signed a Nondisclosure Certificate and who is:

a. an attorney who has entered an appearance in this proceeding for a Party;

b. an attorney, paralegal, or other employee associated for purposes of this case with an attorney described in 5a;

c. an expert or employee of an expert retained by a Party for purposes of advising, preparing for, or testifying in this proceeding;

d. an employee or other representative of a Party with significant responsibility for this docket.

A Reviewing Representative is responsible for assuring that persons under his supervision and control comply with this Protective Order.

6. "Nondisclosure Certificate" shall mean a certificate substantially in the form of the certificate attached to this Protective Order by which a Reviewing Representative who has

been granted access to Protected Material certifies his or her understanding that such access is provided pursuant to the terms of this Protective Order and that he or she agrees to be bound by it.

7. A Party may authorize access to and use of Protected Material by a Reviewing Representative identified by the Party as being necessary in order to analyze the Protected Material, including consultants employed by the Party, but only for the purposes of analyzing the issues, presenting evidence, and preparing testimony, cross-examination, argument, pleadings, briefs, exceptions or other motions or filings in Michigan Public Service Commission ("MPSC" or the "Commission") Case No. U-17735. Such persons may not release or disclose the content of Protected Material to any other person or use such information for any other purpose.

8. All persons authorized to review Protected Material, including copies or reproductions, and copies of notes of Protected Material, must, before reviewing any Protected Material, sign a copy of the Nondisclosure Certificate, which evidences an agreement by such person to be bound by the terms of this Protective Order. A copy of the executed Nondisclosure Certificate shall be provided to the Applicant.

9. Protected Material shall remain the property of the Applicant and shall only remain available to the Party until no later than the conclusion of any appeal of any final order issued by the MPSC in this Case No. U-17735 proceeding. An attorney for a party in Case No. U-17735 who has signed a Nondisclosure Certificate and who is representing such party in an appeal from an MPSC final order in this Case No. U-17735 may retain copies of Protected Material until the date the final order in this Case No. U-17735 is no longer subject to judicial review. On or before the date specified by the preceding sentences, the Party shall return to the Applicant all Protected Material in its possession or in the possession of its Reviewing

Representatives, including all copies thereof and notes of Protected Material, or certify in writing that the Protected Material has been destroyed. The Party shall submit to the Applicant written certification stating that all Protected Material and all copies thereof and all notes of Protected Material in its possession, care, custody or control have been returned or destroyed.

10. The Parties to Case No. U-17735 retain the right to seek further restrictions on the dissemination of Protected Material to persons who have or may subsequently seek to intervene in this MPSC proceeding.

11. Protected Material made available by the Applicant shall be clearly marked by the Applicant as Protected Material subject to this Protective Order, including by labeling such items as "Confidential." Any copies of Protected Material shall be physically designated as Protected Material by the Party or the person authorized by the Party to make the copy. Notes of Protected Material shall be physically marked as Protected Material by the person making the notes. All Protected Material in the possession of the Party shall be maintained in a secure place. Access to Protected Material shall be limited to persons authorized to have such access subject to the provisions of this Protective Order.

12. Even if no longer engaged in this proceeding, every person who has signed a Nondisclosure Certificate shall continue to be bound by the provisions of this Protective Order. The obligations under this Protective Order shall not be extinguished or nullified by entry of a final order in this case and shall be enforceable before the MPSC or in a court of competent jurisdiction. To the extent Protected Material is not returned to a Party, it shall remain subject to this Protective Order.

13. If a Party with access to Protected Material desires to incorporate, utilize, refer to, or otherwise use Protected Material in pre-file testimony, pleadings, direct or cross-examination,

briefs, oral argument, comments or in some other form in this proceeding, such Party shall only do so pursuant to procedures that will maintain the confidentiality of the Protected Material. For purposes of this Order, the following procedures are established:

a. Written submissions using Protected Material shall be filed in a sealed record, to be maintained by the Docket Section of the MPSC in envelopes clearly marked on the outside, "CONFIDENTIAL – SUBJECT TO PROTECTIVE ORDER ISSUED IN CASE NO. U-17735." Simultaneously, identical documents and materials, but with the Protected Material redacted, shall be filed, offered, introduced, or otherwise disclosed in the usual manner for the submission of evidence or briefs.

b. Furthermore, with regard to proceedings before the MPSC or presiding officers designated by it, oral testimony, examination of witnesses, or argument on the Protected Material shall be conducted on a separate record to be maintained by the Docket Section of the MPSC. These separate record proceedings shall be closed to all persons except those furnishing the Protected Material and parties otherwise subject to this Protective Order. The Party presenting the information during the course of the proceeding shall advise the presiding officer receiving testimony of the terms of this Protective Order on sufficient notice to allow the presiding officer an opportunity to take measures within the presiding officer's control to protect the confidentiality of the Protected Material, and suggest that a separate, protected record be made of all testimony concerning the protected information.

c. Copies of the documents filed with the MPSC that contain Protected Material, including the portions of the exhibits, transcripts, and brief that refer to Protected Material, must be sealed and maintained in the MPSC's files with a copy of the Protective Order attached.

14. It is intended that the Protected Material subject to this Protective Order should be shielded from disclosure by the Party only to the extent permitted by law. If any person files a Freedom of Information Act Request with the MPSC or Michigan Attorney General seeking access to documents subject to this Protective Order, the MPSC's Executive Secretary or the Attorney General shall immediately notify the Applicant, and the Applicant may take whatever legal actions it deems appropriate to protect the Protected Material from disclosure. In light of Section 5 of the Freedom of Information Act, MLC 15.235, the notice must be given at least five (5) business days before the MPSC, its Staff, and/or Attorney General grant the request in full or in part.

15. The provisions of this Protective Order shall not apply to a particular document or portion of a document described in Paragraph 2 if a Party can demonstrate that it has been previously disclosed by the Applicant on a non-confidential basis or meets the criteria set forth in Paragraph 3a or 3b. Before disclosing a particular document or portion of a document described in Paragraph 2, however, the Party must first provide reasonable notice to the Applicant of its conclusion that the document or portion of a document is not subject to this Protective Order because of prior disclosure. The provisions of this Protective Order shall terminate as to the Protected Material described in Paragraph 2 to the extent that the content of such Protected Material are filed with a state, provincial or federal agency and are not subject to protection from public disclosure, or are otherwise lawfully disclosed.

16. If a Party violates this Order by an improper disclosure or use of Protected Material, then that Party shall take all necessary steps to remedy the improper disclosure or use. This includes immediately notifying the MPSC, the presiding officer, and the Applicant, in writing, of the identity of the person known or reasonably suspected to have obtained the Protected Material. Parties that violate this Protective Order remain subject to this paragraph regardless of whether the Applicant could have discovered the violation earlier than it was discovered. This paragraph of this Protective Order applies to both inadvertent and intentional violations. Nothing in this Protective Order limits the Applicant's rights and remedies, at law or in equity, against Parties or persons using Protected Material in a manner not authorized by this Protective Order, including the right to obtain injunctive relief to prevent violations of this Protective Order.

17. The MPSC or any presiding officer designated by it may subsequently declare that the protected status of Protected Material should not be continued and immediately communicate that declaration to the Applicant. Thereafter, this Protective Order shall cease to apply to such Protected Material unless, within twenty-one (21) days, the Applicant files a pleading asserting that the information should continue to be protected and setting forth the basis for that assertion. The Applicant shall bear the burden of proving that the asserted Protected Material is entitled to continuing protection from disclosure. If the MPSC or presiding officer finds that an asserted Protected Material no longer qualifies for treatment as Protected Material, it shall remain subject to the protection afforded by this Order for twenty-one (21) days following the issuance of the MPSC's order or the presiding officer's ruling.

18. The obligations of this Protective Order shall not apply if the Protected Material is approved for release by written authorization of the Applicant, but only to the extent of such authorization.

Mark E. Cummins
Administrative Law Judge

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 generation and distribution of electricity and for other relief.	))))))	Case No. U-17735

NONDISCLOSURE CERTIFICATE

I hereby certify my understanding that access to Protected Material is provided to me pursuant to the terms and restrictions of the Protective Order issued in Case No. U-17735, that I have been given a copy of and have read the Protective Order, and that I agree to be bound by the terms of the Protective Order. I am aware that the Applicant asserts that Protected Material, as defined in the Protective Order, includes information that is confidential, proprietary, and commercially sensitive. I understand that the substance of the Protected Material, any notes or other memoranda, or any other form of information that copies or discloses Protected Material, shall be maintained as confidential, shall not be disclosed to anyone other than in accordance with that Protective Order, and shall not be used for any purpose other than in connection with Michigan Public Service Commission Case No. U-17735.

Reviewing Representative

Date:____________________

____
Title:
Representing:

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

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of CONSUMERS ENERGY COMPANY for authority to increase its rates for the generation and distribution of electricity and for other relief.	))))))	Case No. U-17735

PROOF OF SERVICE

STATE OF MICHIGAN)
) SS
COUNTY OF JACKSON)

Dorothy H. Wright, being first duly sworn, deposes and says that she is employed in the Legal Department of Consumers Energy Company; that on October 9, 2015, she served an electronic copy of the **"Exceptions of Consumers Energy Company"** upon the persons listed in Attachment 1 hereto, at the e-mail addresses listed therein. She further states that she also served a hard copy of the same document to the Hon. Mark E. Cummins, Administrative Law Judge at the address listed in Attachment 1 by depositing the same in the United States mail in the City of Jackson, Michigan, with first-class postage thereon fully paid.

Digitally signed by Dorothy H. Wright
Date: 2015.10.09 14:32:19 -04'00'

Dorothy H. Wright

Subscribed and sworn to before me this 9th day of October, 2015.

Digitally signed by Samantha O'Rourke
Date: 2015.10.09 14:33:15 -04'00'

Samantha O'Rourke, Notary Public
State of Michigan, County of Jackson
My Commission Expires: 10/30/21
Acting in the County of Jackson

ATTACHMENT 1 TO CASE NO. U-17735

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ATTACHMENT 1 TO CASE NO. U-17735

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