

STATE OF MICHIGAN  
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of Consumers Energy Company for Authority to increase its rates for the generation and distribution of electricity and for other relief.

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MPSC Case No. U-20134

**Public**  
**The Attorney General's Initial Brief**

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**Introduction**

The Michigan Department of Attorney General, Special Litigation Division, by and through Celeste R. Gill, Assistant Attorney General, files this Initial Brief on behalf of the Attorney General of Michigan before the Michigan Public Service Commission (“Commission”) to respond to Consumers Energy Company’s application seeking rate relief for its electric utility.

On May 15, 2018, Consumers Energy Company (“Consumers Energy,” “Consumers,” “CECo,” or “the Company”) filed its application seeking approximately \$58 million in rate relief for the 12-month period ending December 31, 2019 (“projected test year” or “test year”). However, this amount takes into consideration approximately \$113 million in tax savings. If we factor in the reduction resulting from the lower corporate tax, the Company is in effect seeking a rate increase of approximately \$171 million. As part of its case, Consumers Energy is requesting a return on equity (“ROE”) of 10.75%.

On September 10, 2018, the Attorney General filed the Public Direct Testimony and Exhibits of Sebastian Coppola which consisted of a coversheet and 114 pages of questions and answers, an appendix A with his experience and qualification and exhibits AG-1 through AG-37. The Attorney General also submitted a Confidential version of Mr. Coppola’s testimony with exhibits, including confidential exhibits AG-7 and AG-11 under seal. The exhibits included:

1. Exhibit AG-1 CEC Co Response – Contingent Capital Expenditures
2. Exhibit AG-2 CEC Co Response – SAIDI Goal and EDIIP Expenditures
3. Exhibit AG-3 CEC Co Response – HVD New Business

4. Exhibit AG-4 CECo Response – HVD Lines and Substation Capacity
5. Exhibit AG-5 AG Forecasted HVD & Substation Capacity Capital Spending
6. Exhibit AG-6 CECo Response – LVD Substation Capacity Projects
7. Exhibit AG-7 CONFIDENTIAL – CECo Response – Metro New Business
8. Exhibit AG-8 CECo Response – LVD Repetitive Outage Projects
9. Exhibit AG-9 AG Forecasted LVD Repetitive Outages Capital Expenditures
10. Exhibit AG-10 CECo Response – LVD Grid Automation
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12. Exhibit AG-12 CECo Response – Generation Actual Year to Date 2018 Cap. Ex.
13. Exhibit AG-13 CECo Response – Generation DCS Upgrades
14. Exhibit AG-14 CECo Response – Jackson Plant Unknown Capital Expenditures
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18. Exhibit AG-18 CECo Response – IT Field Contractor Work Management Project
19. Exhibit AG-19 CECo Response – Operations Support Project in Grand Rapids
20. Exhibit AG-20 CECo Response – Fleet Problems
21. Exhibit AG-21 NPV Analysis Fleet Accelerated Replacements
22. Exhibit AG-22 AG Capital Expenditures and Rate Base Adjustments
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33. Exhibit AG-33 FFO Model with AG Assumptions
34. Exhibit AG-34 CECo Response – TCJA Cash Flow and Ratios Not Forecasted
35. Exhibit AG-35 Value Line Response on Impact of California Wildfires
36. Exhibit AG-36 CECo Response – CXST Litigation Status
37. Exhibit AG-37 CECo Response – CXST Litigation Costs Expensed

After reviewing the testimony, exhibits and discovery conducted in this case, the Attorney General concludes that the Company does not have a revenue deficiency for the projected test year.<sup>1</sup> This conclusion is based on the following recommendations and related adjustments:

1. A reduction of \$19 million from the revenue deficiency as a result of a reduction in capital expenditure of \$279.7 million and a reduction of \$252.5 million to rate base for the test year, including adjustments to working capital.
2. A reduction of \$101.9 million from the revenue deficiency based on a recommendation that the Commission adopt a lower cost of capital of 5.62%, a capital structure with 50% equity and a return on common equity of 9.50%.
3. The Commission should reject the Company's proposed Investment Recovery Mechanism (IRM) and Excess Earning Mechanism as proposed.
4. The Company should be required to continue filing the AMI business case.
5. The Commission should reject the special surcharge to recover CSXT litigation costs and accept the Company's alternative recovery proposal.

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<sup>1</sup> Additional deductions may be warranted based on the recommended disallowances in this brief.

6. The Commission should reject the Company's proposed changes to the cost of service allocation for production and distribution costs.
7. The Commission should reconsider and reject the mandatory transfer of residential customers from the Rate RS to the proposed Residential Service Summer On Peak Rate Schedule and instead make this new rate optional.
8. The Commission should further reduce the revenue deficiency related to employee benefits and compensation and certain IT expenses.

The Attorney General requests that the Commission issue an order reflecting a level of revenue deficiency consistent with the recommendations in this brief.

Further, the Commission should not authorize a ROE of more than 9.5%.

This Initial Brief has been prepared based on available resources and therefore it focuses on the significant issues of concerns summarized above. The Attorney General's silence on other issues should not be construed as approval of the Company's position. And, the Attorney General reserves the right to address other issues raised by other parties in their Initial Briefs in a Reply Brief.

## Arguments

### **I. Burden of Proof.**

While examining the Attorney General's substantive objections, the Commission should consider that Consumers Energy bears the burden of proof to demonstrate that its proposals are just and reasonable. The obligation of proving any fact lies upon the party who substantially asserts the affirmative of the issue. *White v Campbell*, 25 Mich 463, 475 (1872). A plaintiff always has the burden of proving its cause of action. *Caruso v Weber*, 257 Mich 333; 241 NW2d 198 (1931). As applied to administrative cases, a party seeking relief must prove his, her, or its claim by a preponderance of evidence. *Dillon v Lapeer State Home & Training School*, 364 Mich 1, 8; 110 NW2d 588 (1961); *BCBSM v Governor*, 422 Mich 1, 88-89; 367 NW2d 1 (1985). Likewise, in cases before the Commission, the utility bears the burden of proof by a preponderance of evidence. *In re Michigan Gas Utilities Co*, MPSC Case No. U-7484, Opinion & Order dated August 30, 1983; *In re Detroit Edison Co*, MPSC Case No. U-8030-R, Opinion & Order dated July 9, 1987, pp 16-17. Given the nature of the burden of proof, the Commission may reject even uncontradicted evidence. *Woodin v Durfee*, 46 Mich 424, 427; 9 NW 457 (1881); *Accord, Yonkus v McKay*, 186 Mich 203, 211; 152 NW 1031 (1915); *Cuttle v Concordia Mut Fire Ins Co*, 295 Mich 514, 519; 295 NW 246 (1940). When the burden of proving a fact falls on one party, then the other party does not have the

burden of proving the opposite fact. *S.C. Gary, Inc v Ford Motor Co*, 92 Mich App 789, 803-804; 286 NW2d 34 (1979).

**II. The Commission should decrease that amount of capital expenditures requested by the Company.**

In this rate case filing, the majority of the Company's requested rate relief is attributable to capital expenditures. "In this rate case filing \$100 million, or 58%, of the requested rate increase of \$171 million, excluding the corporate tax reduction, is for higher rate base related to capital expenditures."<sup>2</sup> And the result is tremendous upward pressure on rates, especially for the most vulnerable ratepayers. As a result, the reasonableness and prudence of these costs must be closely examined and any expenditures that are not supported by the evidence eliminated.

The evidence supports a reduction in the amount of the capital expenditures requested by the Company of \$279.7 million. The recommended changes in capital expenditures and rate base are explained below.

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<sup>2</sup> 6 TR 2775.

**A. No cost attributable to contingency costs should be included in rate base.**

The Company included contingency costs of \$36,489,000 in its forecasted capital expenditures for 2018 and 2019. Exhibit AG-1 summarizes of the contingency expenditures.

In its order in Case No. U-17735 and other subsequent rate cases, the Commission addressed this issue and determined that contingency amounts should be excluded from capital expenditures and rate base. In its February 28, 2017 Order in Case No. U-17990, the Commission rejected the inclusion of contingency amounts in capital expenditures for the Company:

As the Commission has previously determined, “[b]ecause Michigan utilities are permitted to rely on fully projected test year costs and revenues, which already introduces a measure of uncertainty in the rate setting process, the Commission finds that it is far too speculative to add contingency amounts on top of that.” January 31 order, p. 12. In addition, what distinguishes projected contingency costs from other projected costs is not only that these costs are speculative, but also, that the cost depends on the occurrence of some future event outside of the utilities control. The question of whether projected contingency costs should be included in rate base thus requires a determination about who, the utility’s investors or ratepayers, should bear the risk that the contingent event may never occur. In four previous orders, the Commission has consistently answered that question by denying recovery of projected contingency costs. *See, e.g.*, November 19 Order, December 11 order, December 9 order, and January 31 order.

“Contingency expenditures are typically amounts above the base forecast of capital expenditures for non-routine projects. The contingency amounts are usually established early in the life cycle of the project in case cost increases are experienced due to unforeseen circumstances. The fact that these added costs are contingent means that they may not be spent in whole or in part.”<sup>3</sup> It is neither fair nor reasonable for the Company to recover the depreciation expense and the return on the investment on potential costs that may not actually be incurred but have been added to rate base.

Nothing has changed since the Commission made these determinations. In fact it has only reaffirmed its position in Case Nos. U-18124, and U-18322. Therefore, the Attorney General recommends that the Commission exclude the \$36,489,000 from the forecasted capital expenditures in this rate case filing.

**B. The Company does not support all of its proposed electric distribution capital expenditures.**

Company witness James Anderson and Andrew Bordine identify multiple projects related to the Company’s electric distribution system that the Company asserts require capital expenditures. The total expenditures identified for this area is \$447.9 million incurred in 2017, \$880.7 million and \$889.8 million projected to be incurred in 2018 and 2019, respectively. Exhibit A-12 (HJM-48). Included in these

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<sup>3</sup> 6 TR 2776

amounts are capital expenditures for New Business, Reliability programs, Capacity expansions, Demand Failures upgrades, Asset Relocation projects and Electric Operations Other.

The Company's electric distribution system consists of High Voltage Distribution ("HVD") and Low Voltage Distribution ("LVD") facilities and the Company presented its capital expenditures by these categories, therefore, this section of the brief is presented in a similar fashion.

*SAIDI Goal and EDIIP* – It appears that the impetus for the Company's capital expenditures is to achieve a System Average Interruption Duration Index ("SAIDI") goal of 120 minutes by the year 2022. SAIDI, measures both the frequency and average time that electric service to customers is interrupted during the year. The Company's SAIDI has been up and down during the past six years with the index at 207.3 minutes in 2016.<sup>4</sup>

The Company proposes implementing a five-year Electric Distribution Infrastructure Investment Plan ("EDIIP") to allow it to accomplish its SAIDI of 120 minutes by 2022. The EDIIP includes over \$3 billion of capital expenditures plus \$973 million of O&M costs over the five-year period from 2018 to 2022. See, Exhibit AG-2. The EDIIP includes expenditures related to system performance and replacing aging infrastructure such as Reliability and Demand Failures programs,

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<sup>4</sup> 5 TR 1859.

as well as capital expenditures for New Business, Asset Relocation and Capacity expansion projects.

The Reliability and Demand Failure programs account for only 58% of the \$3 billion in capital spending over the five-year period. And, expenditures for those programs remain relatively flat over the five-year period. The Company proposes increasing Reliability expenditures from \$111 million in 2017 to a high of \$232 million during the projected 2018-2022 period. The Company also proposes spending close to \$200 million annually on system reliability projects which is a nearly a 100% increase in capital expenditures from the 2017 level. “However, this increase in capital expenditures does not match the decline in SAIDI. Achieving a SAIDI of 120 minutes in 2022 represents a cumulative decline of approximately 25% from the 160.9 minutes reported in 2017.”<sup>5</sup>

Capital spending in key areas of the EDIIP is not coterminous with the forecasted decline in service outages. In light of the foregoing, the Attorney General recommends the following capital spending disallowances.

**1. HVD New Business**

The Company has forecasted capital expenditures of \$13.5 million for 2018 for HVD New Business. See, Exhibit A-17 (JRA-2), line 1. Of that amount,

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<sup>5</sup> 6 TR 2779

\$2,872,000 is for “anticipated projects yet to be specifically identified.” Exhibit AG-3. This amount appears to be a placeholder and there is no evidence that this amount will be spent. The Company has not identified any projects it will be spent on. It is neither reasonable prudent to include speculative amounts in rate base on which the Company will earn a return and recover depreciation expense. “The Commission has made it clear in prior rate cases that placeholder amounts would not be included in rate base.”<sup>6</sup> Therefore, the Attorney General recommends that the amount of \$2,872,000 be excluded from the Company’s forecasted capital expenditures for 2018.

## 2. HVD Lines & Substation Capacity

The Company has forecasted capital expenditures of \$17.8 million for 2018 and \$22.2 million for 2019 to expand capacity of HVD lines and substations. Exhibit A-17 (JRA-2) line 9. The Company proposes to use those expenditures to address 69 projects in 2018 and 36 projects in 2019. However, in 2017 the Company only spent \$16.8 million to address 62 projects. While the Company may argue that the proposed payments for 2018 and 2019 are for larger or more expensive projects, evidence from the Company shows that over the last few years the level of spending for this program has generally tracked with the number of projects. Exhibit AG-4.

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<sup>6</sup> 6 TR 2780.

However, in 2019 there is a wide divergence between the number of scheduled projects at 36 and the forecasted capital expenditures of \$22.2 million. And, the Company has not explained why the capital expenditures for 2019 increase by \$5.3 million from the 2017 level while the number of projects declines from 62 to 36. Therefore, Mr. Coppola calculated the actual cost per project for the year 2017 and then applying an inflation factor of 2.5% for 2018 and 2.3% for 2019 arrived at a forecasted cost per project. He then multiplied this cost by the number of projects forecasted by the Company for 2019 to arrive at an adjusted capital expenditure amount of approximately \$11.0 million which is \$13.4 million less than the amount forecasted for 2019.<sup>7</sup> The Attorney General recommends that the Commission reduce the Company forecasted capital expenditures by \$13.4 million because the Company failed to adequately support its requested amount.

### **3. LVD Substation Reliability**

The Company has forecasted capital expenditures of \$19.3 million for LVD Substation Reliability for 2018 and \$20.2 million for 2019. Exhibit A-17 (JRA-2), line 4. The Company only spent \$14.1 million in 2017 for this program.

The Company has provided detailed costs for certain substations to be addressed in 2019. It also aggregated costs for other potential projects that may be done in 2019. See, page 2 of Exhibit A-24 (JRA-9). On line 7 of the exhibit, the

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<sup>7</sup> See Exhibit AG-5 and 6 TR 2781.

Company assigned \$816,000 for rebuilding additional substations yet to be identified. On line 30, the Company assigned \$1,975,000 for 19 substations yet to be determined. On line 32, the Company assigned \$3 million for 90 regulator replacements at locations yet to be determined. And, on line 33, the Company assigned \$1.2 million to reclosers, fuses and ground switches at locations yet to be determined. These undetermined projects total \$6,991,000 and appear to be placeholder amounts. It is unknown if any of this amount will be spent. It is not reasonable, prudent or fair to ratepayers to include speculative amounts in rate base on which the Company will earn a return and recover depreciation expense. As stated above, the Commission has made it clear in prior rate cases that placeholder amounts should not be included in rate base. Therefore, the Attorney General recommends that the amount of \$6,991,000 be excluded from the Company's forecasted capital expenditures for 2019.

#### **4. LVD Substation Capacity**

The Company has forecasted capital expenditures of \$11.8 million for 2018 and \$13.1 million for 2019 related to expanding capacity of LVD substations. Exhibit A-17 (JRA-2), line 10. This proposed program involves addressing 11 projects in 2018 and 12 projects in 2019. The Company spent \$13.7 million in 2017 to address 16 projects under this program. The 2019 forecast includes construction of 6 new substations at a cost of \$9.9 million.

In discovery, the Company was asked to provide the cost to build each substation, the contractual arrangement with the major customers to be served by the new substations and the date when the substation is needed. The Company responded that the Seven Mile and Paradise substations' facilities agreement and date of service will be established when the new customer moves forward with each project. Exhibit AG-6. The timing of these projects is still uncertain. It is not clear that those substations will be built in 2019, if at all. The capital cost included in 2019 to build the two substations is \$3.7 million.

Given the speculative nature of these two substation projects, the Attorney General recommends that the Commission remove \$3.7 million from the Company's forecasted 2019 capital expenditures.

#### **5. LVD Metro New Business**

The Company has forecasted capital expenditures of \$5.3 million for 2018 and \$4.8 million for 2019 for new business projects within the larger cities it serves. Exhibit A-39 (AJB-6), line 5. The Company spent \$2.4 million in this same area in 2017.

The Company has identified several projects, with their costs and start dates. However, the Company could not identify a project start date or had assigned amounts to unknown new business projects based on historical spending for four of

the cost items. The total amount of these placeholder items is \$ [REDACTED]  
[REDACTED] See Exhibit AG-7 Confidential.

The Company has not demonstrated that the total amount will be spent. Nor has the Company identified any information about the projects that it may be spent on. Nonetheless the Company seeks to include these speculative amounts in rate base. As stated above, the Commission has made it clear in prior rate cases that placeholder amounts would not be included in rate base. It is neither reasonable or prudent to do so and the Attorney General recommends that the amount of \$ [REDACTED] be excluded from the Company's forecasted capital expenditures for the respective years.

#### **6. LVD Repetitive Outages**

The Company has forecasted capital expenditures of \$9.7 million for the year 2018 and \$9.3 million for 2019 for repetitive outage projects. Exhibit A-39 (AJB-6), line 8. The Company spent \$6.3 million for this program in 2017.

When asked to explain the departure from the number of projects usually implemented under the program, the Company explained that the number of projects vary due to project cost and budget constraints. The Company also disclosed in the request that it reassigned capital to other higher benefit projects outside this category. According to the Company it plans to target 142 projects in 2018, and has provided a new capital expenditure forecast of \$6 million. See,

Exhibit AG-8. The \$6 million forecast for 2018 that was provided in discovery is \$3.7 million lower than the amount included by the Company in Exhibit A-39. Therefore, the Attorney General recommends that the \$3.7 million difference between the Company's filed position and the revised forecast be removed.

With regard to the 2019 forecasted capital expenditures of \$9.3 million, the average cost per project for the 180 projects planned for the year is \$51,667. To assess the reasonableness of the forecast, Mr. Coppola calculated the average cost for the three years from 2015 to 2017 and escalated it at the forecasted rate of inflation of 2.5% for 2018 and 2.3% for 2019. He then used a three-year average for this program to smooth out potential high and low years given the Company's statement that project costs can vary significantly from year to year. "Exhibit AG-9 shows the result of going through the steps outlined above. The result is an average project cost of \$40,179 for 2019, which is significantly lower than the \$51,667 used by the Company. Multiplying the \$40,179 project cost by the 180 projects planned for 2019 produces a reasonable capital expenditure forecast for 2019 of \$7.2 million, which is \$2.2 million lower than the Company's forecast."<sup>8</sup>

The Attorney General recommends that the Commission remove the \$2.2 million from the Company's capital forecast for the year 2019.

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<sup>8</sup> 6 TR 2785 – 2786.

## 7. **Grid Automation & Advanced Technologies**

The Company has forecasted capital expenditures of \$34.8 million for 2018 and \$58.1 million for 2019 to ramp up implementation of a distribution grid automation system and other advanced technology projects. Exhibit A-39 (AJB-6), lines 10 and 11. It appears that the Company began spending on this project as early as 2013 with cumulative expenditures of \$58.8 million from 2013 to 2017.<sup>9</sup>

The Company explained that grid automation is a collection of systems and communication-enabled devices, such as DSCADA, SCADA, automatic transfer reclosers, line sensors and regulator controls. The Company also explains that the FLISR is a subsystem within the larger ADMS platform system and is currently planned for implementation in 2020. See, Exhibit AG-10. The Company sees grid automation as a holistic approach to optimize the entire process of responding to and repairing outages. On the question of how this technology would have prevented customers from losing power service or would have restored service earlier during the last two major storms, the Company stated that if Automation Loops were at full deployment, there would have been a decrease of 2.8 SAIDI minutes. And, if DSCADA systems had been fully deployed, there would have been another decline of 0.35 SAIDI minutes. According to the Company we should expect

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<sup>9</sup> Exhibit A-39, See also, 4 TR 1180.

a total decline of 3 SAIDI minutes with the grid automation technology fully deployed.<sup>10</sup>

On the question of which other utilities have implemented these systems and technology, the Company stated that several utilities have been implementing FLISR functionality or plan to so shortly, and points to First Energy and Duke Energy as two examples. From the description provided, it appears that the two companies have recently implement a limited FLISR network and not the broader approach envisioned by the Company.

As to the total cost of the grid automation project including ADMS and ESME, the Company has projected that from 2015 to 2022, it will need to spend \$273.4 million to fully implement this integrated and holistic network of systems. Exhibit AG-10. However, the Company did not provide a cost/benefit analysis for the entire project. Instead, the Company stated in the discovery that costs and benefits are primarily evaluated at the individual device/program level which allows for a prioritization scheme.

The Company elaborated further on the testimony of Mr. Bordine on this subject of Grid Capabilities – Advance Technology. [BEGIN CONFIDENTIAL]

[REDACTED]

[REDACTED]

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<sup>10</sup> 6 TR 2786 – 2787.

[REDACTED]  
[REDACTED] [END

CONFIDENTIAL] See, Exhibit AG-11 Confidential.

In this discovery response, and specifically AG-CE-287d Confidential,  
[BEGIN CONFIDENTIAL] [REDACTED]

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED] [END CONFIDENTIAL]

While there was a “cost/benefit analysis of some sort,” the analysis performed does not evaluate the costs of the specific grid modernization programs and projects to be undertaken by the Company and the related benefits of completing implementation of those systems.

The Attorney General’s witness identified three basic concerns with the Company’s proposed investments in grid automation and advance technology. First, the program does not appear to make much of difference in reducing outage

time for customers. As discussed above, the reduction in SAIDI will be approximately 3 minutes from a reported 160 SAIDI minutes in 2017. The benefit of reducing SAIDI by three minutes does not seem to justify a capital investment of more than \$273 million (or approximately \$91 million per a minute).

Second, the Company has not presented a robust cost/benefit to justify the entire \$273 million in capital investments. The Company characterized grid modernization as a holistic approach with a coordinated network of systems. But instead of providing a cost/benefit analysis evaluating the entire investment and financial benefits that would result from implementing the entire system or network. The Company's approach attempts to justify investments by individual devices and program. "Given the large capital investment over multiple years, the Company needs to perform a cost/benefit analysis akin to what it did to justify the implementation of AMI. At present, there is no overall economic justification for undertaking the grid modernization program."<sup>11</sup>

Third, the planned implementation of grid modernization over the next four years seems premature. The Company has not presented sufficient evidence that the technology it wants to implement has had a consistent and sufficient record of success. There are risks to being an early adaptor of new technology.<sup>12</sup>

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<sup>11</sup> 6 TR 2790.

<sup>12</sup> 6 TR 2789 – 2790.

The Company has not provided an economic or technological justification for the grid modernization and advance technology and until it does so, the Attorney General recommends the Commission disallow the capital investments incurred by the Company from 2015 to 2017 of \$45.3 million, and the \$34.8 million and \$58.1 million forecasted for 2018 and 2019, respectively, as shown on lines 10 and 11 of Exhibit A-39.

## **B. Power Generation Expenditures**

The Company has forecasted \$172.6 million in capital expenditures for 2018 and \$168.7 million for 2019 for various projects related to the Company's power generation facilities.<sup>13</sup> In 2017, the Company spent \$177.7 million for power generation.

The Attorney General has an initial concern that the Company may not spend the amount projected for this category of expenditures. Through the first seven months of the year actual expenditures totaled only \$92.2 million although the Company forecasted spending nearly \$100 million (\$99.9 million) during that same time.<sup>14</sup>

While it is hard to forecast with exact precision and some variability between actual and forecasted spending may occur, the amount of variance in this case (\$7.7

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<sup>13</sup> See, Exhibit A-12, Schedule B-5.1., page 2.

<sup>14</sup> Exhibit AG-12 and 6 TR 2791 - 2792.

million) is not insignificant and appears to reflect more than just the typical forecast inaccuracy.<sup>15</sup> It also appears indicative of a level of spending in the forecast that is not materializing. Even if we assume that for the remaining five months of 2018 the Company will spend at the levels forecasted, then the \$7.7 million gap for 2018 capital expenditures may not close. The Attorney General recommends that \$7.7 million be removed from the Company's 2018 forecasted capital expenditures in this area.

The Attorney General has identified several other adjustments that should be made to the capital expenditure for the power generation area.

1. **Distributed Control Systems**

The Company proposes to upgrade the Distributed Control System ("DCS") and Simulator at Campbell Unit 1, Campbell Unit 3, Karn Unit 1&2 and Karn Unit 3 facilities.<sup>16</sup> The cost for each upgrade and in total for the four systems is as follows:

Campbell Unit 1: \$1,031,000

Campbell Unit 3: \$1,929,000

Karn Unit 1&2: \$1,142,000

Karn Unit 3: \$4,000,000

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<sup>15</sup> In fact, the Company has a pattern in this case of over-projecting its expenditures.

<sup>16</sup> [Broschak p. 15].

Total:                   \$8,102,000

According to the Company, components and software are upgraded every four years as part of a routine replacement cycle before potential end of life failures. The Company believes that it is following best practices by upgrading software and preventing malicious activity. In discovery, the Company admitted that it had not experienced any incidents or failures in any of the four DCS units during the past three years.<sup>17</sup>

The Attorney General's witness opines that the four-year upgrade cycle appears to be too frequent because the Company has not experienced any incidents or failures during the most recent three years. The Company has not presented sufficient evidence that such a short replacement cycle is necessary. Without more concrete evidence of failures, expenditures in this case seem premature. Furthermore, the Company is also seeking millions of dollars of capital expenditures to address cyber-security attacks as part of its funding requests for Information Technology.<sup>18</sup>

Without additional evidence supporting the need for an additional \$8.1 million for software upgrades, the Attorney General recommends that the

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<sup>17</sup> See, Exhibit AG-13.

<sup>18</sup> Exhibit A-84 sponsored by Mr. Josh Hall, Executive Director of IT Customer Experience and Operations, shows that the Company spent \$4.8 million in 2017, and plans to spend \$9.4 million in 2018 and \$9.2 million in 2019 on cyber-security for Company's system and facilities.

Commission remove this amount from the Company's forecasted capital expenditures.

## 2. **Jackson Plant**

The Company forecasted capital expenditures of \$18.7 million for 2018 and \$19.4 million for 2019 for the Jackson Generating Plant. Exhibit A-12 (JPB-3), line 6. The Company only spent \$12.8 million in this same area in 2017.

The Company has identified several projects with project cost and start date. But, it also identified three cost items as "Extra Work Expected".<sup>19</sup> These items appear to be estimates of potential expenses, such as contingency amounts that may or may not occur. As discussed above, the Commission has rejected inclusion of contingency cost amounts and placeholder items in forecasted capital expenditures because they are speculative. Further, it is not reasonable to allow the Company to recover such amounts or include them rate base and to earn a return and recover depreciation expense. The Attorney General recommends that the Commission remove \$2,500,000 for 2018 and \$1,500,000 for 2019 from the forecasted capital expenditures.

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<sup>19</sup> See, Exhibit AG-14.

### 3. Ludington Generating Plant

The Company has forecasted capital expenditures of \$42.2 million for 2018 and \$44.2 million for 2019 for the Ludington Generating Plant. Exhibit A-12 (JPB-3), line 10. In 2017, the Company spent \$56.4 million on various upgrades and replacements at this facility.

The Ludington Plant is unique in that it functions as an energy storage facility by using electricity during low demand periods to pump water into large reservoirs which is later released to power water turbines to generate power during peak demand periods. Although the plant has been operating for several years, the Company began a major overhaul and expansion of the facility to upgrade operations and expand capacity a few years ago. That work will continue for at least the next two years with \$34.2 million planned in 2018 and \$32.7 million in 2019 to upgrade and overhaul certain turbines.<sup>20</sup>

According to the Company, most of the units at this facility are operated for very short periods of time, which of course raises the question of whether it is economically advantageous to continue to expand the facility and invest hundreds of millions of dollars for such limited use.<sup>21</sup>

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<sup>20</sup> 6 TR 2795

<sup>21</sup> Exhibit AG-15.

The Company provided a cost benefit analysis performed in 2010 with a comparison to a previous analysis performed in 2009. The financial analysis shows a significant decrease in economic value from one year to the next. For example, for the Ludington Upgrades Scenario through 2030 the NPV dropped 88% (NPV Net Savings of \$112.2 million in August 2009 declining to \$14.0 million in August 2019). It is not known what utilization assumptions were made in either 2009 or 2010.<sup>22</sup>

It has been eight years since the last cost/benefit analysis and the Attorney General believes that an updated cost/benefit analysis should be performed to assess whether it is still economically advantageous to continue with the planned upgrades or if these upgrades should stop or be delayed to a time when it makes more economic sense. Therefore, the Attorney General recommends that the Commission order the Company to present an updated cost/benefit analysis of the Ludington plant to justify capital investments from 2019 into the future in its next electric rate case. The cost/benefit analysis should be presented on a forecasted utilization basis and also based on recent historical utilization of the facility to provide a full perspective of its economic value.<sup>23</sup>

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<sup>22</sup> 6 TR 2796.

<sup>23</sup> 6 TR 2796 – 2797.

### **C. Information Technology Expenditures**

The Company has forecasted \$84.9 million in capital expenditures for 2018 and \$78.6 million for 2019 for various information technology (“IT”) projects.

Exhibit A-12 (JRH-2). In comparison, the Company spent \$64.6 million on IT projects in 2017.

An initial issue is that the Company may not spend the requested amount forecasted for 2018. The actual capital expenditures for the first seven months of 2018 totaled \$34.1 million. In comparison, the capital spending forecast for the same seven months of 2018 shows that the Company expected to spend \$43.8 million.<sup>24</sup> Through the first seven months of 2018, the Company has under-spent by \$9.7 million. Even, if the Company is given the benefit of the doubt that for the remaining five months of 2018 it will spend at the levels it forecasted, there would still be an \$9.7 million difference between projected and actual capital expenditures for 2018. Ratepayers should not be forced to fund more than the Company can reasonably spend. Therefore, the Attorney General recommends that \$9.7 million be removed from the Company’s 2018 forecasted capital expenditures in this area.

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<sup>24</sup> Exhibit AG-16.

The Attorney General has also identified several other adjustments that the Commission should consider in this area.

1. **ARP Storage and Server**

The Company requests \$5.553 million to evaluate and potentially replace data storage hardware.<sup>25</sup> It is also requesting \$1.230 million to evaluate and possibly replace server hardware.<sup>26</sup> Both requests appear to be based on incomplete evaluations. According to the Company, the projected cost for the ARP Storage project includes \$33,500 to performing the evaluation and \$3.5 million to potentially replace the hardware. For the ARP Sever, the Company identified an amount of \$25,800 to perform the evaluation and \$1.2 million to potentially replace the server hardware.<sup>27</sup>

Evidence of an evaluation that provides a reasonable basis for the replacement let alone the cost of the replacements has not been provided. The requested expenditures of \$3.5 million for Storage hardware and \$1.2 million for Server hardware is unsupported and premature. Therefore, the Attorney General recommends that the Commission remove these amounts from the Company's forecasted 2019 capital expenditures.

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<sup>25</sup> 2 TR 261 – 262.

<sup>26</sup> 2 TR 262.

<sup>27</sup> Exhibit AG-17.

## 2. ARP Collaborative and Workstation Asset Management

The Company requests \$1.126 million to update the Company's employee Collaborative system, because it is no longer supported by the vendor.<sup>28</sup> The Company also asks for \$4.649 million to validate, procure and deploy desktops and laptops throughout the Company.<sup>29</sup> According to the Mr. Hall, the Company's witness, Consumers is on a four-year replacement cycle and delaying these purchases could results in technical failures and loss of employee productivity.

The Company was unable to identify any failures that have occurred with the Collaborative system in the past 12 months. And, likewise with regard to the ARP Work Station Asset Management project, the Company stated that it had not experienced any problems with the Collaborative system in the past 12 months and noted that generally the computer replacement cycle in the industry is 3 to 5 years. Exhibit AG-17.

The Collaborative no system failures have occurred in the past year indicating the system is still functioning well. Replacement seems premature. The Company has not provided compelling evidence that it is critically necessary to replace the system in 2019. Therefore, I recommend that the \$1.1 million expenditures be removed from the Company's forecast.

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<sup>28</sup> See, page 13, beginning on line 43, of his direct testimony Mr. Hall.

<sup>29</sup> See, page 14, beginning on line 34, Mr. Hall.

The Company has not provided any evidence that replacing computers on the four-year cycle proposed in the Workstation Asset management project is necessary. Pointing to industry averages is not sufficient. It is not reasonable or prudent to throw out computers still in good working order without more. The Company must demonstrate that it has experienced higher failure rates with its personal computers once they reach that fourth year of use to justify such expenditures.

Absent additional evidence, the Attorney General recommends that the Commission deduct the \$4.6 million of capital expenditures for Workstation Asset Management for 2019 and the \$1.1 million for the employee Collaborative system from the Company's forecasted capital expenditures.

#### **D. Operations Support**

The Company is projecting capital expenditure of \$21.4 million for 2018 and \$33.5 million for 2019 for the Operations Support area. Exhibit A-12 (LDJ-1), Schedule B-5.2I. That compares to actual expenditures of \$21.5 million for the same area in 2017. Most of the expenditures pertain to building new service centers and upgrading other buildings under the Asset Preservation heading.<sup>30</sup>

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<sup>30</sup> 6 TR 2802.

Under this category, the Company is planning to invest \$11 million in a new Grand Rapids office. It expects to spend \$1 million in 2018 and \$10 million in 2019. Exhibit AG-19. According to the Company, Grand Rapids is the largest market and fastest growing area in the Company's service territory. And, significant investments are being made in electric grid modernization. The new office building would house engineering working on the grid automation project and call center support personnel. Indications are that very few of the employees that it anticipate will be located there will work on grid modernization.<sup>31</sup>

The Attorney General is concerned that the Company has not shown that it is necessary to build a new office when it could potentially lease office space for types of functions that will take place at the new building. According to the Company it performed a lease vacancy review but did not talk with any lessors. While it indicated that it talked with a developer regarding a build option, there is no indication that it engaged with a commercial leasing agent.<sup>32</sup>

Another concern is whether the grid modernization project should proceed at the level and pace that the Company has outlined. The Company has not adequately justified that the grid modernization project is economically viable and

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<sup>31</sup> Exhibit AG-41, p.6.

<sup>32</sup> Exhibit AG-41, pp. 2 and 5.

that it will provide sufficient customer benefits. More evidence on the benefits of this project needs to be provided before any expenditures are incurred.

The Attorney General recommends that the Commission not approve the \$11 million of capital expenditures forecasted by the Company for 2018 and 2019 unless and until it can fully demonstrate the reasonableness and prudence of such expenditures.

#### **E. Fleet Services**

The Company has projected capital expenditure of \$13.3 million for 2018 and \$31.9 million for 2019 for Fleet Services. Exhibit A-12 (BKS-1), Schedule B-5.2. This compares to the \$13.0 million the Company spent in 2017. Most of the expenditures relate to transportation equipment. According to Company witness, Bruce Straub, the Company plans to accelerate replacement of transportation equipment beginning in 2019.<sup>33</sup> The projected level of annual capital expenditures is more than double the amount spent in the prior two years and historical levels.

The Company engaged the services of Utilimarc, a consulting firm, who evaluates the life cycle of equipment in the utility industry. Utilimarc proposes to increase spending on transportation equipment from the current level of \$24.5 million Company-wide in 2018 (\$13.2 million in the electric business) to \$51.7

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<sup>33</sup> 6 TR 2804

million Company-wide beginning in 2019 (\$31.9 million in the electric business) escalated at 3% annually.<sup>34</sup> Ultimarc asserts that the key benefits of the increased spending are lower maintenance expense over the next 10 years and a decrease in the average age of the fleet from 8.38 years to 5.55 years.<sup>35</sup>

In recent years, transportation fleet unit availability has ranged from 98.5% to 98.9%.<sup>36</sup> According to Company witness Straub, availability is measured at the beginning of the day, this indicates that each day the Company starts with almost 99% of its vehicles available for use.<sup>37</sup> Which means that nearly in all cases when a vehicle or a piece of equipment is needed, it is available for use.<sup>38</sup> According to the Company, the current replacement cycle has experienced elevated responsibility dollars for repairs on deteriorating components such as rusted bodies, bin doors, brake line failures, engine overhauls and suspension failures. The Company also states that current vehicles do not have safety features such as detection and active braking, blind spot monitoring and lane assist features.<sup>39</sup>

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<sup>34</sup> 6 TR 2804.

<sup>35</sup> Exhibit A-112 (BKS-2), page 9.

<sup>36</sup> 5 TR 1503.

<sup>37</sup> 5 TR 1535.

<sup>38</sup> 6 TR 2805

<sup>39</sup> Exhibit AG-20.

It is not clear what elevated responsibility dollars means and the Company has not provided adequate quantification of how maintenance and repair costs have escalated in recent years. Further, evidence is lacking on the number of rusted utility trucks and equipment failures that have occurred and if the occurrences are increasing at a more rapid pace in recent years. The Company's ability to achieve a unit availability rate of nearly 99%, indicates the condition of the fleet is not dire. And, the lack of more modern features alone do not justify spending an additional \$30 million annually.

The analysis performed by Utilimarc and the testimony of Mr. Straub lack even a rudimentary cost/benefit analysis to assess whether the incremental capital investments over the next 10 years, as proposed by the Company, are justified by a reduction in maintenance expense. In fact, the number presented represent a composite average across a proxy group compiled by Utilimarc.<sup>40</sup> There is no indication that this large increase in capital spending will provide the claimed economic benefit on a net present value basis. In fact, further analysis indicates that the Company's proposal creates a significant economic cost over the next 10 years.

Exhibit AG-21 shows the difference in capital spending between the level proposed by Utilimarc to achieve a lower replacement lifecycle versus the current

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<sup>40</sup> 5 TR 1544.

spending level as outlined in the Utilimarc report included in Exhibit A-112. The present value of the incremental purchase costs proposed by Utilimarc is \$230 million. The same exhibit shows the Maintenance cost savings of implementing the Utilimarc spending plan over the next 10 years. The present value of the fleet maintenance savings is \$48 million. Therefore, the present value of the incremental spending proposed by Utilimarc exceeds the cost savings by almost \$182 million. This is not a sound economic proposal.<sup>41</sup> It is neither reasonable or prudent to undertake such a large increase in capital spending without demonstrating attendant savings.

#### **F. Plug-in Electric Vehicle Pilot Program**

The Company has proposed a 3-year pilot program to purportedly assess the impact of growth in plug-in electric vehicles (“PEV”) on the electric grid and the related demand for power. Company witness Michael Delaney describes the objective of the PEV pilot program<sup>42</sup> as follows:

“The objective of the Program is to ensure Consumers Energy is prepared to facilitate the full benefit of EV adoption for all customers by learning to manage grid impacts while the EV market is small, thereby being well-positioned to capture benefits for customers while avoiding expensive, reactive adjustments once the market has matured. PowerMIDrive is designed to seed the EV market in Consumers Energy territory with an initial infrastructure investment...”

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<sup>41</sup> 6 TR 2807.

<sup>42</sup> 4 TR 1039.

The Company proposes spending \$7.5 million for the program with \$3.8 million to be spent in the first year and the remainder in the subsequent two years.

The \$7.5 million would be allocated as follows:

\$1.5 million for \$500 rebates to 3,000 residential customers buying an EV charger.

\$1.0 million for \$5,000 rebates to 200 public or workplace site hosts installing Level EV chargers.

\$1.7 million for \$70,000 rebates for a maximum 24 installations of Direct Current Fast Chargers (“DCFC”).

\$1.0 million for education and outreach to customers and site hosts.

\$2.3 million for technical development of IT systems and networks, and program management.

The Company has also proposed a Nighttime Savers Rate with three period time-of-use rates and a super off-peak rate that customers who choose to charge their EV from 11 pm to 6 am can use.

The Company expects that the number of PEVs in its service area will at least double over the next three years of the pilot program from the current 4,000 to 8,000 EVs. The Company is also relying on information from different sources showing EV car sales in Michigan reaching levels of 150,000 to 800,000 by 2030.<sup>43</sup> That would be up from the 12,000 – 15,000 PEVs currently in circulation in Michigan. The Company asserts that there are some barriers to consumers fully

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<sup>43</sup> Exhibit A-73 (MJD-1).

embracing PEVs, including range anxiety, gaps in charging infrastructure, lack of consumer awareness and knowledge of PEVs. Mr. Delaney also discusses alleged lifetime benefit of an electric vehicle and the potential customer benefits of lower rates and social benefits of lower emissions.<sup>44</sup>

The Attorney General has several concerns about the objectives of the Company's program, the necessity of spending \$7.5 million on a 3-year program, and the credibility of the financial benefits presented to support of the program. First, the objective of the Company's pilot program is very vague and questionable. The Company seeks to find out whether it is prepared to facilitate some potential large future increase in EV power demand on the grid. It is not clear how adding another 3,000 to 4,000 EVs with a potential annual load of less than 13,000 MWh will be perceptible in a grid that delivers 37,632,000 MWh<sup>45</sup> in sales in 2018. This load represents less than 0.035% of total company sales.<sup>46</sup>

It also seems that the Company should be able to model the impact of this potential new load on the power grid instead of incurring millions of dollars on a pilot program that relies on a small number of new EV chargers dispersed throughout the service area. In any event, Mr. Delaney testifies that the grid has

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<sup>44</sup> 6 TR 2805 – 2806.

<sup>45</sup> Exhibit A-15 (EMB-2), Schedule E-1.

<sup>46</sup> 6 TR 2810.

enough overall capacity to handle increased EVs in the near-term which he indicates encompasses 2018-2025.<sup>47</sup>

Second, it is not clear what the objective is for giving rebates to residential customers and sites hosts for Level 2 and DCFC chargers. The obvious objective would be to spur more EV sales. However, adding PEV customers and increasing sales are not part of the stated objective of the pilot program. The effect of the rebate program is doubtful. The little likelihood that a rebate of up to \$500 will spur an additional 3,000 – 4,000 EV purchases by residential customers when from 2010 to 2014 the Company had an EV charger rebate in place of \$2,500 and was able to add only 1,300 EV customers. Further, rebates do nothing to resolve range anxiety given that these chargers are slow chargers requiring EV battery charging time from 2-10 hours for a 40 mile drive. Even DCFC fast chargers require about half hour to recharge a battery to an 80% level.<sup>48</sup>

Third, the cost/benefit analysis presented in Exhibit A-74 (MJD-2) and the lifetime benefit of \$1,900 to \$2,300 per EV over a 10-year period (\$190-230 annually) discussed on page 11 of Mr. Delaney direct testimony are not credible. The calculations underlying these numbers assume that the Company will collect capacity and distribution revenue from each EV connected to its power grid without

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<sup>47</sup> 6 TR 2810 – 2811 and 5 TR 1032.

<sup>48</sup> 6 TR 2811.

any cost for generation, power distribution, fuel costs and O&M expenses for customer service, marketing and administrative costs.<sup>49</sup>

The cost/benefit analysis also assumes that in 75% to 85% of the time EV charging will take place at off-peak time when generating capacity is available. However, it does not quantify the costs of new generating capacity needed for charging EVs during on-peak periods. It is unrealistic to think that the wider use of PEVs will not lead to charging during the day when peak power demand occurs. A specific cost/benefit analysis justifying the payment of rebates to residential customers and site hosts for Level 2 and DCFC chargers is lacking. “The payments need to be justified by incremental power sales made through those chargers. If the economic benefit of incremental sales over the 10-year life of the chargers falls short from the cost of the rebates, then the Company is providing a cost subsidy to those customers at the expense of the rest of the customers. Such subsidies should not be allowed by the Commission.”<sup>50</sup>

Fourth, the Company wants to embark on an educational and outreach program to promote the use of EV at a cost of \$1 million. Again, this does not seem to fit into the stated objective of the pilot program. It only makes sense to promote the use of EVs if the objective is to increase EV power sales.

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<sup>49</sup> 6 TR 2812.

<sup>50</sup> 6 TR 282812 – 2813.

Fifth, Mr. Delaney also identified reductions of tail pipe emissions as a social benefit of EVs. Although reduction of tail pipe emissions is true with PEVs, it does not tell the whole story. One must include the entire cycle from power generation to power use. Currently, most of the Company's power generation comes from burning fossil fuels. When the total emissions are calculated from power generation to PEV power use and compared to vehicles using gasoline, the emissions are currently higher from EVs.<sup>51</sup> If and when more power is generated by renewable energy on a sustainable basis, perhaps the emission benefits will materialize. Further, the Commission directed the utilities to consider PEV and the cost to customers not as members of society, but by the specific benefit to ratepayers. There is no such analysis in the Company's presentation.

From the proposed rebates to the installing of charging stations, the Company's pilot program is nothing more than a subsidization of a personal consumer purchase decision at the expense of ratepayers who do not have the ability to opt-out or avoid the cost. It is fundamentally unfair to those ratepayers who will never consider purchasing a PEV. To the extent that the unstated goal of the pilot is to increase PEV sales, it is not the core business of Consumers Energy. It is neither reasonable or prudent. This is an issue that should be left to the private market to address. The Attorney General recommends that the Commission

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<sup>51</sup> 6 TR 2813.

reject the pilot program and the expenditures of \$7.5 million. If the Commission disallows capital expenditures for the pilot program rejected, there is no need to address the Company's request for cost deferral and subsequent recovery of those costs over the ensuing 10 years.

**G. Summary of Capital Expenditure Disallowances**

The chart below summarizes the Attorney General's proposed capital expenditure reductions.

<b>Summary of AG Disallowed Capital Expenditures</b>	
	<b>Amount (millions)</b>
Contingent Capital Expenditures	\$36.5
Electric Distribution	172.6
Power Generation	19.8
Information Technology	21.7
Operations Support	11.0
Fleet Services	18.1
<b>Total</b>	<b>\$ 279.7</b>

The Commission should reduce the Company's proposed capital expenditures by \$279.7 million and reduce average rate base by \$252.5 million, including working capital adjustments, as shown in Exhibit AG-22, with the resulting effect of reducing the revenue deficiency by \$19 million.

**H. The Commission should require the Company to continue filing the AMI business case in future rate cases.**

The Company requests that the Commission conclude that its obligation to provide updates to the business case should cease with this rate case because the implementation of AMI meters was completed during 2017.<sup>52</sup>

The Commission should not adopt this recommendation. The business case is not simply a budget of costs for the implementation of the AMI meters. It and its underlying cost/benefit analysis have been critical to the Commission's decisions to allow recovery of AMI costs in rates. And, it is a comprehensive analysis of costs and benefits of the program and tracks whether the benefits of installing the AMI meters will surpass the cost of installation and operation over the life of the meters.<sup>53</sup>

The point has not been reached yet where the cumulative benefits accruing to customers have exceeded the cumulative revenue requirement billed to customers. It appears that the annual benefits will not exceed the revenue requirements until the year 2021. See, Exhibit A-116 (LDW-3), page 6, column (g). And, on a cumulative basis, benefits do not exceed the net billed revenue requirement until 2028. In the meantime, the updated business case provides transparency and

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<sup>52</sup> 4 TR 974.

<sup>53</sup> 6 TR 2814 – 2815.

accountability, and helps ensure that the promised savings will be achieved ,and the program fulfills its goal of being a net benefit to customers.

The Attorney General recommends that the Commission reject the Company's request and instead direct the Company to continue reporting the status of the AMI business case as it has done in this case and prior rate cases.

### **III. Working Capital Adjustments**

The Company requests approval of \$804 million in working capital. The Attorney General recommends that the level of working capital in this case be reduced by \$49.9 million to \$754.1 million to reflect: (1) a lower cash balance level (a \$36.3 million reduction), and (2) a lower level of accounts receivable and accrued revenues (a \$13.6 million reduction). See, Exhibit AG-25.

#### **A. The Commission should reduce the Company's proposed cash balance.**

The Company included a cash balance amount of approximately \$58.3 million in its working capital balance. It is based on roughly 2% of revenue. In several of the recently filed rate cases, the Company has proposed a cash balance level equal to 1% of revenues.<sup>54</sup> Had the Company taken the same position in this rate case, the result would be a \$44 million cash balance level.

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<sup>54</sup> See e.g., page 21 of Denato testimony in Case U-18124.

However, the Company opted to use the historical cash balance level which results in larger cash balances. Clearly there is no consistency on the part of the Company with respect to forecasting this item. It is neither appropriate or advisable for the Company to hold large cash balances and include the cost of those high balances in working capital because the Company can earn a return at the overall cost of capital on this larger cash balance which is costly for customers. Furthermore, it is unnecessary.

The Company has multiple bank lines of credit and access to the commercial paper market. In fact, the Company plans to increase the bank lines of credit by \$200 million to \$850 million in 2019. These sources of short-term borrowing can be accessed when the Company needs funds to meet short term working capital requirements. Other utilities, such as DTE Electric and DTE Gas, use this approach and avoid carrying large cash balances. Financially, it is overkill for the Company to increase its bank lines of credit and at the same time forecast high cash balances for inclusion in rate base. Customers end up paying higher rates for both higher bank line of credit facilities fees and higher working capital in rate base which is not reasonable.<sup>55</sup>

The Attorney General recommends that the Commission approve a cash balance level in this case that is equal to one-half percent of revenues which is \$22.0

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<sup>55</sup> 6 TR 2827.

million. This level is more than adequate for the Company and the cost to customers is minimized.

**B. The Accounts Receivable balance should be lower.**

In the Tax Refund A Case U-20102, the Company was directed to reduce its electric rates by approximately \$113 million annually beginning in mid-2018. As a result, account balances for Revenues, Accounts Receivable and Accrued Revenues will all be lower due to this rate change. Exhibit AG-25, page 2 shows the change in Accounts Receivable and Accrued Revenues that will occur due to the reduced revenue level.

The Company has overstated the amount of cash that it needs to keep on hand. The Company failed to consider the lower revenues and the resulting lower accounts receivable that will occur in the forecasted test year due to lower tax rates. Instead, the Company simply used the unadjusted historic tax account balances for the projected 2019 test year. The lower accounts receivable balances must be considered in establishing a reasonable level of working capital.

As discussed above, the Attorney General recommends that the Commission reduce the Company's forecasted working capital for the projected test year by \$49.9 million.

#### **IV. Capital Structure and Cost of Debt**

Consumers Energy proposes a capital structure with 52.50% equity. The Attorney General is recommending that the capital structure with a debt/equity ratio of 50% debt and 50% equity as shown on page 1 of Exhibit AG-26 be used in this case. The first three lines show the projected long-term debt, preferred equity and common equity permanent capital of the Company for the test period ending December 2019. The permanent capital balances in this exhibit reflect the numbers set forth in Company Exhibit A-14 (AJD-1), Schedule D1, with an adjustment to rebalance the capital structure. The long-term debt component in Exhibit AG-26 has been increased by \$354 million and the common equity component has been reduced by the same amount. All other capital balances reflect the same amounts recommended by Company Witness Denato. The result is a capital structure with 50% of common equity and 50% of debt and preferred stock.<sup>56</sup>

In response to the Company's penchant for ever increasing equity ratios in recent years, the Commission in its February 17, 2017 order of in Case No. U-17990 stated:

“The Commission expects that Consumers will have arrived at, or will present a strategy to return to, a balanced structure within the five year infrastructure plan time period. If Consumers is unable to do so, a more complete analysis should be included to explain why such a result is reasonable and prudent.”

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<sup>56</sup> 6 TR 2829.

In Case No. U-18424, the Company presented a plan to gradually decrease its common equity ratio. According to the Company witness, Mr. Denato, the Company planned to reduce its common equity ratio to 52.5% in 2018, 52.0% in 2019 and by a half of a percentage point in each year until the 50% ratio is achieved in 2023. However, in this case Mr. Denato claims that the challenges of the Tax Cuts Jobs Act (TCJA) “...make the glide path to a 50% equity ratio by 2023 no longer reasonable...” and that “...maintaining an equity ratio of 52.5% will be appropriate for the foreseeable future...”<sup>57</sup> The Company’s plan to put the move to a 50% equity ratio on hold indefinitely is not supported by the record. Enactment of the TCJA, does not require this result. The Company has not presented any quantitative analysis about how cash flow and credit ratios will change post-TCJA to support his proposed 52.5% equity ratio.

Consumers Energy offered three reasons for maintaining its common equity ratio at 52.5%. First, Mr. Denato claims that the reduction of the tax rate from 35% to 21% reduces cash collected from customers. It appears to be a wash. While less cash will be collected from customers, less cash will be paid to the IRS. In response to discovery, the Company stated that due to tax losses carryover, it is not currently

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<sup>57</sup> 4 TR 819.

paying federal taxes.<sup>58</sup> This is a cash flow benefits that the Company has been enjoying for several years and continues to benefit from currently.

Second, Mr. Denato refers to the return of the excess deferred tax balances to customers as Tax Credit C refunds. However, these tax balances would have been paid to the federal government in future years instead of customers under the Tax Credit C refunds with or without the change in the tax law. It is unlikely that the timing of the cash flow will be altered significantly due to the TCJA.

Third, Mr. Denato claims that the loss of bonus depreciation reduces future tax deferrals. This is a timing issue where current year tax benefits are offset by higher tax payments in later years. With the Company being in a net operating loss position for federal tax purposes, there is no cash flow impact in the foreseeable future. Therefore, this is a non-issue.

Finally, Mr. Denato notes that the Funds From Operations (“FFO”) to debt ratio is a concern and points to Mr. Maddipati’s analysis of this ratio.<sup>59</sup> However, the models and calculations presented by Mr. Maddipati are incorrect and

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<sup>58</sup> Exhibit AG-34.

<sup>59</sup> 4 TR 817 – 818.

misleading. The Commission should give no weight to Mr. Maddipati's testimony on this matter. Detailed analysis is provided in Mr. Coppola's direct testimony.<sup>60</sup>

The Company has not performed a separate analysis of the cash flow forecast and credit ratio analysis and instead is waiting for the tax Credit A, Credit B and Credit C cases to be decided to calculate any impact. See, Exhibit AG-34. There is no basis for the Company to assert that it must increase its equity ratio to 52.5% and receive a ROE of 10.75% because its credit ratios are weakening when it has not calculated what those ratios will be going forward. In fact the Company's credit ratio has not been downgraded nor has it been put on credit watch. Further Moody's, six months after the enactment of the TCJA rated the Company as stable.<sup>61</sup>

There are other factors that might influence the Company's debt/equity ratio including (1) the Company's practice of funding a significant part of its equity contributions with funds from long term debt issued at the parent company level; and (2) the fact that the common equity ratio of the peer group, used to assess the cost of common equity in this case, averages slightly below 49%. Regarding this latter point, this lower average common equity percentage supports these companies' utility operations, as well as non-utility operations which tend to be

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<sup>60</sup> 6 TR 2833 – 2844.

<sup>61</sup> See Exhibit RCG-4.

somewhat more risky. The riskier non-utility businesses require a higher common equity cushion to maintain similar credit ratings.

Using a 50-50 debt/equity ratio leads to a savings for ratepayers of approximately \$18 million annually. This reflects (a) the difference between the pre-tax cost of common equity of approximately 13% versus the cost of long-term debt of approximately 4.5%; (b) the Company's proposed rate base of approximately \$10.7 billion; and (c) the percentage of total capital being shifted from common equity to long term debt.<sup>62</sup>

Mr. Coppola proposes a long-term debt cost rate 4.38%, which is calculated in Exhibit AG-26, page 2. See his testimony for further analysis.<sup>63</sup> The revenue requirement difference is approximately \$8.8 million.<sup>64</sup> He used a 4.5% rate for CEC's preferred stock which is consistent with the rate recommended by Company witness Denato. For Short Term Debt and Deferred Taxes, Mr. Coppola also utilized the cost rates recommended by witness Denato.

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<sup>62</sup> 6 TR 2839.

<sup>63</sup> Id.

<sup>64</sup> 6 TR 2841.

**V. The Commission should adopt the Attorney General’s adjustment to the cost of capital and ROE.**

**A. The Company’s requested ROE.**

According to Company witness Srikanth Maddipati, an appropriate ROE for the Company is 10.75%.<sup>65</sup> Mr. Maddipati used two forms of the Capital Asset Pricing Model (CAPM) – the Normalized CAPM and the Projected Risk Premium CAPM, the Empirical Capital Asset Pricing Model (ECAPM), two forms of Risk premium analysis – Normalized Risk Premium and Projected Risk Premium, the DCF model, and Comparable Earnings Analysis to reach his conclusion unfortunately he used flawed assumptions and novel and untested analysis which led to grossly overinflated estimates for ROE.

**B. Standard for determining ROE.**

A utility company is entitled to a fair return that will allow it to attract capital and be sufficient to assure investors of its financial soundness. In its opinion in *Bluefield Water Works and Improvement Company v Public Service Commission of West Virginia* (the “Bluefield Case”) 262 U.S. 679 (1923), the United States Supreme Court indicated that “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 being made at the same time...on investments in other business undertakings which are attended by corresponding

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<sup>65</sup> 3 TR 411.

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...” The principals of the Bluefield Case were re-affirmed by the U.S. Supreme Court in 1944 in the case FPC v Hope Natural Gas Company, 320 U.S. 591. The Attorney General’s witness followed these guiding principles. Based on these standards, Mr. Coppola recommends a ROE that will enable the Company to maintain its financial integrity.

Before addressing the calculation of the ROE, it should be noted that one of the most important factors in determining the required return on equity of a utility is risk. And utilities face a smaller degree of risks compared to most of other businesses due to the regulatory scheme which provides for rate increases if reasonable and prudent and authorized rates of return. Therefore, a utility’s return should be lower than other riskier businesses. Second, utilities should earn comparable returns to other businesses with similar degree of risk in order to maintain its financial soundness including maintain its credit standing, attract capital for investment and so on.

### **C. The Attorney General ROE calculation and recommendation**

Consistent with the legal principles stated above and the proper application of recognized models, the Attorney General's expert recommends a reasonable ROE of 9.50%, as described below.

#### **1. Approach taken for the Attorney General's ROE analysis.**

Despite not being publicly traded (it is a subsidiary of CMS Energy, Consumers Energy operates in and its financial performances are a part of the general economic and industry environment. Potential investors will still compare Consumers Energy's expected returns on investment to the market returns on other available alternatives. Consequently, a broad analytical approach including studying the underlying economic environment, Federal Reserve policy, likely investors' expectation of the future returns, and the utility industry's expected returns in the current market is appropriate.

Consumers Energy is also subject to the same risks that other firms in its industry face, including variation in demand, limits on growth, environmental compliance costs, employee benefit costs, the cost of infrastructure improvements, regulatory decisions, capital market conditions (interest rates), and the availability to credit and access to capital markets. Therefore, Mr. Coppola utilized standard DCF and CAPM methodologies to evaluate a group of comparable companies. The CAPM model considers market risk. He also used a third method – a Utility Risk Premium approach. To avoid bias and make the cost of capital analysis more

reliable, the conventional approach is to select a proxy group of comparable companies.

Mr. Coppola established a peer group beginning with a fairly broad search and narrowing it down until he had eleven (11) comparable proxy companies. Mr. Coppola's and Mr. Maddipati's groups are the same except Mr. Maddipati includes both NISource and Dominion Energy in his peer group. NISource is mainly a natural gas distribution company with approximately 88% of its customers being gas customers. Mr. Maddipati justifies inclusion of this company in his peer group based on the fact that NISource has over 4,000 MW of generating capacity and meets other criteria he has established. Dominion Energy was included in Mr. Maddipati's peer group despite the fact that it is in the process of purchasing SCANA, a large electric company in South Carolina. Oddly enough, Mr. Maddipati on page 39 of his testimony noted his exclusion of SCANA due to M&A activity with Dominion Resources. Notwithstanding this fact, he has opted to include Dominion in his peer group.

Mr. Coppola included Consolidated Edison and P.E. Enterprise Group, which are two large combination gas and electric companies instead of NISource and Dominion. Accordingly, the peer group recommended by Mr. Maddipati is not truly

a comparable peer group of companies and the Commission should give it less weight.<sup>66</sup>

## 2. Cost of Common Stock

As noted above, Mr. Coppola used a total of three approaches to assess the cost of common equity. Two of the approaches are market-based methods: the Discounted Cash Flow (DCF) method and the Capital Asset Pricing Model (CAPM), which are both recognized methods used in the cost of capital proceedings. The DCF method is based on the anticipation of the company's future earnings and growth opportunities. The CAPM model is based on the risk premium concept. The third method is a Utility Risk Premium approach. In addition, he also considered investors' understanding and expectation of the economic environment, Michigan's economy and the current industry and company specific information. [Coppola pp 77-78]

### a. Discounted Cash Flow Methods

The DCF method calculates the required return for an investor as follows:

$$K = \frac{D}{P} + g$$

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<sup>66</sup> 6 TR 2844 – 2845.

Where:  $K$  = cost of common equity  
 $D$  = dividend per share  
 $P$  = price per share and  
 $g$  = growth rate of dividends, or alternatively, common stock earnings.

In the equation, “ $K$ ” is the required rate of return on investment by investors. It is also the discount rate that is used to convert the future cash flows from the investment into the present value. “ $D$ ” is the amount of dividend paid to equity holders. “ $P$ ” is the market price of the common stock, representing the current valuation of the company by the market. So “ $D/P$ ” is the current dividend yield on the company’s common stock. And “ $g$ ” is the expected growth rate of the dividend or earnings.

The DCF method provides the minimal return for a company to attract and maintain investment in the company’s common equity. It represents the investor’s expectation based on available current market information. It is a measuring stick to compare alternative investment opportunities. Mr. Coppola further explains his inputs for the constant growth DCF model in testimony, including the stock price he uses, his calculation of the dividend yield, the growth rate he utilized and why he used it and summarized his ROE calculations under the constant growth DCF model as follows:

The results of my DCF analysis are summarized in Exhibit AG-28. The stock price information in column (c) of this exhibit reflects the average of the high and low prices for each of these equity securities on each of the 30 trading days from June 29, 2018 to August 17, 2018. The annual dividend in column (d) is the projected dividend level for 2019 as projected by the Value Line Investment Survey. Column (h) shows the average long-term earnings growth rate based on (1) an estimate of earnings growth for five years (2017 to 2022) per Value

Line; and (2) a short term earnings growth estimate by stock analysts for a one year period which is available from Yahoo.com.<sup>67</sup>

The resulting calculation of the DCF Method is an average required return on common equity of 9.04% for the proxy group.

This result is lower than the Company's DCF calculations. In Mr. Maddipati shows two DCF cost of equity calculations. The first at 10.50% with dividend growth guidance from each peer group company management and the second at 10.31% with earnings growth estimated from security analysts. See, Exhibit A-14 (SM-1), Schedule D5, page 5. The differences between the Company's DCF rate of 10.3% and Mr. Coppola's calculation of 9.04% are shown below.

DCF ROE %

10.31%	Company DCF Estimate
	Adjustments
(0.54)	Exclude Dominion & NISource
(0.18)	Exclude Flotation Costs
(0.42)	Dividend Yield Difference

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<sup>67</sup> 6 TR 2846.

Growth Estimate Differences  
(0.10)

Attorney General DCF Rate  
9.04%

See Mr. Coppola's testimony for an explanation of these adjustment including flotation costs which the Commission determined in Case No. U-14347 that flotation costs should not be allowed in setting the ROE of Consumers Energy since it is not a public company. Also, a significant portion of the equity infusions in Consumers Energy has been funded with CMS debt issued in the public markets and not CMS equity capital issued in the public markets.<sup>68</sup> And, there is no reason for the Commission to depart from the precedent it established in case U-14347, especially since (a) the Company does not issue common equity in public offerings, (b) the Company has not provided any analysis of its flotation costs (even for the past five years), and (c) a substantial portion of the new common equity being invested in the Company is from retained earnings and the issuance of long term debt at the parent company level.

**b. The CAPM Method**

As noted above, the CAPM method is based on an analysis of risks. It considers two types of risks: risk that investors can diversify away or reduce by combining different investments into a portfolio; and market risk that an investor

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<sup>68</sup> 6 TR 2847 – 2850.

cannot reduce by diversification. Therefore, the CAPM method is a risk premium model, based on the calculation of the risk differential between investments on the market portfolio and the individual stock. The calculation of the required rate of return on the company's stock is as follows:

$$K = R_F + \beta (R_M - R_F)$$

Where:       $K$  = the required return.  
               $R_F$  = the risk-free rate.  
               $R_M$  = the required overall market return; and  
               $\beta$  = beta, a measure of a given security's risk relative to that of the overall market.

The purpose of using the CAPM model to calculate the required return on the individual investment is to find the equivalent return for an investor based on the relative risk of the investment as compared to the alternative investment opportunities. The CAPM model has two general components: one is the risk-free rate, and the other is the company risk premium, which is the product of the company's beta and market risk premium ( $R_M - R_F$ ). The market risk premium is the difference between the market return and the risk-free rate. Mr. Coppola provide the following detailed explanation of his calculation of the required return based on the CAPM model:

This measure of risk reflects the extent to which the price of a particular security varies in relationship to the movement of the overall market. Some securities vary less in price over time than the overall market. In these cases, the Beta will be less than 1.00. Securities that vary over time more than the overall market will have a Beta that is greater than 1.00.

The Attorney General's CAPM calculation can be found in Exhibit AG-29. See, Mr. Coppola's testimony at 6 TR 2850 to 6 TR 2852 for a detailed explanation of the calculation.

Mr. Coppola believes that the CAPM is useful in assessing the relative risk of different stocks or portfolios of stocks. However, it has limitations because it assumes that the entire risk of a stock can be measured by the "Beta" component and as such the only risk an investor faces is created by fluctuations in the overall market. In actuality, investors take into consideration company-specific factors in assessing the risk of each particular security. Therefore, he gives the CAPM approach less weight than the DCF approach in determining the cost of common equity. 6 TR 2852.

**c. Utility Risk Premium Approach**

The Utility Risk Premium approach to determining a ROE involves adding together three components: (1) the risk free rate of return on 30-year U.S. Treasury Bonds; (2) the historical differential between yields of the rated utility bonds of the Company and the 30-year U.S. Treasury Bonds (risk-free rate); and (3) the average return differential of utility common stocks over utility bonds. The outcome of this approach depends on the how the three components are determined. In calculating

a return on common equity of 9.01% using this approach,<sup>69</sup> Mr. Coppola explained his methodology:

To arrive at this cost rate, I have used the 3.60% projected risk-free rate for the projected test year determined as discussed under the CAPM section of my testimony. To this rate I have added 1.37% which approximates the average spread over 30-year U.S. Treasury Bonds calculated in Company Exhibit A-81, page 3. The sum of these two rates results in a utility debt rate of 4.97%, which is shown on line 4 of Exhibit AG-30. To this debt rate, I added the historical equity premium of 4.44% which is the difference between electric utility common stock returns of 10.85% (from 1932 to 2017) and the utility bonds average return of 6.41% for the same time frame.

The result of Mr. Coppola's analysis using his proposed peer group of companies is a cost of equity of 9.41%.<sup>70</sup>

Mr. Maddipati's calculations under this approach are reflected in Exhibit A-14 (SM-1), Schedule D-5, page 10. However, the outcome is very different.

Mr. Maddipati's Long Term Risk Free Rate for both his CAPM and Utility Risk Premium approach reflect a risk-free rate of 4.99%. He refers to these estimates as his "Normalized CAPM", "Normalized ECAPM" and his "Normalized Risk Premium" estimates as shown on pages 2, 3 and 4 of Exhibit A-14 (SM-1). The Commission should recognize that the 4.99% risk-free rate used by Mr. Maddipati in his CAPM and Utility Risk Premium calculation was derived by

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<sup>69</sup> Exhibit AG-30.

<sup>70</sup> 6 TR 2852.

taking the historical returns of the 30-year U.S. Treasury bond from the years 1926 through 2017. As such, the 4.99% represents a 91-year historical average. The 91-year average rate is approximately 200 basis points higher than the long term forecasted Treasury bond rates for the 2019 projected test year as of August 2018. This approach is not commonly used by cost of equity experts because the long term historical period is not reflective of interest rate conditions expected during the projected test period ending in December 2019.<sup>71</sup>

It is by this unorthodox method that Mr. Maddipati arrives at a 9.98% ROE under the CAPM and the rate of 10.80% under his Risk Premium approach. The use of this approach in rate cases disregards the reality of lower interest rates as a factor in calculating the rate of return on equity and the Commission should reject this “novel” approach. Another difference in the Company’s cost of equity estimates and my estimates are due to the inclusion of flotation costs of 18 basis points by Mr. Maddipati in his CAPM estimate

The Commission should note that Mr. Maddipati uses some very high market risk premium factors by using data for various short timeframes. These market risk premium factors are 11.46% for the CAPM and 8.04% for the Utility Risk

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<sup>71</sup> 6 TR 2854 – 2855.

Premium approach whereas, Mr. Coppola uses the more conventional risk premium rates for the CAPM (7.07%) and for the Utility Risk Premium (4.44%).<sup>72</sup>

For his Utility Risk Premium approach, Mr. Maddipati utilizes the difference in the average equity return versus the average debt rate for the years 2011 to 2017 to develop his 8.04% Utility Risk Premium. In addition to this being an extremely short timeframe for development of a risk premium factor, Mr. Maddipati's approach considers only the recovery years following the 2008 recession. As such, the equity return component he derives to calculate his equity risk premium during this short period of time is inflated.<sup>73</sup>

For his CAPM Risk Premium of 11.46%, Mr. Maddipati develops an average from a variety of methods which are: (1) the 2011 to 2017 economic recovery years for a rate of 11.34%, (2) the 1942 to 1951 great depression recovery years for a rate of 15.71%, (3) an estimate of risk premium he developed from Bloomberg data for the return of the S&P 500 expected for 2019 for a rate of 8.58%, and (4) a 12% estimate of the risk premium published in a Federal Reserve study (supposedly applicable to low interest rate periods) which was published several years ago.

The use of returns and risk premiums during these short periods of time of unusual economic recovery are inappropriate. Further, Mr. Maddipati's approach is

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<sup>72</sup> 6 TR 2855 - 2856

<sup>73</sup> 6 TR 2856.

skewed because of his tendency to pick only the equity return premiums during periods of economic rebound.<sup>74</sup>

**3. The Attorney General's ROE calculation is reasonable and fair to the Company and ratepayers.**

The weighted average return on equity is 8.95% which Mr. Coppola believes reflects the Company's true cost of equity.<sup>75</sup> However, he recommends an allowed ROE of 9.5% taking into consideration what he believes are unique risks related to Consumers Energy and how investors may perceive those risks. He also considered the possible impact of higher interest rates. The recommended ROE is fair to the Company. By allowing a higher ROE that is slightly higher than the required ROE for investment purposes, it represents a gradual return to the true and just ROE.<sup>76</sup>

To confirm his analysis Mr. Coppola compared his recommended ROE of 9.5% to allowed ROEs granted by the public service commissions in the U.S. Pages 2, 3 and 4 of Exhibit AG-31 shows a summary of the more recent commission electric decisions published by Regulatory Research Associates during the period of January 2017 to June 2018. Nearly 80% of the electric decisions rendered (excluding limited

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<sup>74</sup> 6 TR 2856.

<sup>75</sup> See, Exhibit AG-27 which summarizes the cost equity rates from the three method utilized by Mr. Coppola.

<sup>76</sup> 6 TR 2868 – 2869.

issue riders) involved ROE rates averaging approximately 9.5% during this time frame.<sup>77</sup>

While Page 2 of Exhibit AG-31 shows that there were 13 ROE decisions for electric companies in 2017 and 2018 with ROE rates at 10% or higher, four of those decisions were handed down by the Michigan Commission. In contrast, there were 49 other electric ROE decisions with authorized rates below the 10% level. The 49 decisions are summarized on pages 3 and 4 of Exhibit 31 and include information regarding financing subsequent to the rate orders. From this information, it is clear that the capital markets and investors have not become skittish with respect to electric utilities with authorized ROEs below 10%.<sup>78</sup>

Page 5 of the exhibit shows the utility companies who issued 30-year debt in February 2018 and the spread over 30-year U.S. Treasuries in each case. It is obvious from this information that ROE rates were not a factor influencing the rates set at pricing for new long-term debt in these cases.<sup>79</sup>

Therefore, Mr. Maddipati's fears that investors would abandon or penalize the Company if the Commission grants a ROE below 10% are unfounded. The cases Mr. Maddipati highlights with authorized ROEs above 10%, are for the most part

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<sup>77</sup> 6 TR 2862 – 2863.

<sup>78</sup> 6 TR 2863.

<sup>79</sup> Id.

special situations involving incentive rate making situations, rate plans over protracted multi-year periods and special situations which allow for higher risk cases. None of the cases highlighted by Mr. Maddipati in his testimony have any bearing on this case. Mr. Maddipati has taken unusual and special situations and argues that they are analogous to Consumers Energy and the Commission should disregard this information.<sup>80</sup>

As noted above, Mr. Maddipati also used the ECAPM and a novel approach he termed the Comparable Earnings Analysis in this ROE analysis, both of which only served to increase the ROE rate. The ECAPM is not widely used.<sup>81</sup> His Comparable Earnings Analysis is not an academically sound approach.<sup>82</sup> The Commission should give no weight to either of these approaches.

The Attorney General recommends of ROE of no more than 9.5%.

**VI. The Company's proposed Investment Recovery Mechanism is neither reasonable or prudent and should be rejected.**

The Company has proposed an investment recovery mechanism (IRM) to recover costs for capital expenditures to be incurred in 2020 and 2021. The IRM includes capital expenditures for New Business, Demand Failures, Asset Relocations, Reliability, Capacity, and Tools and Technology. In effect, the IRM

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<sup>80</sup> 6 TR 2860.

<sup>81</sup> 6 TR 2857 – 2860.

<sup>82</sup> 6 TR 2860 – 2861.

includes all capital expenditures for the Electric Distribution system and related support functions. The amount of the projected capital expenditures is \$541 million for 2020 and \$546 million for 2021.

To pay for the IRM, the Company proposes to impose a surcharge on customer bills during those years to generate incremental revenue of \$48.8 million in 2020 and \$97.2 million in 2021. As part of the IRM, the Company proposes to file a reconciliation at the end of each year and would credit customer bills for the revenue requirement applicable to the amount of actual capital spending below the forecasted capital level. The reconciliation would be a contested case where the Commission Staff and intervenors can challenge the reasonableness and prudence of the capital expenditures after they have been incurred. The Company has requested full flexibility to spend any amount in any cost category it deems appropriate without any ranges or limitations imposed by the Commission.

The Company has proposed an Excess Returns Sharing Mechanism (“Excess ROE Mechanism”) in conjunction with the IRM. This mechanism would refund to customers the revenue related to 50% of any excess earnings over an earned Return on Equity (“ROE”) of 11% and 100% of the revenue for earnings above a 12% ROE. In addition, the Company has indicated that it may not file a general rate case before February 2021 if certain conditions are met.

The Company has attempted to tie the proposed IRM to its Electric Distribution Infrastructure Investment Plan (“EDIIP”), which it filed in response to the Commission’s request for a comprehensive and long-term plan to assess the condition of the Company’s electric distribution infrastructure. However, the Commission did not indicate in its order in Case No. U-17990 that the Company should request recovery of costs related to the EDIIP through a special cost recovery mechanism.

The proposed IRM raises several concerns and issues, some of which are similar to and some that are different from other mechanisms that the Commission has approved in the past. The proposed IRM creates another stand alone cost tracking mechanism that extends cost recovery past the projected test year period. While specific projects proposed for the projected test year can be evaluated and if necessary challenged within a general rate case before the Company undertakes those projects or at least in the early stages of construction, the review and potential disallowance of costs under the IRM occur after costs are incurred which may negatively affect the Company’s earnings. That could make the Commission reluctant to disapprove costs after they are incurred. The result could be higher costs passed on to customers than is reasonable.

The Company has not yet performed detailed modeling for certain items that would be included in the IRM.<sup>83</sup> So, the Company is basically requesting the approval of distribution costs with few or no specific projects and applications identified of how and where those costs will be spent. Approving recovery of such unknown specific costs and only in broad categories is not reasonable or prudent. It is bad ratemaking and not in the best interest of ratepayers.<sup>84</sup>

There is also the possibility for over or double-recovery for certain capital expenditures. The Company will receive revenues from some of the investments included in the IRM in addition to the IRM surcharge. The capital investments in the New Business category, which amount to \$208 million over 2020 and 2021, will generate incremental revenues as electricity sales are made to new customers. Similarly, in the Capacity category, some of these investments may bring in additional revenue as new facilities are built and capacity constraints and bottlenecks are resolved to allow some existing customers to take more electric power. The inclusion of these capital expenditure categories in the IRM seems unnecessary and could lead to revenues being collected more than once for the same capital investments.<sup>85</sup>

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<sup>83</sup> Exhibit AG-23.

<sup>84</sup> 6 TR 2816 – 2819.

<sup>85</sup> 6 TR 2819 – 2820.

The Attorney General has historically been opposed to single (or limited) issue rate tracking mechanisms, such as the IRM, because they make for bad regulatory policy. The following list addresses some of the major reasons against implementing the IRM:

1. One of the benefits of a general rate case and having a projected test year is the ability to scrutinize and challenge capital projects before those costs are incurred. The IRM avoids the prudence and reasonableness review of the capital expenditures before they are incurred. Reconciliation is an inferior approach for addressing major capital expenditures that can become part of rate base. Further, the projected expenditures could be incurred up to three years from now, so these projections are at best “ballpark” estimates that in many cases are not based on any specific plans.

2. The incentive to reduce capital expenditures and other costs would be eliminated since recovery is nearly assured. The IRM gives the Company basically a blank check to further accelerate rate base growth and increase rates almost unabated. The Company is already increasing rate base at a double digit rate. The IRM would accelerate further that rate of growth, not abate it. This risk should be very concerning to the Commission.

3. Once started, the IRM will likely be expanded to other capital cost categories. As we have seen in the natural gas business, in the last gas rate Case

No. U-18424, the Company proposed an expansion of the IRM to other capital cost categories from the initial program scope approved by the Commission.

4. The IRM inappropriately shifts the business risk away from the Company and onto the customers.

5. The IRM reduces regulatory lag in the recovery of capital costs, reduces earnings volatility and reduces overall business risk for the Company. The Company has not made any allowance for this reduction in business risk in the calculation of its proposed return on equity rate of 10.75%.

6. The IRM is isolated from other changes in costs and revenues occurring within the Company. Therefore, the Company could be over earning in the rest of the business and still surcharge customers for a cost that should be offset against the rest of the business. This is particularly concerning since the Company has earned a return on equity above the authorized level in four of the past five years.<sup>86</sup> And, the Company's proposed Excess ROE Mechanism is inadequate to address this concern.

7. An IRM surcharge would be confusing and perplexing to customers. CEC's residential customer bills currently have multiple line items showing basic charges, power cost recovery factor, various surcharges and taxes. The IRM

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<sup>86</sup> Exhibit A-1 (HJM-2), Schedule A2, page 4.

surcharge would add to that list and raise concerns with customers that they are being burdened with additional charges.<sup>87</sup>

Through the direct testimony of Company witness Maddipati, the Company has proposed an excess return sharing mechanism as a feature of the IRM. According to Mr. Maddipati, the Company believes that the Company should earn an ROE between 10% and 11% without having to share any excess returns over the Commission authorized ROE with customers. For any earnings over 11%, Mr. Maddipati proposes that the revenue related to those earnings be shared 50% with customers. Once the Company's ROE exceeds an ROE of 12%, the excess earnings or related revenue would be refunded 100% to customers.<sup>88</sup>

As noted above, the Company's Excess ROE Sharing proposal is wholly inadequate. First, the ROE threshold at which sharing begins is set too high. If the Commission sets an allowed ROE in this case of 10% or below, the Company would retain excess earnings of at least \$45 million on the 1% ROE over 10%.<sup>89</sup> This amount is nearly equivalent to the IRM revenue requirement billed in 2020, which indicates that the IRM is not necessary if the Company expects to earn an ROE up to 11%.

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<sup>87</sup> 6 TR 2820 – 2821.

<sup>88</sup> Maddipati direct testimony at page 60.

<sup>89</sup> Calculated on rate base of \$10.667 billion x equity capital of 41.9% from Exhibit A-14 (AJD-1), Scheduled D-1 multiplied by 1%.

Second, the proposal to share earnings after the Company reaches an ROE of 11% is at best disingenuous because in the past five years, from 2013 to 2017, the Company reached an ROE above 11% on a ratemaking basis only once in 2013 when it reported an ROE of 11.01%.<sup>90</sup>

Third, it is not clear from Mr. Maddipati's proposal if the Company would use an ROE calculated on a ratemaking basis or on a financial reporting basis with actual weather-impact on earnings and other items not included in ratemaking.

In summary, the Company's proposal lacks specificity and offers nothing to customers unless the ROE sharing threshold rate is set at the authorized ROE rate established by the Commission in this rate case.

The Company proposal on its face would appear to be nearly a 2-year rate filing moratorium if we assume an annual cycle of rate case filings. Although the proposal may seem appealing, it is important to analyze the conditions placed by the Company to this loose commitment. First, the Company has conditioned its commitment on the premise that it must receive acceptable and timely rate relief in this proceeding. Second, the Company requires that the IRM be approved as

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<sup>90</sup> 6 TR 2822 – 2823.

proposed with no modifications. Third, the Company wants to review the Commission order before committing to the filing moratorium.<sup>91</sup>

The Company has not provided the specific rate relief amount that it considers acceptable. Its requirement for management review of the order gives the Company the right to withdraw its “commitment” for a rate case filing moratorium without negative consequences.<sup>92</sup> In effect, the Company’s proposal to have a 15-day review period of the Commission order so that it can make a firm commitment or withdraw its commitment for a rate case filing moratorium gives the Company veto power over the Commission order.

Even if the rate case filing moratorium survives the Commission’s order in a case, it is not a firm commitment because under the Company’s proposal, the “commitment” can be reversed if certain events, such as catastrophic storms, tax and energy policy changes and loss of a major customer would occur. On page 35 of his direct testimony, Mr. Torrey has outlined even broader categories of events that may result in the Company’s withdrawing from the rate filing moratorium.

The Company simply has not shown that the IRM is needed. It has enjoyed at least five years of returns on equity near or above the authorized level. Act 286 seems to be working as intended in allowing the Company to obtain frequent and

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<sup>91</sup> Michael Torrey direct testimony at page 33.

<sup>92</sup> Exhibit AG-24.

timely rate relief to keep earnings at healthy levels.<sup>93</sup> And, a rate case proceeding is the best venue in which to consider past and future capital expenditures within the context of changes in other costs and revenues. The Excess ROE Mechanism and the proposal to delay filing the next rate case until February 2021 are not adequate consideration for the approval of the IRM. Therefore, the Attorney General recommends that the Commission reject the Company's proposal to establish an IRM.

**VII. The proposed special surcharge to recover CSXT litigation costs should be rejected and replaced by the Company's alternative recovery proposal.**

The Company filed a complaint with the Surface Transportation Board ("STB") in January 2015 claiming that the rail transportation rates charged by CSXT were excessive, arbitrary, and detrimental to Consumers Energy's customers.<sup>94</sup> The Company has incurred approximately \$7.6 million of litigation-related costs from 2015 to 2018. As shown in Exhibit A-35 (RTB-3), most of these costs were incurred in 2015 and 2016.

The Company attempted to recover the litigation costs through the Power Supply Cost Recovery ("PSCR") mechanism. In its order in Case No. U-17918, the Commission determined that litigation expenses were not appropriate for inclusion

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<sup>93</sup> 6 TR 2823 – 2824.

<sup>94</sup> See, page 17 of Mr. Richard Blumenstock's direct testimony .

and recovery in PSCR cases and recovery of this type of expense is more suitable in a rate case. So, in this rate case, the Company is proposing a special surcharge per kWh on customer bills to recover the litigation costs from 2015 to 2018. See, Laura Collins page 25 of her direct testimony and Exhibit A-69 (LMC-6).

**A. The Commission should deny the Company's proposed surcharge to recover CSXT litigation costs.**

Recovery of the litigation costs is premature. There is no assurance that the cost savings presented by the Company in Exhibit A-35 will in fact occur. CSXT has not agreed to the STB determination and in fact it has filed a petition for reconsideration and technical corrections challenging the STB ruling of January 11, 2018. See, Exhibit AG-36. Although the STB generally reconfirmed its earlier ruling in its subsequent order on August 2, 2018, an appeal may be possible. Therefore, litigation is still on-going and the potential savings are still uncertain.

More importantly, the Company has already expensed the litigation costs to O&M expense as they were incurred with a portion expensed subsequent to the Commission order in Case No. U-17918. Further, the Company failed to defer the cost and a request for deferred accounting treatment to permit future recovery as not filed. See, Exhibit AG-37.

It would not be proper for the Commission to now approve recovery of O&M expenses incurred in historical years notwithstanding the order in case No. U-17918 because under the circumstances of this case Such an approval for recovery of O&M

expenses incurred in prior years and not deferred under a Commission cost deferral order would result in prohibited retroactive ratemaking. It is the responsibility of the Company to follow proper ratemaking procedures which in these circumstances would have required that the Company file a request with the Commission to defer the costs for future recovery.<sup>95</sup>

**B. The Commission should approve the Company's alternate proposal to recover litigation costs.**

While approval of the Company's proposed surcharge is unreasonable under the circumstance, the Attorney General agrees that it is important to allow the Company the opportunity to recover a portion or all of the litigation costs up to achieved cost savings in order to provide a purposeful incentive to litigate matters or negotiate a favorable outcome for customers pertaining to power supply costs. The Company's alternative proposal to retain a portion of only the 2015-2017 reparation cost savings achieves that goal. Therefore, the Attorney General recommends that the Commission approve the Company's alternative approach of retaining a portion of the 2015-2017 reparation cost savings to recover all or a portion of the costs incurred for the CSXT litigation.

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<sup>95</sup> In MPSC Case No. U-17918, Mr. Coppola made such a suggestion in testimony on page 14.

**VIII. The Commission should reject the Company's proposed changes to the cost of service allocation for production and distribution costs.**

The Company proposes to change the current production capacity cost allocation methodology of 4CP 75/0/25 to a new method, referred as the Average and Excess ("A&E") cost allocation.<sup>96</sup> According to Company witness Josnelly Aponte this new method better allocates production capacity costs to those customer groups that cause those costs because it differentiates between average demand and excess or peak demand by customer rate class, and allocates costs accordingly using four coincident peak ("CP") times during the year. The financial impact of changing from the 75/0/25 allocation method to the A&E method is a shift of \$16 million of revenue requirement to residential customers and \$3 million to commercial customers for the benefit of approximately \$20 million to Primary rate customers which are mostly large industrial and commercial customers.<sup>97</sup>

The Company also proposes to change the allocation of distribution system costs by allocating more distribution costs based on the number of customers and less on system capacity. The result of this change is to again shift more revenue requirement to residential customers. The Company proposes making only a small

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<sup>96</sup> Beginning on page 10 of her direct testimony, Ms. Josnelly Aponte.

<sup>97</sup> 6 TR 2875,

change in this rate case and address the bulk of the change in the next rate case after it completes gathering additional customer load data and other information.

Other than to shift the revenue burden to residential ratepayers, there is no evidence that the proposed change from the 4CP 75/0/25 to the A&E production capacity cost allocator is an improvement over the existing method. There is no showing or evidence that the A&E is a better allocator of production costs other than reference to theoretical concepts of cost causation.<sup>98</sup> Further, the Company's application of the A&E is vague. For example, it is not clear, that in allocating excess costs, the Company used those capacity costs or a broader set of costs.

[coppola]

More importantly, the Commission decided in Case No. U-17688 to approve the 4CP 75/0/25 method after considerable litigation of the issue. Case No. U-17688 was a specific proceeding to address production capacity cost allocation methods and other cost allocation items presented by the Company, the Commission Staff and several intervenors to the case. Since that order from June 2015, the Company has filed a proposal to revisit the 75/0/25 methodology in almost every electric rate case filed since that date. The Commission has rejected every one of those attempts

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<sup>98</sup> 6 TR 2876 – 2877.

to revise the approved methodology and should do so again in this rate case with regard to the latest proposal to adopt the A&E method.<sup>99</sup>

The Company has not yet collected all the data it needs to perform a more complete study of the allocation of distribution costs. Until that is completed, it is premature and unwise to make any changes to the allocation methodology.

Therefore, the Attorney General recommends that the Commission reject the small changes that the Company has proposed in this area.

**IX. The Commission should reconsider and reject the mandatory transfer of residential customers from Rate RS to the Residential Service Summer on Peak Rate Schedule.**

In response to the Commission order in Case No. U-18322, the Company has proposed the Residential Service Summer On Peak Rate Schedule. The proposed rate schedule includes On-peak and Off-peak rates for both capacity and non-capacity charges during the summer months of June through September with On-peak being defined as the period from 2 pm to 7 pm. The difference between the Off-peak and On-peak capacity rates is approximately 2.2¢ per kWh and the difference between the two periods for the non-capacity rates is about 3¢. See Page 1 of Exhibit A-16, (LMC-3) Schedule F-3, and page 15 of Exhibit A-16 (RLB-2).

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<sup>99</sup> 6 TR 2877.

While the Company has followed the Commission's directive, it has expressed concerns about the cost to implement this new rate schedule and moving all residential customers currently under Rate Schedule RS to the new rate. The Company projects that the total cost to implement the rate change is approximately \$12 million.

The Company has proposed to implement other new voluntary residential rate schedules, such as the Smart House Rate with Universal Rewards for reducing peak time usage and the Nighttime Savers Rate.

The Residential Service Summer On Peak Rate Schedule proposed by the Company will likely result in less rate shock than the summer rate schedule proposed by Staff in Case No. U-18322, which formed the basis for the Commission's directive. Based on bill comparison data provided by the Company, residential customer bills for the summer months on average increase about 3% from the previous RS Rate Schedule. However, it is likely that during those months of high demand and high air conditioning use, the monthly bill could be much higher, potentially creating financial hardship for customers on fixed income.<sup>100</sup>

The Attorney General recommends retaining RS Rate Schedule as a safe-harbor rate for most customers who are not interested in tracking what time of the day they should turn their lights on or off, do their laundry, cook their meals or turn

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<sup>100</sup> 6 TR 2877 – 2880.

their air conditioning unit on. These customers simply want to pay a fair amount for the electricity use at prices that averages high and low use during the month. Time of use rates should be voluntary. The Commission should reject the Company's proposal to transfer customers from the RS rate schedule to the new Residential Service Summer On Peak and make this new rate optional by informing customers of the benefits of the new rate and any potential drawbacks.

**Relief Requested**

The Attorney General respectfully requests the Administrative Law Judge to issue a proposal for decision that is consistent with the positions set forth in the Attorney General's initial brief.

Respectfully submitted,

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**PROOF OF SERVICE - U-20134**

The undersigned certifies that a copy of the *Public Attorney General's Initial Brief* was served upon the parties listed below by emailing the same to them at their respective e-mail addresses on the 9th day of November 2018.

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