

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of  
**DTE ELECTRIC COMPANY**  
for authority to increase its rates, amend  
its rate schedules and rules governing the  
distribution and supply of electric energy,  
for miscellaneous accounting authority

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Case No. **U-20561**  
**(e-file paperless)**

**MICHIGAN PUBLIC SERVICE COMMISSION STAFF'S  
REPLY TO EXCEPTIONS TO THE  
PROPOSAL FOR DECISION**

**MICHIGAN PUBLIC SERVICE  
COMMISSION STAFF**

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## **I. Introduction**

In accordance with the schedule established for this case, the Michigan Public Service Commission (MPSC or Commission) Staff (Staff) files the following Reply to Exceptions to the Proposal for Decision (PFD) issued by the Administrative Law Judge (ALJ) in this matter. Staff continues to vigorously support all the positions taken in its testimony, exhibits and briefs. Given the volume covered in this matter, Staff's failure to opine on any particular exception to the PFD by any party should not be viewed as a concession or abandonment of any Staff position. Staff continues to rely on its original briefs, testimony, exhibits and positions in this case.

## **II. Exceptions**

### **A. Rate Base and Capital Expenditures**

- 1. The PFD correctly rejected the underexplained request for additional spending on other demand response (DR) pilots.**

The Company takes exception with the PFD's recommendation to approve Staff's proposed disallowance for other DR pilots except for the bring-your-own-device (BYOD) and EPRI pilots. (Company's Exceptions, pp 56-58.) The Company repeats its arguments made throughout the case that Staff's concerns would be mitigated by meeting with Staff periodically, that delays in recovery approval would delay pilots, and that approval in the instant case gives the Company flexibility in how pilots are designed. *Id.*

Staff now repeats its counter arguments, which the Administrative Law Judge (ALJ) and Commission found compelling in the Company's recent integrated resource plan (IRP) case, and with which the PFD in the instant case agreed. (PFD, p 202.) The pilots in the instant case for which Staff recommends disallowance are not sufficiently defined. (Staff's Initial Brief, p 10.) Future meetings with Staff are not a suitable substitute for record evidence to support approval for cost recovery. (Staff's Initial Brief, p 11.) The Company may engage in and spend on other DR pilots on its own time without preapproval of cost recovery by the Commission. The Company may then request recovery of prudently spending on pilots through the annual DR reconciliation or longer-term IRP processes. (Staff's Initial Brief, p 11.)

As the PFD recognize these arguments and decided the issue appropriately based on the record, the Commission should continue to approve Staff's recommendation regarding other DR pilots that it previously found reasonable in the Company's latest integrated resource plan case, and not approve the capital spending of those pilots.

- 2. Staff requests that the Commission use factors to make an appropriate determination, partially adopting the Company's exceptions, and reject ABATE's opinion, as adopted by the PFD, regarding accrued or prepaid assets.**

ABATE's proposal, adopted by the PFD, is insufficient to reverse the long-standing inclusion of prepaid pension assets and liabilities in rate base for Detroit Edison, as requested in the Company's exceptions. The Company's exceptions at page 81 should be adopted with the realization that any negative amount would

later result in a liability. The Company's exceptions quote the PFD, stating, "The Commission provided DTE with the opportunity to demonstrate that the entirety of the prepaid pension asset was supplied by investors rather than ratepayer funding. DTE made no effort whatsoever to comply." (PFD, p 250.)

Staff disagrees with the PFD's adoption of ABATE's view that there should be a total bar to inclusion of the pension asset if it not proved to have been *entirely* paid by investors. Instead, a totality of the circumstances should be assessed. Staff will explain how it came to this recommendation that a factor test rather than a bright line test continue to be used in this case and concluded that in this case the prepaid pension asset should be included in rate base.

Since 1987, employers have been required to use Financial Accounting Standard (FAS) 87 for financial reporting of pension costs. FAS 87 requires employers to recognize the cost of their pension plans on an accrual basis rather than a cash basis. Pension cost is recognized over the period during which benefits are earned, or "accrued." Because FAS 87 expense is based on an accrual, and not a cash basis, the annual amount of pension costs recorded is generally different than the actual amount of annual contributions. Over the life of the plan, total contributions are expected to equal total FAS 87 expense, as well as other expenses related to the plan's termination.

A prepaid pension asset or accrued pension liability results from these differences between accrued expense and cash contributions. The Company has accurately defined this difference as, "the cumulative difference between the

Company's pension expense (FAS 87 Expense), *which is funded by customers* and the Company's contributions to its pension trusts, *which is funded by the Company's investors.*" Emphasis Added. (Company's Exceptions p. 81.) The Company states that the excess above the amount funded by customers is the amount that should be included in rate base.

Staff agrees with the Company's definition indicating "who pays what," but with the clarification that when FAS 87 Expense is negative, the prepaid pension asset will increase, (or the accrued liability will decrease) without any contributions to the plan.

In Case Nos. U-13898, U-13899, the Commission Order recognized this phenomenon:

Present accounting procedures require Mich Con to evaluate the yearly costs of pensions that will be provided to its employees. The procedures are designed to produce an appropriate pension expense for an accounting period, but are greatly dependent upon the investment return from pension assets, actuarial projections, plan expenses, etc. Each of these may have a substantial effect on the yearly pension expense to be recorded by the company. For a number of years, this accounting calculation has actually resulted in a negative expense. *The recording of the negative expense creates an asset that is the sum of the various negative amounts—future positive expense amounts would reduce that asset.* Mich Con's existing pre-paid pension expense asset has grown quite large—\$376.3 million, and it forms part of the working capital calculation for the test year.

However, in developing the test-year expenses, it became apparent to the Staff and to Mich Con that the test-year pension expense would be large and would be negative. Such a negative expense when placed within test-year O&M reduces a revenue deficiency, *but does not provide any offsetting cash flow from rates to accommodate the creation and support of the pre-paid pension expense asset.* Rather than continue to see the increased growth of the pre-paid pension expense asset, with its increased working capital requirement, the Staff and

Mich Con both proposed that Mich Con's pension-expense level be established at zero for purposes of setting rates within this proceeding. *The Staff and Mich Con also proposed that the Commission authorize Mich Con to record a regulatory liability in its financial statements for any negative pension costs as determined under generally accepted accounting principles. Thus, any future growth in the prepaid pension asset would be offset by the regulatory liability, eliminating any further growth in the working capital requirement.* [MPSC Case Nos. U-13898, U-13899, 4/28/2005 Order, pp 30-31.]

The Commission adopted Staff's recommendation to keep the prepaid pension asset in rate base in U-13898, U-13899 and to curtail any future growth of the prepaid pension asset with an offsetting regulatory liability equal to the negative NPPC. *Id.*, p 32.

Note that the cumulative difference between FAS 87 Expense and contributions are timing differences that could swing either way – that is, either as a prepaid pension asset or accrued pension liability. Over the course of the pension plan, these differences will either increase or *decrease* revenue requirements.

This, consistency in regulatory treatment is important. It's Staff's understanding that since the adoption of FAS 87, that these differences with regard to Detroit Edison and DTE Electric Company, have been consistently reflected in the revenue requirement.

An Oregon docket highlights why consistency is important. In Oregon Case No. UM-1633, the Oregon Public Utility Commission opened a docket to investigate the ratemaking treatment of pension related costs. Oregon's policy was to recognize FAS 87 Expense only, without regard to the finance costs of the required contributions. It had been that jurisdictions consistent policy to not include prepaid

pension assets or accrued pension liabilities in the revenue requirement. A utility in that jurisdiction requested a change to that policy. In the Order, the Oregon Public Utility Commission stated:

At the outset, the timing of the requested policy change appears opportunistic and does not fairly reflect the history of pension recovery under FAS 87. Prepaid pension assets and accrued pension liabilities fluctuate and are cyclical by nature. Although the Joint Utilities currently have prepaid pension assets, all but one previously maintained accrued pension liabilities... During those periods the utilities benefitted under our current policy, as the accrued pension liabilities were not used to offset their rate base, which would have reduced customer rates... Seeking to include the actuarial balances in rate base now while the Joint Utilities have prepaid pension assets is arbitrary and would produce an unbalanced result.” [Attachment 1, p 9.]

Just as in the case in Oregon where the Joint Utilities proposed a new treatment when the timing difference pendulum swung to their favor, it could be viewed as similarly opportunistic for an intervening party in this jurisdiction to make such a proposal when it swings to theirs. The risk is an unbalanced result.

As such, Staff believes that ABATE’s proposal is insufficient to reverse the long-standing inclusion of prepaid pension assets *and* liabilities in rate base for Detroit Edison. Just because the difference is large due to timing and that it represents an increasingly larger portion of working capital is an insufficient basis to reverse the Commission’s prior determinations. The mere existence of this difference does not, in itself, suggest any questionable activity by the Company. Further, Staff is concerned that, if the PFD and ABATE’s view is adopted, the Commission may set an overall precedent, based on the utility’s present circumstances, using a bright line test that is not necessarily sufficiently nuanced.

Examining each utility's prior treatment of pension expense and related balance sheet impacts holistically should be encouraged instead, using a factor approach.

Staff understands ABATE's concerns, however, and recognizes that the Commission and Staff have consistently used a more nuanced approach. Staff would not prefer a bright line-test, nor a bar, below which the Commission should reject a proposal to include a pre-paid pension asset or liability, or beyond which, their inclusion is adopted, but, rather, an analysis in the Company's next rate case that instead facilitates a further understanding between the stakeholders of this complex issue. Staff proposes a factor test below comprised of appropriate criteria.

For example, such an analysis looking back as far as the adoption of FAS 87, could consider the following:

- 1) whether the Company's funding decisions have cumulatively provided a net benefit to ratepayers or that reduced NPPC in a cumulative amount at least equal to the pre-paid asset sought to be included in rate base has been flowed through to the benefit of utility ratepayers;

- 2) a demonstration that the prior history of ratemaking treatment has been accurately accounted for and that the current levels of pre-paid pension assets have been funded by investors;

- 3) a demonstration of when negative NPPC has occurred, that those benefits have been captured by ratepayers;

4) managements' rationale behind discretionary funding above statutorily set levels with a cost/benefit analysis; and finally

5) whether the differences in timing, when it has resulted in an accrued pension liability, has been symmetrically captured as a reduction in rate base.

Staff does not believe that any one piece of information should be a condition on which the Company, or any given utility, fails or succeeds in including the amounts in rate base because determining some amounts may not be feasible, as it would involve an examination going back decades and the records may not be available. Such an analysis would also rely on a myriad of assumptions, not least of which relates to black-box settlements. Instead, the Commission would examine the totality of the record and weigh the evidence in a way that is fair to ratepayers and investors and develop an ongoing approach that reflects sufficient nuance and fairness. In the instant case, Staff recommends that the Company's request to include the amounts in rate-base be upheld.

**3. The PFD correctly recommended that the Commission reject the Company's proposed fixed bill pilot, including any associated spending.**

The Company takes exception to the PFD's recommendation to reject the fixed bill pilot and repeats its arguments in favor of conducting a fixed bill pilot in its exceptions. (Company's Exceptions, pp 134-137.) Those arguments are: there is customer demand for a fixed bill pilot, fixed bill renewal offers send better price signals than *actual* price signals, the fixed bills pilot is not contrary to the State's energy waste reduction efforts, and a pilot is necessary to study these concerns. *Id.*

Customer demand is not an argument in favor of approving a new pilot or rate. (PFD, pp 414, 416.) Staff posits that there is high customer demand for a pilot in which the Company charges a flat bill of \$0.00 per month, but that is not a compelling reason to approve such a pilot.

A monthly estimated renewal offer does not arguably provide “a much clearer price signal” nor is it “real time” insight. (Company’s Exceptions, p 136.) The ALJ found Staff’s arguments to the contrary persuasive. In particular, the Company’s pilot design includes an assumption that customers will increase their consumption, despite the Company’s forecast for a class-wide consumption decrease. (PFD, p 418.) Staff found this particular argument by the Company “absurd.” (Staff’s Reply Brief, p 16.) The best price signal is a price. The proposed fixed bill renewal offer is based on a mix of approved rates plus two separate markups, which neither the Company nor the Commission calculate. (Staff’s Reply Brief, p 16.)

In its exceptions the Company claims that fixed bill renewal offers provide “real time” insight. (Company’s Exceptions, p 136.) Real time means concurrence with actual events, whereas a monthly estimated renewal offer represents a potential *future* bill based on usage from the *past*. For insight or information to be considered “real time” they must occur in the *present*. It is lost on the Company that it already offers a program that gives customers real time information which can be used along with approved rates (i.e. the actual price signal) for customers to determine future bill impacts. This program is called DTE Energy Insight.

The Company claims that, “The PFD also indicated concerns about energy efficiency (PFD, pp 418-19). But Mr. Clinton convincingly rebutted these and other concerns seriatim (6T 1044-1045,1049-1060).” (Company’s Exceptions, p 136.) This is in error, because Company witness Clinton did not convince a single intervenor with a position on the topic, nor the ALJ. (Staff’s Reply Brief, p 17; PFD, p 418.) The Company’s arguments continue to be unpersuasive despite its claims otherwise.

The Company suggests that Staff’s objections to a fixed bill program appear superficial and can only be addressed through a pilot. (Company’s Exceptions, p 137.) Staff’s objections are the opposite of superficial. A pilot will not address the fundamental flaw that the pilot’s base assumptions are contrary not only to energy waste reduction efforts, argued ad nauseam herein, but also contrary to the base assumptions for the Company’s rate case.

As the PFD appropriately decided the issue based on the record, the Commission should again reject the Company’s proposed fixed bill pilot along with associated spending.

**4. The PFD correctly finds that the Company failed to justify the reasonableness and prudence of its projected capital expenditures for the Digital Engagement Group and recommends its disallowance.**

The Company proposed the establishment of a new Digital Engagement Group at an investment of \$9.2 million (Company Exhibit A-24, Schedule N1.34) which will be “dedicated to improving the Company’s customer experience” (8 TR 2382.) Staff and the Attorney General recommended disallowance of projected

spending for the Digital Engagement Group due to uncertainty in its objectives, benefits, and costs.

The PFD agreed, finding “DTE has failed to justify the reasonableness and prudence of its projected capital expenditures on the Digital Engagement Group” (PFD, p 231.) It also finds “DTE’s effort to present a new ‘business case’ to support the expenditures through Mr. Griffin’s rebuttal testimony is not proper” and that “[t]he Commission has previously made clear that the utility may not reserve line items of capital as a placeholder, only to explain its actual plans in the rebuttal phase” (PFD, p 231.)

As noted earlier, the Company bears the burden of proving its rate case by a preponderance of evidence or face a disallowance of requested costs. Lengthy as Mr. Griffin’s direct testimony was, as noted by the Company (Company Exceptions, p 76), the Company still failed to provide clear evidence supporting the reasonableness and prudence of the Digital Engagement Group costs. The information provided in rebuttal and cross-examination still failed to clarify the benefits and costs associated with the Digital Engagement Group establishment project, as they focused on current digital interaction statistics (Staff’s Initial Brief, p 22.) The PFD agrees, saying “it is clear that the Digital Engagement Group is intended essentially to assist on other ongoing projects, and the benefits Mr. Griffin has claimed for the group are the benefits associated with those other projects” (PFD, p 232.)

To add further confusion regarding the benefits of establishing a Digital Engagement Group, the Company claims “[t]he Digital Engagement Group is responsible for implementing and/or designing many of the projects that have been included in this rate case, and in so doing bring value to the customers” (Company’s Exceptions, p 77). During the discovery phase, the Company asserted that the Digital Engagement Group Establishment “business case is currently under development” (Exhibit S-12.9). However, the Company’s exceptions explicitly state that the Digital Engagement Group has not only been established, it is also responsible for implementing and designing many of the projects in this rate case (Company’s Exceptions, p 77). It is all the more concerning that the Company did not have a developed business case for the Digital Engagement Group if it was already established and responsible for the development of many rate case projects as it now claims.

Regardless of whether the Digital Engagement Group is already established or not, the Company failed to provide a preponderance of evidence as required to establish the reasonableness and prudence of the costs associated with it. The PFD is correct in supporting Staff’s and the Attorney General’s recommended disallowance of all associated costs.

**5. The PFD correctly supports Staff’s and the Attorney General’s recommended disallowances for the 2019 Emergent Project and the Applied Innovation Project.**

The PFD adopts Staff’s recommended disallowance to the 2019 Emergent project as well as Staff’s and the Attorney General’s recommended disallowance to

the Applied Innovation project (PFD, pp 236-37). These disallowances were recommended based on the speculative nature of the costs associated with both programs, due to undeveloped and uncertain business case objectives (Staff's Initial Brief, p 25), and the Attorney General's concerns regarding lacking evidence supporting the project and likely less expensive ways to track Company innovations (9 TR 2999.)

The Company disagrees in exceptions. It believes that given the historical data from the 2018 Emergent project, the Company now has "demonstrat[ed] that the method used to project spending is sound...[and that] [t]he forecasted investment for 2019 Emergent did not prove to be speculative as Staff suggested" (Company's Exceptions, p 78).

As Staff noted, and as quoted by the PFD (p 235), "No guidelines or overall project goals were provided that help check the adequacy or effectiveness of any investments made under this program. Therefore, little weight should be given to the Company's ability to spend down the allocated funds. The Company's ability to spend an arbitrary program budget is not proof of its ability to use funds prudently or reasonably" (Staff's Initial Brief, pp 26-27).

As such, the PFD was correct in supporting Staff's and the Attorney General's recommended disallowances for the 2019 Emergent Project and the Applied Innovation Project.

**6. The PFD is correct in supporting the complete disallowance of the Bill Redesign project.**

Staff recommended complete disallowance of the Bill Redesign project as “the key metric for success was reduction in MPSC billing complaints and ...99.99% of DTE customers have not submitted MPSC complaints” (9 TR 3369). The PFD also noted “[a]s also shown in Exhibit S-12.6, Mr. Griffin also responded that the expected impact of the program on the identified metric ‘is not quantifiable until a solution is in place’” (PFD, p 224.) The Attorney General also recommended a reduction in projected spending for this project due to questionable project value and no identification of any financial benefits for cost savings (PFD, p 224-25.)

The PFD “finds Dr. Wang’s and Mr. Coppola’s testimony persuasive that DTE has not established the reasonableness and prudence of its proposed expenditures on bill redesign. As Dr. Wang concluded, DTE had the opportunity to provide additional metrics of success for the program and did not. As Mr. Coppola testified, DTE had the opportunity to provide a benefit cost analysis in support of its projected expenditures and did not” (PFD, p 226).

The Company disagrees and believes the requested capital recovery for the project should be approved. (Company’s Exceptions, pp 72, 75.) The Company reiterates rebuttal statements that reduction in MPSC complaints is not the sole indicator of success for the program and provides various projected benefits of the program (Company’s Exceptions, p 73; 8 TR 2471-72). However, given Mr. Griffin’s response that the expected impact of the program “is not quantifiable until a solution is in place” (Exhibit S-12.6), the projected benefits are questionable.

The PFD is correct in supporting Staff's and the Attorney General's recommended disallowance of the Bill Redesign project. The burden of proof in the rate case lies with the Company and it did not provide adequate evidence to support the reasonableness and prudence of the Bill Redesign project.

**7. Contrary to the Company's exceptions, the PFD correctly adopts Staff's proposed disallowance regarding Advanced Power Quality Meters, as the installation appears to be arbitrary, not based on need, and with unquantified benefits or costs to justify the investment.**

The Company, in its exceptions is ineffective at rebutting the Staff position, as adopted by the PFD. Staff initially recommended a \$4,450,000 disallowance for costs associated with installation of advanced power quality meters at 950 locations. (9 TR 3366.) First, no study was conducted to quantify benefits. (Exhibit S-12.3; 9 TR 3365.) Second, site selection appears arbitrary (9 TR 3365). The Company selected 950 sites selected based on customers with 1 MW or higher load (Exhibit S-12.3; 9 TR 3365), but it only has 739 customers with loads of 1 MW or higher (Exhibit S-12.3). Third, none of the selected sites presented historical or current power quality issues (Exhibit S-12.3; 9 TR 3365-3366). Lastly, the AMI 3G to 4G industrial communication upgrade can occur without installing advanced power quality meters (Exhibit S-12.3; 9 TR 3365).

In rebuttal, the Company proposed an alternative request to replace existing 3G meters at the 950 sites with a non-power quality 4G meter for \$1,358,500 (9 TR 2634). In brief, Staff agreed that the Company should be allowed to install a non-

power quality 4G meter instead at the sites and used the Company's updated cost numbers in rebuttal to recommend a revised disallowance of \$3,820,000.

In exceptions, the Company describes how discovery works in response to the PFD reasoning that DTE had "ample time to explain the need for the advanced quality meters in response to Staff's discovery" (PFD, p 179.) The Company says, "[it] is not reasonable to expect DTE Electric to repond [*sic*] rapidly to discovery and anticipate every position, question or impression of the numerous parties to this proceeding. Due process and fair treatment require that discovery not be utilized as suggested in the PFD." (Company's Exceptions, p 49.)

However, the Company fails to recall that the burden of proof in the rate case rests with the utility. Pursuant to MCL 460.6a(1), an electric, gas, or steam utility must receive approval from the Commission to increase its rates and charges. "[I]n matters before the Commission where statutory law is silent regarding the correct quantum of proof needed to review a utility's costs, the Commission assesses those costs using the preponderance of the evidence standard adopted in civil cases." *In re Detroit Edison Co on Remand*, MPSC Case No. U-15768, 10/17/2013 Order, p 16, citing *Residential Ratepayer Consortium v Public Service Comm*, 198 Mich App 144, 149 (1993). MCL 460.6a(1) does not alter that burden. DTE, therefore, has the burden of proving its rate case by a preponderance of evidence or face a disallowance of costs requested.

Preponderance of the evidence means "such evidence as, when weighed with that opposed to it, has more convincing force and the greater probability of truth."

*People v Pugh*, 48 Mich App 242, 245 (1973). The Michigan Supreme Court has explained how administrative agencies should apply this standard:

The comparative degree of proof by which a case must be established is the same in an administrative as in a judicial proceeding – that is, a preponderance of the evidence. It is not satisfied by proof creating an equipoise, but it does not require proof beyond a reasonable doubt. No essential issue may be left to surmise, guess, or conjecture, for an administrative body cannot base an award or decision upon conjecture or speculation, although a determination may properly be based on circumstantial evidence. [*Dillon v Lapeer State Home & Training Sch*, 364 Mich 1, 8; 110 NW2d 588 (1961) (quotation marks and citation omitted).]

The Company failed to provide any evidence that investment in the advanced power quality meters at the proposed approximate 950 sites is prudent or reasonable. As the Company bears the burden of proving its rate case by a preponderance of the evidence, it should have provided sufficient evidence in its initial application and testimony to support its case, instead of depending on Staff or intervenor discovery questions to request such evidence. The Company, as well, can conduct discovery, if it wishes to clarify Staff's positions prior to trial.

With no analyses or evidence to support its claims, the Company's assertions, which it continues to provide even in exceptions to the PFD, are essentially conjecture or speculation. As noted above, the evidence presented is insufficient based upon which an administrative body may grant the Company's request. As such, the PFD is right to adopt Staff's recommendation to disallow funds associated with the installation of advanced power quality meters at 950 industrial sites. And, the Company's exceptions should be rejected.

**8. The PFD correctly adopts Staff's proposal to disallow the \$2M Optimization Phase to Install Additional Cell Relays of the AMI 3G to 4G Communication upgrade project.**

Staff recommended a \$2,000,000 disallowance of the Optimization Phase to Install Additional Cell Relays project. The project is to strengthen the communication network from 99% to 99.5%. (Exhibit S-12.1), and the Commission has previously disallowed funds to further strengthen the AMI communication network as it was already above the required 85%. (9 TR 3363.) The PFD supported Staff's disallowance. (PFD, p 182.)

In exceptions, the Company disagrees, emphasizing once again that the "main purpose of strengthening the communications network is to *sustain* read rates, not *improve* them." (Company's Exceptions, p 51.) As noted in Staff's brief, "Staff...disagrees with the Company that increasing read rate from 99% to 99.5% is a sustainment of current read rates. It is clearly an improvement and strengthens the current AMI read rate. Sustainment would entail remaining at a 99% read rate." (Staff's Initial Brief, p 33.) The ALJ agreed that "this is a planned improvement." (PFD, p 182.)

The Company's claim that the Optimization Phase is both reasonable and prudent is unsupported by evidence. The burden of proof in the rate case, as noted above, rests with the Company. In exceptions, the Company reiterates that the cost to strengthen the AMI communication network through the Optimization Phase, which addresses pockets of meters affected by vegetation, is prudent, without any evidence to support that claim. (Company's Exceptions, p 51.) In its brief, Staff

noted that there may be other possible solutions to the AMI communication issue presented by vegetation, such as tree trimming. However, “No analysis of the benefits or costs associated with the proposed solution and alternative solutions were provided to demonstrate that the \$2M optimization phase to install additional relay devices is the most reasonable and prudent solution.” (Staff’s Initial Brief, p 33.)

The PFD is correct in supporting Staff’s disallowance of the \$2M Optimization Phase to Install Additional Cell Relays. The Company’s claims of reasonableness and prudence are unsupported by evidence. The project is to increase AMI read rate from 99% to 99.5%, which is an improvement and not sustainment of the AMI read rate. Past spending for projects increasing AMI read rates beyond the required 85% have been disallowed. Therefore, Staff requests that the Company’s exception regarding the PFD’s disallowance be rejected.

## **B. Capital Structure and Rate of Return**

### **1. Return on Equity**

As stated in the Company’s exceptions, the PFD recommends a weighted, after-tax overall rate of return of 5.42% (PFD, pp 303, 440 and Appendix D). The Company states further:

DTE Electric agrees with the PFD’s recommended capital structure (PFD, p 257), but takes exception regarding the PFD’s cost factors of 4.22% for long-term debt and 2.73% for short-term debt (PFD, p 264), and 9.8% return on equity (ROE). (PFD, pp 302, 440). The Company requests a weighted, after-tax 5.73% overall rate of return (6T 1461; Exhibit A-14, Schedule D1, line 10, column (g)...”)

Staff requests that the Company's exceptions regarding ROE be denied and that the PFD be upheld.

**2. DTE Electric's claim that the PFD's recommended ROE was unfairly low is unsupported.**

Staff disagrees with DTE Electric's claim that the PFD's recommended ROE was unfairly low. Staff recommended a ROE of 9.8%, which was adopted by the PFD. The PFD quotes Staff's analysis as follows:

The average authorized ROE of the proxy group is 9.69%. Schedule D-5, page 3 of 12 describes the realized return on common equity for the proxy group and DTE Electric from 2014 through 2018. The average return on equity over the 5-year period for the proxy group was 8.9% and for DTE Electric was 10.44%. Thus, on average, the proxy group's financial return did not reach its average authorized return on equity over the five-year period. **However, DTE Electric earned over its authorized ROE of 10.00% on average over the period, earning well above its allowed ROE in 2014, 2016 and 2018 and earning its authorized in 2015 and 2017.** [Emphasis supplied. PFD, p 275.]

DTE's exceptions rely on arguments that have been recently and soundly rejected by the Commission, such as "the challenging Michigan economic environment, the differences in financial risk for DTE Electric as compared to the sample companies," as the ALJ points out in her well-reasoned opinion. (Company's Exceptions, p 93.) Staff requests that the Commission reject DTE Electric's exceptions to the PFD as unfounded concerning its adoption of a ROE of 9.8%, which balances ratepayer and Company interests.

**3. DTE Electric's exceptions that the cost factors for long-term and short-term debt should be rejected.**

Staff submits that DTE's exceptions should be rejected concerning Staff's updated cost factors for long-term and short-term debt, as adopted by the PFD. The PFD was correct in stating:

Contrary to [DTE witness] Mr. Solomon's preference, it is common in rate cases for Staff to update the debt costs and for the Commission to rely on the updated figures. While interest rates fluctuate, there is no suggestion here that Mr. Ufolla cherry-picked an aberrant or unreflective date on which the interest rates were particularly low, and indeed, his testimony reflects his considered opinion that interest rates would continue to be lower than DTE's projection. The interest rates cited by Mr. Solomon in his rebuttal testimony, not incorporated into a revised projection, are nonetheless lower than the interest rates underlying the company's filing. Thus, this PFD concludes that the updated debt costs projected by Staff should be adopted in this case. [PFD, p 264.]

There is no reason for the Commission to depart from its well-established practice of updating interest rates, and the PFD's cost factors for long-term and short-term debt should be upheld.

**4. Long-Term Debt Rate**

In the PFD, Staff believes the ALJ correctly stated that a long-term debt rate of 4.22% is appropriate for this case (PFD, p 264). Staff's recommendation for the long-term debt rate is in line with the PFD. (9 TR 3319.) In its exceptions to the PFD, DTE Electric Company (the Company) continues to insist that its 4.31% is appropriate despite the derivation of that figure being from projections that were not as recent as those utilized by Staff (PFD, p 92.) As discussed in Staff's brief, it is appropriate to use the most recent projections for development of cost rates for a

rate case. (Staff Initial Brief, pp 41-42.) Additionally, as pointed out by the ALJ, the projections used by Staff were not “cherry-picked” to artificially lower the cost rate. (PFD, p 264.)

The Company’s argument about the everchanging nature of interest rates being reason to not update projections in a rate case is erroneous as new rate projections are released each month in order to attempt to more accurately predict what the future rates will be. It is true that interest rates change and will continue to change; but as the ALJ correctly points out, it is common for Staff to update rates and rates will likely remain lower than the Company’s projection going forward (PFD, p 264). Additionally, the Company has not stated at any point in the instant case that Staff’s recommendation is unreasonable. Thus, the Commission should approve the long-term debt rate of 4.22% as recommended by both Staff and the ALJ.

### **5. Short-Term Debt Rate**

In the PFD, Staff also believes the ALJ correctly stated that a short-term debt rate of 2.73% is appropriate for this case. (PFD, p 264.) Staff’s recommendation for the short-term debt rate is in line with the PFD. (9 TR 3319.) In its exceptions to the PFD, the Company continues to insist that its 3.25% is appropriate citing the same reasoning used to attempt to justify its long-term debt rate. (DTE Exception, p 93.) For the same reasons that pertain to long-term debt rate, as found above, Staff disagrees and maintains this argument erroneous. Thus, the Commission should approve the short-term debt rate of 2.73%, as recommended by both Staff and the ALJ.

## **C. Net Operating Income**

### **1. Fuel and Purchased Power Revenue and Expense**

Staff stands by its original position in its Initial Brief, which involved adjusting both PSCR revenue and PSCR expense to reflect historical loss percentages. (Staff's Initial Brief, pp 65, 68.) The PFD correctly summarized Staff's proposal on page 310. However, Staff still disagrees with DTE's position as stated in its Initial Brief and Exceptions to the PFD, while also arguing that the line loss study and the loss factor are not related. In the alternative, Staff maintains its original position but would not object to the position articulated in the PFD; recommending staying with the already in place loss factor until a loss study could be done.

### **2. The Company over-collected revenue for RIA credits not disbursed due to billing error, so the error should be incorporated in future RIA enrollment estimates.**

The Company disagrees with the PFD's finding that Staff's reliance on the 5-year historic average for RIA enrollment be used for projected test year enrollment, and thus test year revenue. (Company's Exceptions, p 140.) Because it fixed the billing error attributed to the severe decrease in RIA enrollment in 2018, the Company expects increased enrollment in the test year. (Company's Exceptions, p 139.) However, Staff's use of the 5-year average enrollment for its projection not only incorporates the possibility of future billing system errors but also any over-or under-collection of revenue when compared to actual enrollment during the historic period. In other words, Staff's method smooths out the impact of unusual

circumstances like billing system errors over a number of years, while also allowing for normal variance between actual enrollment and revenue collection.

For these reasons the Commission should concur with the PFD that Staff's method of setting test year projected RIA enrollment to the 5-year historic average. This recommendation does not limit any customer from enrolling but is only used for rate setting to collect the revenue necessary to offset the credit.

**3. DTE's exceptions on the low-income renewable program should be rejected.**

In its exceptions, DTE provides no arguments that make its proposed low-income renewable pilot any more palatable to Staff. (Company's Exceptions, pp 137-39.) Staff sees no reason for the Commission to deviate from the PFD's conclusion that the program be disallowed. (PFD, pp 336-37, 423.) Staff's brief thoroughly explained why this program should not be approved as proposed by DTE, as it does not actually provide benefit to low-income customers. (Staff's Initial Brief, p 126.) Staff recommends that the Commission adopt the PFD's finding that the Company should work closely with the Staff's Renewable Energy and Energy Waste Reduction sections and other stakeholders, to design a pilot that provides low-income customers a program that combines renewable energy (RE) with energy waste reduction (EWR), weatherization measures, and other tangible benefits to those customers. (PFD, p 423.) Therefore, DTE's exceptions regarding its low-income renewable pilot should be rejected for the reasons contained in the Staff's initial brief and the PFD.

#### **D. Distributed Generation**

In its exceptions, GLREA argues that Rider 18, also referred to as the DG tariff, is inadequate and not cost based and that the Commission should revisit this tariff in a separate filing. (GLREA Exceptions, p 5.) Staff responded to those arguments thoroughly in its reply brief on page 30. The PFD recognized this, as well as other parties' contra arguments, and appropriately ruled against GLREA. (PFD, pp 404-8.) In addition, GLREA excepts to the claim in the PFD that GLREA's arguments were addressed in the previous case, stating that Staff failed to respond to its arguments in the previous case. (GLREA Exceptions, p 5.) This is incorrect. A review of the record in that case will show the PFD was correct and these arguments were, in fact, addressed by Staff and the Commission.<sup>1</sup> GLREA's exceptions should be rejected for the reasons above, and the Commission should accept the recommendations of the PFD.

#### **E. The number of eligible customers is not a compelling reason to increase the cap for LIA enrollment.**

The Company argues in its exceptions that there are a sufficient number of eligible customers for the LIA credit and that it does not expect under-enrollment. (Company's Exceptions, p 140.) No parties to the case disputed this expectation. Staff instead objects to increasing the enrollment limit for the credit because it has yet to show measurable success as discussed by Staff and NRDC/SC/MEC/AG. (PFD, p 436.) The PFD correctly recommended a formal study of the Company's

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<sup>1</sup> See, for example, 8TR 4245-4254 in MPSC Case No. U-20162, and MPSC Case No. U-20162, 5/2/2019 Order, pp 171, 178, 181, 182, 190, 191-194.

LIA credit along with Staff's recommendation to continue the cap on enrollment. The Commission should adopt the PFD's recommendation regarding customer credits.

**F. Cost of Service and Rate Design**

- 1. It is unimportant if Staff's present revenue adjustment related to PSCR forecast artificially increases the revenue deficiency.**

In its exceptions, the Company points out that Staff's application of a negative PSCR factor to incorporate its recommendation regarding PSCR base expense would increase the revenue deficiency. (Company's Exceptions, p 107.) The Company agreed with Staff on its adjustment to PSCR base, but not on the corresponding adjustment to present revenue. *Id.* It is important to note that the Commission does not approve a revenue deficiency, but rather rates based on a revenue requirement. The deficiency is the difference between present revenue and approved test-year revenue, or revenue requirement. While the revenue deficiency in Staff's case may be higher with Staff's adjustment to present revenue, the ultimate revenue requirement is unchanged. Present revenue is the "before," revenue requirement is the "after," and revenue deficiency is the difference. Changing the "before" only affects the difference, not the "after." Staff made the adjustment to present revenue to preserve the function of the rate design model, and values such a preservation despite the increase in a derivative measure of the revenue requirement. Therefore, the Commission should incorporate any necessary

adjustment to present revenue based on the decision on PSCR loss factor into its final order.

**2. The Commission may clarify the tariff for Rate D8 after the instant case, but before the conclusion of the Company's next general rate case.**

The Foundry Association and Energy Michigan agree with the PFD that the tariff language for Rate D8 is insufficiently clear but disagree that delaying clarification until the next rate case is necessary. (Foundry Association and Energy Michigan's Exceptions, p 5.) Staff posits that there is a third option not yet considered by the ALJ or the Foundry Association and Energy Michigan. The tariff language may be updated *ex parte*, outside of a rate case, because such a change would not change the cost of service for any customer. Staff is currently engaging with customers, utilities, and other stakeholders to review interruptible tariffs, including Rate D8, as part of the Commission's MI Power Grid initiative.

If the Commission decides to not grant the relief requested by the Foundry Association and Energy Michigan in the instant case, it may still approve clarified tariff language for Rate D8 as part of an order at the conclusion of Staff's workgroup well before the conclusion of the Company's next rate case.

**3. Soulardarity's arguments were not misunderstood or conflated, they were misplaced and wrong with respect to where Soulardarity should seek relief.**

Soulardarity claims that the PFD misunderstood its arguments regarding investment in the quality of service received by some customers. (Soulardarity Exceptions, p 5.) However, Soulardarity then goes on in its exceptions that,

“[w]here the funding for this program comes from is separate from and secondary to ensuring comparable quality of service among ratepayers in the same class.” *Id.* In the context of a general *rate case* Soulardarity is incorrect. The purpose of the instant case is to set rates to recover revenue based on cost causation as described by the cost of service study. Staff directs Soulardarity to the Company’s distribution planning process, where it may seek relief relevant to its concerns.

## **G. Future Rate Cases**

### **1. The PFD correctly supports reiteration of the Commission’s IT reporting guidance and adoption of Staff’s recommendations.**

The PFD correctly recognizes the need for IT reporting guidance. Two focus areas for the Company’s reporting are:

- provide evidence of prudent and reasonable spending for historic and year to-date spending when submitting the rate case for any business case where the program objectives are not determined until each initiative is approved, and
- concisely and clearly state and quantify the initiative objectives and benefits to allow an assessment of its value

While reviewing IT business costs and projected spending, Staff found that “many business case specific exhibits still did not provide enough information to assess its purpose and benefits” (Staff’s Initial Brief, p 122). The PFD recommends the Commission adopt Staff’s recommendations listed above and for the Commission to reiterate the reporting criteria adopted in U-20162.

In exceptions, the Company does not dispute the existing filing requirements but otherwise disagrees with the PFD’s assessment that “DTE did not make an

organized or coherent presentation in support of its IT capital expenditures, and did not fully comply with the Commission’s filing requirements” (PFD, p 241.) The Company asserts that “it made a good faith effort to fulfill the requirements” (Company Exceptions, p 59.) It goes on to detail the information it provided, its location, and the filing requirements that it was intended to satisfy at length.

The PFD finds that for a selection of workpapers relating to the top 25 IT projects, “ostensibly intended to meet the ‘Part III’ filing requirements..., *all* fail to quantify benefits, *all* report that no benefit-cost analysis was conducted, and *all* fail to identify any alternative considered to the project. This comes along with the Company’s acknowledgement that the top 25 projects represent 75% of the Company’s projected spending” (PFD, p 206).

The Company notes in exceptions that “a cost/benefit analysis is not required for every business case as the ALJ seems to state...There is no requirement that the Company actually perform a cost/benefit ratio analysis for any particular business case included either in the Part III filing requirements or in the Commission’s specific instructions included in its order in the Company’s last general rate case regarding IT.” (Company’s Exceptions, p 60).

In U-20162, the Commission adopted additional IT reporting requirements MPSC Case No. U-20162, 5/02/2019 Order, p 44-45. In the order, the Commission stated that “representative investments must be supported by a demonstration of the need for the investment (what is its priority and why) and the cost of the investment.” *Id.*, p 42. Staff argues that the need for an investment is in part

proven by the project objectives and its anticipated benefits. In this case, the Company did not express business case objectives and expected benefits clearly or consistently. The Company affirms that it is not currently required to conduct cost benefit analyses or provide cost benefit ratios. Given that the Company currently provides cost information, it only needs to assess expected program benefits to conduct a cost benefit analysis.

As such, Staff continues to recommend adoption of additional requirements for the Company to (Staff's Initial Brief, p 124): (1) concisely and clearly state and quantify the initiative objectives costs and benefits in monetary terms; and (2) provide evidence of prudent and reasonable spending for historic and year to-date spending for any business case where the program objectives are not determined until each initiative is approved.

The PFD was correct in supporting the adoption of these additional recommended requirements along with reiteration of current IT reporting requirements, as it will help provide Staff necessary information to review future IT programs for reasonable and prudent spending.

- 2. Contrary to the Company's exceptions, the PFD should be adopted as supporting Staff's recommendations for actual historical evidence of AMI benefits to be provided, while also clarifying the information the Company should present to meet its guidance.**

The Company exceptions should be rejected, which imply that the PFD agreed with the Company that historical evidence of AMI benefits are not necessary. (Company's Exceptions, p 52.) Staff recommended the Company

continue reporting AMI benefits and to supply actual yearly realized AMI benefits data in addition to the forecasted values from AMI installation to the present. The Company proposed to cease reporting the information in Exhibit A-19, Schedule II, which provides projected AMI benefits from 2019 to 2030, as “...most of the initial benefits for AMI are already realized” due to near complete AMI installation in 2018. (9 TR 2618.) Though AMI installations are nearly complete, Staff points out that AMI benefits will continue to accrue as the Company better leverages AMI data and functionalities. The “true benefits of AMI do not arise from technology implementation and data collection [but]...from the analysis and use of AMI data to improve Company operations and to improve customer experience.” (9 TR 3361.)

The intent of the AMI benefit information is to meet the Commission’s directive in U-18255, which states, DTE Electric “will provide the Commission with important evidence on the record regarding the ongoing and long-term benefits of AMI” *In re DTE Electric Company’s 2017-2018 Rate Case*, MPSC Case No. U-18255, 4/18/2018 Order, p 84.

Contrary to the assertions in the Company’s exceptions, the PFD quoted Staff’s testimony, saying “the benefit forecast information DTE provided does not comply with the requirements established by the Commission in Case No. U-18255:

Forecasted benefits may differ significantly from actual realized benefits due to forecasting methods and assumptions. Forecasts only provide the best guess of future performance and cannot serve as evidence of realized benefits. Only actual realized benefits from AMI implementation can demonstrate the ongoing and long-term benefits of AMI technology.”<sup>2</sup>

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<sup>2</sup> PFD, p 367. Staff quote from 9 TR 3359.

The PFD also discusses and rejects the Company's objections to providing actual realized benefits of AMI implementation, where the Company says a full-time staff member would be required. The PFD quotes Staff's concerns and conclusion that "[i]f the Company is routinely tracking the implementation of its programs, their ongoing costs and realized benefits, and providing redirection as needed, then the aggregation of benefits from AMI programs should not require an additional staff member."<sup>3</sup>

The PFD finds that "DTE should continue to comply with the AMI reporting requirements the Commission has already established and should work with Staff to make sure that it is not misunderstanding the work involved." (PFD, 367).

The PFD does not "[implicitly reject] Staff's additional reporting requirements" as the Company states in its exceptions (DTE Exceptions, p 52). The PFD quotes Staff's testimony that evidence can only be actual realized historical AMI benefits. (PFD, p 367.) The PFD speaks for itself and finds that the Company misunderstands the work needed to provide evidence of AMI benefits. As only actual realized AMI benefits serve as evidence, it appears the PFD finds Staff's recommendation necessary to comply with the existing Commission requirements.

Instead of adopting Staff's recommendations and directly requiring them to be followed, the PFD instructs the Company to work with Staff to comply correctly with the Commission's established requirements. Staff recommends that the

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<sup>3</sup> PFD, p 368. Quote from Staff brief, p 21.

Commission adopt Staff's recommendations and provide clarity in its final determination by detailing that actual realized historical AMI benefit information is required to comply with the Commission's established requirements.

### **III. Conclusion**

Staff respectfully requests the Commission adopt all of Staff's positions presented and explained in its testimony, exhibits, Initial Brief, Reply Brief, Exceptions to the Proposal for Decision and these Replies to Exceptions to the Proposal for Decision. Staff reiterates that failure to respond to any parties' arguments should not be construed as agreement with those positions. Staff maintains and stands by all of the positions stated in its case and briefs.

Respectfully submitted,

**MICHIGAN PUBLIC SERVICE  
COMMISSION STAFF**

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Dated: April 7, 2020

U-20561/Replies to Exceptions 4-7-20

# Attachment 1

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON**

UM 1633

In the Matter of

PUBLIC UTILITY COMMISSION OF  
OREGON,Investigation into Treatment of Pension  
Costs in Utility Rates.

ORDER

**DISPOSITION: USE OF FAS 87 RECOVERY AFFIRMED; PROPOSAL TO  
PLACE ACTUARIAL ACCOUNTS IN RATE BASE REJECTED**

We affirm our policy of allowing a utility to recover its pension contributions through Financial Accounting Standard 87 (FAS 87) expense and reject the Joint Utilities' proposal to include their prepaid pension assets and accrued pension liabilities in rate base.

**I. INTRODUCTION**

We opened this docket to investigate the ratemaking treatment of pension-related costs and to determine policy for how utilities should recover these costs on a going forward basis. We did so after utilities in various proceedings requested that we expand our approach to pension cost recovery to include costs that our current policy does not address. Specifically, the utilities noted that our current recovery policy—based on the expense determined under FAS 87—does not provide recovery for any costs incurred by the utilities to finance the required contributions to their pension plans.

We divide our order into three parts. First, to provide a proper context for this investigation, we begin with a discussion of pension plans and how they are regulated. We describe the accounting and funding requirements that govern pension plans, how employers calculate FAS 87 expense, and how we have treated pension costs in utility ratemaking.

Second, we summarize the recommendations of the parties. A group of utilities propose changes to our current pension policy to allow the recovery of financing costs. These utilities, which we will collectively refer to as the Joint Utilities, are PacifiCorp, dba Pacific Power; Portland General Electric Company; Northwest Natural Gas Company, dba NW Natural; Avista Corporation, dba Avista Utilities; and Cascade Natural Gas Corporation. All other parties recommend no changes to our method of pension cost recovery or recommend significant changes to the Joint Utilities' proposal. These parties

include Commission Staff, Idaho Power Company, the Citizens' Utility Board of Oregon (CUB), the Industrial Customers of Northwest Utilities (ICNU), and the Northwest Industrial Gas Users (NWIGU).

Finally, we provide our resolution and reasoning to reject the Joint Utilities' proposal and affirm the use of FAS 87-based recovery.

## II. BACKGROUND

A "defined benefit" pension is an employer-sponsored retirement plan through which employees accrue benefits and receive specified payments after they retire. The payments made under pension plans are guaranteed and an employer must keep the plan funded at a level to meet this obligation.

Pension plans are highly regulated. The Employment Retirement Income Security Act of 1974 (ERISA) and the Pension Protection Act of 2006 (PPA) establish funding requirements to provide benefit security for retirees by protecting the assets of pension plans to guarantee payment of benefits.

Employers fund a pension trust with cash contributions or investments. A custodian is tasked with managing the funds' assets solely in the interests of participants and beneficiaries. The returns on fund investments increase the pool of assets, which is used to pay retirees.

### A. Accounting Requirements

Since 1987, employers are required to use FAS 87 accounting standards for financial reporting of pension costs. FAS 87 requires employers to recognize the cost of their pension plans on an accrual rather than a cash basis. In other words, pension cost is recognized over the period during which benefits are earned, or "accrued"—that is, during the working years of the employees that will receive the pension benefits during retirement.

Because FAS 87 expense is based on an accrual, not cash basis, the amount of pension costs recorded is generally different than the actual amount of annual contributions made. Over the life of the plan, however, total contributions are expected to equal total FAS 87 expense (as well as FAS 88 expense related to pension plan termination).

The FAS 87 expense, which can be positive or negative, is calculated based on four components:

- Service cost – The value of the benefits earned, or accrued during the current year based on the applicable benefit formula for each participant.
- Interest cost – The interest on the pension plan liability (projected benefit obligation) for the year. This amount increases pension cost and represents the time value of money on the benefit obligation.

- Expected return on assets – The expected return on assets for the year, which if positive will reduce pension cost. The difference between the actual return on assets and the expected return on assets represents an actuarial gain or loss that will be recognized in future pension cost.
- Amortizations of unrecognized costs – The change in liability due to plan changes, changes in actuarial assumptions used to value plan liabilities, differences between past differences between expected and actual asset returns, and other unrecognized gains and losses.

When the pension fund trust is producing significant investment gains, the FAS 87 expense can be negative, signaling that the trust is in good financial health. When the pension fund investments lose value, the FAS 87 turns positive, signaling a need for increased contributions.

## **B. Funding Requirements**

Employers use actuaries to determine the amounts to contribute to the plans. Contribution levels are designed to meet specified targets, which are typically guided by federal minimum funding requirements based on the value of plan assets and the projected future obligation.

Employers are generally required to annually fund the amount of benefits being earned for the year plus a portion of any unfunded liability. Traditionally, ERISA required employers to amortize any unfunded liability over a 10 to 15 year period. The PPA included additional requirements to ensure that a plan is fully funded. Among other changes, the PPA decreased the period for amortizing the unfunded liability to 7 years, which has accelerated and front-loaded required employer contributions.

Due to these funding obligations, employers are required to make contributions to their pension plans that are often significantly different than their recorded FAS 87 expense in any given year. If cumulative contributions exceed recorded FAS 87 expense, the difference is recognized as a *prepaid pension asset*. If cumulative contributions are less than the recorded expense, the difference is recognized as an *accrued pension liability*.

A prepaid pension asset represents only the financial accounting difference between actual contributions and the FAS 87 determined accruals. For this reason, a prepaid pension asset balance does not necessarily represent the cumulative contributions to a pension fund. A decrease in FAS 87 expense due to excess returns earned on the pension fund will increase the prepaid pension asset balance—regardless of whether the employer made any cash contributions.

Employers may make contributions above minimum funding obligations; however, the Internal Revenue Code contains provisions limiting the maximum tax deduction for pension fund contributions. Contributions above the minimum funding obligation and up to the maximum tax deductible amount for the year are often referred to as discretionary contributions.

### C. Rate Recovery

All the utilities have defined benefit pension plans. With the exception of Idaho Power and Avista,<sup>1</sup> all the defined benefits plans are closed and are not being offered to new employees.

Prior to the adoption of FAS 87 in the late 1980s, most regulatory commissions allowed utilities to recover, as an operating expense, their annual cash contributions to the pension plans. Some jurisdictions, including the Idaho Public Utilities Commission, still use cash contributions for purposes of setting rates.

Since its inception, however, FAS 87 expense has been used by a majority of commissions, including Oregon, as a proxy for cash contributions when setting rates. The use of FAS 87 to determine utility operating expense has been favored because it spreads the cost of the plan over a reasonable period of time and is less volatile than actual cash contributions.

In Oregon, NW Natural was the first utility to seek a switch to FAS 87-based rate recovery in 1986. The other utilities followed suit until the Commission had approved, by 1998, requests by all the Joint Utilities and Idaho Power to recover pension costs through FAS 87 expense. Under this approach, utilities recover their pension contributions through an annual FAS expense forecast in a test year period. At the time of transition to FAS 87-based recovery, no utility sought recovery of financing costs to address the issue of the potential timing differences between the build-up of a prepaid pension asset and its amortization through FAS 87 expense.

As expected, the utilities' pension contributions have not matched the forecast FAS 87 expense, and the utilities have had, at any given time, either a prepaid pension asset or an accrued pension liability. Since use of FAS 87 was implemented, all but one utility has had an accrued pension liability. For example, PacifiCorp, shortly after it switched to FAS 87-based recovery, twice had an accrued pension liability balance that exceeded \$100 million. Currently, however, all but one energy utility has a prepaid pension asset:

Utility	Prepaid Pension Asset (Accrued Pension Liability) <sup>2</sup>
Avista	\$80.7M
Cascade	\$17.7M
Idaho Power	(\$28.8M)
NW Natural	\$25.2M
PacifiCorp	\$310M
PGE	\$76.6M

<sup>1</sup> Avista's defined benefit plan is still open to union employees, but only in Idaho and Washington.

<sup>2</sup> Idaho Power's balance is from December 31, 2012; all others are from December 31, 2013.

### III. POSITIONS OF THE PARTIES

All parties favor the continued use of FAS 87 expense for ratemaking purposes for the return of the utilities' pension plan contributions. They generally agree that FAS 87 is a reasonable proxy for cash contributions when determining utility operating expense, and oppose reverting back to the recovery of actual cash contributions due to the volatility of short-term funding requirements.<sup>3</sup>

The parties disagree, however, as to whether our current pension cost recovery policy should be revised to allow the utilities the opportunity to recover financing costs associated with prepaid pension assets. We summarize their arguments below.

#### A. Joint Utilities

The Joint Utilities contend that the passage of the PPA, coupled with financial market downturns, have significantly increased the Joint Utilities' required contributions to their pension plan funds and have accelerated the timing of such required payments. Moreover, the Joint Utilities contend that these prepaid pension assets will persist for many years, particularly because the increased cash contributions also serve to immediately decrease FAS 87 expense to be recovered in rates. For this reason, and given the growth of their prepaid pension asset balances, the Joint Utilities contend that recovery of FAS 87 expense only—with no recovery of the financing costs—has resulted in pension cost recovery that is no longer fair or reasonable.

In addition to the *return of* pension costs through FAS 87, the Joint Utilities now seek a *return on* the cash contributions to cover the financing costs associated with prepaid pension assets. To accomplish this, the Joint Utilities request that prepaid pension assets be added to rate base, where they will earn a return at their respective cost of capital. The utilities contend this will provide them an opportunity to recover the financing costs associated with the cash outlay in excess of the cumulative accrual expense until the cash costs have been recovered in rates. The Joint Utilities state this proposal is consistent with the Commission's practices for other investments, where it allows a return of the investment (through the recovery of depreciation expense) and a return on the investment (representing the utility's financing costs).

The Joint Utilities emphasize that they are only seeking to recover future—not past—financing costs. They seek approval of a methodology that allows them to recover only the costs they incur in the future to finance pension contributions until FAS 87 expense allows the return of the contributions.

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<sup>3</sup> Although Idaho Power currently recovers its pension costs in its Idaho jurisdiction on a cash basis, the company does not request a transition in Oregon from FAS 87-based rate recovery to cash-based rate recovery.

The Joint Utilities also clarify that they propose both actuarial balances—prepaid pension assets and accrued pension liabilities—be included in rate base to ensure symmetrical ratemaking treatment. The inclusion of an accrued pension liability would reduce rate base, effectively lowering customer rates.

## **B. Idaho Power**

Idaho Power requests no change to its method of pension cost recovery. As noted above, unlike the Joint Utilities, Idaho Power currently has an accrued pension liability, not a prepaid pension asset. Because the company is not currently incurring any financing costs related to a prepaid pension asset, Idaho Power states that the rate recovery of FAS 87 expense provides the company with a reasonable opportunity to recover its prudently incurred pension costs.

## **C. Staff**

Staff supports the Joint Utilities' proposal in part. Staff recognizes that the "financing cost of cash outlays in excess of those recognized under accrual accounting and regulatory recovery mechanisms does represent a real cost to the companies" that should be recovered in rates.<sup>4</sup> Staff opposes, however, recovery of any financing costs on past pension contributions. Because pension costs were examined in prior rate cases, Staff does not believe that utilities should now be able to seek a return on amounts that accrued during periods when overall just and reasonable rates were set. Staff contends that allowing recovery of financing costs associated with past contributions would constitute single-issue ratemaking and violate the prohibition on retroactive ratemaking.

Staff proposes that the utilities be allowed to collect financing costs *only* on a prospective basis. To ensure that utilities earn a return on prospective pension expense and contributions, Staff recommends the prepaid pension assets be placed in rate base beginning with a zero balance, with certain modifications. At the outset, Staff states that the prospective balance should be adjusted to (1) offset the associated deferred tax asset or liability created by the difference between an employer's cash expense and accrual expense<sup>5</sup>; and (2) exclude amounts accumulated due to excess investment returns on pension funds. Staff notes, however, that quantifying the effects of excess investment earnings might not be possible. In addition, Staff contends the prospective account balances should receive a lower rate of return. Staff does not believe that the account balances should be treated like a capital investment in rate base and receive a return equal to the authorized rate of return. Instead, Staff believes a lower rate, more commensurate with that of a balancing account, should be used.

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<sup>4</sup> Staff/100, Bahr/20.

<sup>5</sup> CUB also requests that customers receive the benefit of deferred tax benefits, but believes such treatment is mandatory under ORS 757.269—and should not be adopted as a conditional provision to granting the Joint Utilities' proposal.

Alternatively, Staff would support the Joint Utilities' request to recover a return on the portion of the account balances accumulated since 2008, the year of the PPA and the economic recession, but with the balance adjusted consistent with its recommended modifications above *plus* one more adjustment. Under its alternative recommendation, Staff recommends that the account balances be further adjusted to exclude the difference between pension costs recovered from customers in rates and actual FAS 87 expense paid by the utility. Staff adds that pension costs placed in rates might have to be estimated due to the "black box" nature of prior rate case settlements.

#### **D. CUB and ICNU/NWIGU**

CUB and ICNU/NWIGU oppose the Joint Utilities' request to recover financing costs on prepaid pension assets on numerous policy and legal grounds. First, they contend the utilities' proposal is imbalanced given the past history of pension costs. They point out that, while many utilities now have a prepaid pension asset on which they seek a return, they previously had accrued pension liabilities that were never used to benefit customers. CUB notes that PacifiCorp, for example, had an average accrued pension liability of \$63 million per year between 1998 and 2005. They also question the Joint Utilities' assertion that the new federal funding requirements under the PPA, coupled with the 2008 economic recession, warrant a change in policy. They note that the current prepaid pension asset balances for both PGE and NW Natural are roughly equivalent to, or even less than, the balances that existed prior to 2008.

Second, CUB and ICNU/NWIGU argue that the Joint Utilities seek a return on amounts that may not represent an investment by utility shareholders. They explain that, because the prepaid pension asset is the cumulative difference between FAS 87 expense accrued by utilities and amount of contributions to the pension trust fund, this cumulative "difference" is affected by both cash contributions and negative FAS 87 expense. CUB asserts that significant portions of the prepaid pension asset balances come from periods of high economic growth during the late 1990s that created negative FAS 87. As an example, CUB notes that PGE's prepaid pension asset grew significantly between 1995 and 2004 without a single contribution by the utility. CUB and ICNU/NWIGU question why the utilities should be permitted to recover financing costs on monies that they did not, in fact, finance.

Third, the customer groups also contend that the characteristics of prepaid pension assets make them inappropriate for inclusion in rate base. ICNU/NWIGU contend that pension assets are not tangible assets like a utility plant that is providing utility service, and unlike other non-tangible assets that have received rate base treatment (like prepaid insurance), they might not represent actual shareholder investment. CUB and ICNU/NWIGU also emphasize that prepaid pension assets do not necessarily depreciate over a set period of time and, under certain conditions, could increase. CUB explains that pension contributions not only work to increase the prepaid pension asset balance, but to also reduce future FAS 87 expense and delay recovery of the contributions. CUB views the Joint Utilities' proposal as a potential perpetual revenue mechanism that may tempt

utilities to make additional contributions even if their pension plans are full or over-funded.

Moreover, CUB and ICNU/NWIGU contend that the Joint Utilities' proposal would be difficult to implement. They explain that providing a return on prepaid pension assets will require a retrospective examination of how those assets developed. Determining the prudence of past pension plans investments will be difficult, if not impossible, due to a variety of reasons. CUB states that the relevant data might simply not exist, noting that PacifiCorp has no pension data prior to 1998. Other factors, such as corporate acquisitions and black-box rate case settlements, would, according to the customer groups, make a retrospective prudence review extremely costly and time consuming.

In addition to these policy arguments, CUB and ICNU/NWIGU also raise legal objections to the Joint Utilities' proposal. CUB contends that asking for a return on prepaid pension assets violates the rule against retroactive ratemaking because the prepaid pension asset reflects the sum of prior decisions related to pensions that have flowed through several rate cases. In addition, CUB and ICNU/NWIGU argue that the Joint Utilities' proposal violates the principle of single issue ratemaking. ICNU/NWIGU explain that the Joint Utilities have asked the Commission to find that including the prepaid pension asset in rate base is necessary to establish "fair and reasonable rates" without examining the full picture of Joint Utilities' costs and revenues.

#### IV. RESOLUTION

We affirm our long-standing policy of allowing a utility to recover its pension contributions through FAS 87 expense and reject the Joint Utilities' proposal to include their current prepaid pension assets in rate base.<sup>6</sup> We find no systemic change to the dynamics of FAS 87 expense that justifies a change to our current pension cost policy. Moreover, the Joint Utilities' proposal is inequitable and would be problematic to implement.

We are not persuaded that the new federal funding requirements under the PPA, coupled with the 2008 economic recession, constitute sufficiently changed circumstances to warrant modifications to our FAS 87-based recovery. The evidence shows that these events did not disproportionately and systematically affect the utilities' prepaid pension assets. In fact, two of the Joint Utilities' prepaid pension asset balances peaked in 2005, before the PPA and 2008 financial crisis. The record also fails to support the Joint Utilities' claim that these events will lead to large prepaid pension assets that will persist for the foreseeable future. Idaho Power has maintained an accrued pension liability balance since the passage of the PPA. Moreover, while one utility maintains a large balance, other prepaid pension assets are declining significantly as the economy recovers and grows. For example, PGE's prepaid pension asset, which had a balance of

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<sup>6</sup> Because the prepaid pension asset or accrued pension liability will not be included in rate base, we conclude that the associated deferred tax asset or liability should also not be included in rate base.

\$108 million in 2008, is projected to be just \$18 million at the end of 2015.<sup>7</sup> Thus, based on this record, we conclude that any impact of the new federal funding obligations are temporary and will continue to be mitigated over time.

We also share three primary concerns raised by Staff and the intervenors about the Joint Parties' proposal to place their prepaid pension assets in rate base. At the outset, the timing of the requested policy change appears opportunistic and does not fairly reflect the history of pension recovery under FAS 87. Prepaid pension assets and accrued pension liabilities fluctuate and are cyclical by nature. Although the Joint Utilities currently have prepaid pension assets, all but one previously maintained accrued pension liabilities—including PacifiCorp with accrued pension liability balances that exceeded \$100 million. During those periods the utilities benefitted under our current policy, as the accrued pension liabilities were not used to offset their rate base, which would have reduced customer rates. Like Idaho Power is today, the utilities then were satisfied with our current FAS 87 recovery. Seeking to include the actuarial balances in rate base now while the Joint Utilities have prepaid pension assets is arbitrary and would produce an unbalanced result.

Second, prepaid pension assets are not traditional rate base items.<sup>8</sup> Contrary to the arguments made by the Joint Utilities, shareholder contributions do not solely drive prepaid pension asset balances. When FAS 87 expense is negative, such as periods of high economic growth, a prepaid pension asset balance will increase even with no shareholder contributions. This in fact happened beginning in 1995, when some of the utilities' prepaid pension assets grew significantly without a single shareholder contribution. In some years, the balance grew by as much as \$14 million annually with no investment.<sup>9</sup> Thus, placing the current prepaid pension asset balances in rate base would allow them to earn a return on amounts that do not necessarily represent shareholder investments.

Third, any effort to determine what amounts actually represent shareholder investments would be severely compromised by the fact that the prepaid pension assets represent the culmination of decades of actions related to the pension plans. To isolate actual investments, we would be required to perform a complicated retrospective examination of each pension plan to determine what contributions were made, whether they were made prudently in light of the then existing circumstances, and to what extent they were addressed in prior rate proceedings. The difficulty of such an exercise would be further exacerbated in light of questions about the availability of past records, as well as the inability to identify what amount of pension expense was included in prior rate cases that

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<sup>7</sup> Under OAR 860-001-0460(1)(d), we take official notice of PGE/500, Barnett-Jaramillo/34, filed *In the Matter of Portland General Electric Company, Request for a General Rate Revision*, Docket No. UE 294. Within 15 days, any party may explain or rebut the noticed fact. OAR 860-001-0340(2).

<sup>8</sup> For this discussion, we assume, without deciding, that pension contributions should be treated as investments rather than expenses. See, e.g., *In the Matter of Northwest Natural Gas Company, dba NW Natural, Request for a General Rate Revision*, Docket No. UG 221, Order No. 12-437 at 21 (Nov 16, 2012).

<sup>9</sup> CUB/100, Jenks-McGovern/13-14.

were resolved via settlement.<sup>10</sup> Although we are not required to make such determinations at this time, these concerns are relevant to our consideration as to the feasibility of the Joint Utilities' proposal.

Based on the totality of the circumstances, we conclude that the Joint Utilities have failed to establish that a change in our current FAS 87-based recovery is necessary. Although this methodology does not provide for the recovery of financing costs when prepaid pension assets increase and pension contributions are collected over time, FAS 87 has been used successfully for almost 30 years as part of this Commission's overall ratemaking formula to appropriately balance the interests of the utilities and customers and establish overall rates that were just and reasonable.

Given our resolution, we need not address the legal arguments raised by Staff and the intervenors about whether the Joint Utilities' proposal constitutes retroactive ratemaking or single issue ratemaking.

Finally, we recognize that NW Natural previously sought and obtained approval for the use of a balancing account to track the difference between the actual pension expense experienced by the company and the amount covered in rates.<sup>11</sup> Although we reject the Joint Utilities' proposal here, the utilities may seek similar, utility specific relief as they find necessary to ensure rates are just and reasonable.<sup>12</sup>

## V. ORDER

IT IS ORDERED that:

1. The policy of allowing utilities to recover pension costs through FAS 87 expense is affirmed; and

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<sup>10</sup> Although Staff's proposal to reset the actuarial accounts and place them in rate base prospectively would eliminate these challenges, its proposal, like the Joint Parties' request, is arbitrary and would similarly produce an unbalanced result. Because the cumulative pension contributions will generally equal the cumulative FAS 87 expense over the life of a pension plan, and because the Joint Utilities currently have prepaid pension assets, the cumulative FAS 87 expense will exceed the cumulative cash contributions on a prospective basis. Thus, going forward the Joint Utilities will have, on average, greater accrued pension liabilities than prepaid pension assets.

<sup>11</sup> See *In the Matter of Northwest Natural Gas Company, dba NW Natural, Application to Defer Pension Costs* Docket No. UM 1475, Order No. 11-051 (Feb 10, 2011).

<sup>12</sup> We note that NW Natural, PGE, and PacifiCorp also sought to defer certain costs related to their pension plans. Although PacifiCorp later withdrew its application, the applications filed by NW Natural (UM 1619 and UM 1630) and PGE (UM 1623) have been held in abeyance pending the resolution of this docket. We direct the Administrative Hearings Division to activate these dockets and establish proceedings to determine the appropriate treatment of these applications in light of our decisions here.

2. The Joint Utilities' proposal to include prepaid pension assets in rate base is rejected.

Made, entered, and effective AUG 03 2015.



**Susan K. Ackerman**  
Chair



**John Savage**  
Commissioner



**Stephen M. Bloom**  
Commissioner



A party may request rehearing or reconsideration of this order under ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-001-0720. A copy of the request must also be served on each party to the proceedings as provided in OAR 860-001-0180(2). A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480 through 183.484.

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of  
**DTE Electric Company** for authority  
to increase its rates, amend its rate  
schedules and rules governing the  
distribution and supply of electric  
energy, and for miscellaneous  
accounting authority.

Case No. **U-20561**  
(e-mail paperless)

PROOF OF SERVICE

STATE OF MICHIGAN    )  
                                  ) ss  
COUNTY OF EATON    )

**Pamela A. Pung**, being first duly sworn, deposes and says that on **April 7, 2020**, she served a true copy of **Michigan Public Service Commission Staff's Replies to Exceptions to the Proposal for Decision** upon the following parties **via email only**:

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Pamela A. Pung

Subscribed and sworn to before me  
this **7th** day of **April, 2020**.

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De Ann M. Payne, Notary Public  
State of Michigan, County of Eaton  
Acting in the County of Eaton  
My Commission Expires: 11-29-24