

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the approval)
of a Code of Conduct for)
CONSUMERS ENERGY)
COMPANY and the DETROIT)
EDISON COMPANY)
_____)

File No. U-12134

REPLY BRIEF OF ENERGY MICHIGAN

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I. INTRODUCTION

This Reply Brief responds to arguments by the Michigan Public Service Commission (Commission) Staff, Unicom, the Detroit Edison Company (Edison) and the Consumers Energy Company (Consumers). Failure to address all or part of the positions filed by the aforementioned parties or any other parties to this case may not be interpreted as agreement with those positions.

II. APPLICABILITY OF THE CODE OF CONDUCT: REPLY TO MPSC STAFF,
CONSUMERS, EDISON AND UNICOM

A. Position of the Commission Staff, Consumers Edison and Unicom

The Commission Staff has recommended that the Code of Conduct contained in Exhibit S-16 cover all electric utilities rather than just Consumers and Detroit Edison. *Staff Brief, p. 38.* Presumably, this interpretation would cover affiliates of Edison and Consumers as well as affiliated Alternate Electric Suppliers (AES). Staff also recommends that the Code of Conduct provisions dealing with cross subsidization be applied to the affiliates of out-of-State electric utilities serving retail customers in Michigan as part of the licensing process authorized in Sec.10a(2) of PA 141. AES affiliates of out-of-State electric companies would sign a Statement of Compliance regarding

cross subsidization or demonstrate compliance by virtue of an applicable Code of Conduct in the home State. *Id.*, p. 39.

Consumers argues that PA 141, Sec.10a(2) authorizes Code regulation of only electric utilities and Alternate Electric Suppliers participating in open access not electric utility affiliates which participate in other industries. Consumers would apply the Code of Conduct only to participants in the Retail Open Access program. *Consumers Brief*, p. 31.

Unicom argues that the Code should apply only to Michigan electric utilities and their affiliates because the statutory construction of PA 141 references the term “electric utility” to mean only Michigan jurisdictional utilities. Also, Unicom argues that the Code should not apply to out-of State electric company affiliates because these entities and their parents have no market power and thus cannot share information, cross subsidize, give valuable information or use a valuable company logo. Unicom argues that cross subsidization, if any, would and should be regulated by the home State of the electric utility. *Unicom Brief*, p. 12.

Indiana and Michigan Power Company (I & M) argues that the Code should not apply in its case because I & M is subject to affiliate standards approved in Case U-12204, December 6, 1999.

B. Energy Michigan Reply

1. A Code of Conduct which is developed under the authority of 2000 PA 141, Sec.10a(4) is limited in its application to Michigan jurisdictional electric utilities and their affiliates including affiliated Alternate Electric Suppliers.

2000 PA 141, Sec.10a(4) authorizes establishment of a Code of Conduct which applies to “electric utilities”. “Electric utility” is defined at Sec.10g(c) to be essentially a utility regulated by the Michigan Public Service Commission. Sec.10a(4) prevents cross subsidization, information sharing and preferential treatment between a Michigan

jurisdictional electric utility's regulated and unregulated services, which could include affiliated Alternate Electric Suppliers and any other affiliate providing service not regulated by the Michigan Public Service Commission. Sec.10a(4) does not prohibit or govern the relationships between two unregulated but affiliated entities which are not related to or affiliated with an electric utility under the jurisdiction of the Commission, nor do the 10a(4) prohibitions extend to activities between an Alternate Electric Supplier and a non-jurisdictional (out-of-State) electric utility.

Thus, a consistent reading of Sec.10a(4) is that it applies to both Alternate Electric Suppliers that are affiliates of Michigan electric utilities and to Michigan jurisdictional electric utilities to prevent either entity from engaging in the prohibited anti-competitive activities specified in 10a(4) or other activities which the Commission may specify. The Code would not apply to AES entities which are not affiliated with Michigan jurisdictional electric utilities having no market power.

The reading of PA 141 urged above is supported by findings of the Commission itself that only Consumers and Edison have market power and therefore only these regulated electric utilities need to be restrained by a Code of Conduct from exercising market power. *U-11290, June 5, 1997, p. 5.* The argument is also supported by the fact that out-of-State utilities provide little or no advantage to their affiliated AES entities by sharing information, granting use of an out-of-State logo or granting tariff preferences, etc.

2. There are other statutory provisions which allow effective policing of AESs affiliated with out-of-State electric utilities.

The reading of PA 141 urged above does not prevent effective regulation of Alternate Electric Suppliers that are independent or are affiliates of out-of-State, non-jurisdictional electric utilities.

2000 PA 141, Sec.10a(2) allows the Commission to create licensing requirements applicable to independent Alternate Electric Suppliers who are or affiliates of out-of-State electric utilities. Staff witness VanHaften recommended that the Commission's licensing powers be used by the Commission to police AES entities. *6 Tr 424-25*. Ms. VanHaften explained that this authority could be used to require an AES commitment that cross subsidization would be prevented or a demonstration that out-of-State Codes of Conduct applicable to the out-of-State utility or its AES affiliates will address the issue. *Id.*

Also, PA 2000 141 contains other restrictions or requirements applicable to out-of-State AES affiliates. Specifically, customer protection measures such as those contained in Sec.10c regarding slamming or Sec.10e regarding merchant plants and licensing are applicable to all Alternate Electric Suppliers including out State AES entities. Thus, this interpretation would satisfy the requirement of Sec.10a(4) that the Code established by that section of the Act also be applicable to Alternate Electric Suppliers consistent with the entire statute.

Summary

In summary, a reading of 2000 PA 141 which is justified by testimony and the plain language of the statute itself is that the Code of Conduct authorized in Sec.10a(4) should apply to Michigan jurisdictional electric utilities and all of their affiliates, including their affiliated Alternate Electric Suppliers. This application of the 10a(4) Code of Conduct would prevent an exercise of market power between Michigan jurisdictional electric utilities and their affiliates. Alternate Electric Suppliers not affiliated with a Michigan jurisdictional electric utility could be regulated through Sec.10a(2) licensing provisions or the other provisions spelled out in 2000 PA 141 which are specifically applicable to all AES entities including, but not limited to, customer protection, anti-slamming and other provisions.

III. CURRENT CONSUMERS AND EDISON PROVISIONAL CODES ARE NOT EFFECTIVE, A COMPREHENSIVE NEW CODE IS REQUIRED

A. Edison and Consumers Positions

1. Edison and Consumers Claim that their current provisional Codes of Conduct are satisfactory.

Detroit Edison claims that the approved Code provisions are superior to other proposals in this case because they are narrowly focused on Retail Open Access activities (Edison Brief, p. 16), allow capture of economies of scope and scale (*Id.*, p. 7) and allow continued use of the trade name and logo (*Id.*, p. 11, 20) and prevent abuses such as “undue discrimination”, “undue preference”, ensure non-discriminatory treatment of competitive suppliers. *Id.*, p. 23.

Consumers attacks the Staff’s alternatives broadly by claiming that the Staff witness gave no concrete examples of problems (*Id.*, p.9), that new Codes or approaches would raise utility customer costs by depriving the utility of scope and scale economies as well as imposing new costs for requirements such as structural separation (*Id.*, p. 14) and finally that the existing Code contain none of these problems and is a workable solution (*Id.*, p. 36). Consumers claims that the new Code proposed by Staff will cause waste, increased expense (Brief, p. 37) and that this conclusion is not contradicted. *Id.*, p. 37.

B. Energy Michigan Reply

A new comprehensive and stringent Code of Conduct is needed for the following reasons:

1. Commission Findings

The Commission has already found that Consumers and Edison possess market power. *U-11290, June 5, 1997, p. 5*. Given this conclusion, application of some Code of Conduct is clearly necessary.

2. Testimony

The evidence of record presented by Staff witness Margaret Roberts VanHaften, William J. Celio, Maurice Brubaker and Douglas Oglesby demonstrate that the existing Consumers Energy and Detroit Edison Codes of Conduct are inadequate. The testimony of all of these witnesses is summarized in the Energy Michigan Initial Brief at pages 5 through 9. The testimony of these witnesses gives an adequate evidentiary and hence legal basis for the Commission to conclude that the existing provisional Codes are inadequate and must be revised or revoked. JAF Properties Inc. v Michigan Public Service Commission, MichCon Pipeline Co, Saginaw Bay Area Limited Partnership and Saginaw Bay Lateral Co, unpublished opinion per curiam of the Court of Appeals, decided December 3, 1999, No. 209405.

The record in this case also contains testimony by witnesses VanHaften, Celio, Brubaker and Oglesby supporting the new Code of Conduct proposed by the MPSC Staff. The testimony of those witnesses in support of the new Code is summarized in the Energy Michigan Brief at pages 11 through 19.

The foregoing evidence of record is sufficient to justify and support a new Code of Conduct proposed by the MPSC Staff over the objections of Consumers and Detroit Edison.

3. Statutory Authority

2000 PA 141 Sec.10a(4) gives the Commission authority to promulgate a new Code along fairly broad lines so long as that Code applies to all electric utilities (defined as

Michigan jurisdictional electric utilities) and includes, but is not limited to, measures to prevent cross subsidization, information sharing and preferential treatment between a utility's regulated and unregulated services.

As will be seen below, the prohibitions against exercise of utility market power will not increase utility costs. Quite the contrary, appropriate pricing standards for transfer of property or services between a utility and its affiliate may increase utility revenue and be used to lower rates for regulated services. Nonetheless, even if the net result of the new Code were to increase utility costs, that result could be justified by the statutory mandate to the Commission to implement a Code. It should also be noted that Michigan electric utilities are free to make a case in the future that costs of implementing the Code were mandated by the Commission and therefore implementation costs are recoverable from customers at some future date.

In view of the deficiencies contained in the existing provisional Codes and the demonstrated desirability of the new Code provisions recommended by Staff, the Commission should use the factual basis and legal authority presented in this case to implement the new Code of Conduct recommended by witness VanHaften.

IV. THE CODE OF CONDUCT RECOMMENDED BY MPSC STAFF DOES NOT PREVENT ECONOMIES OF SCOPE AND SCALE

A. Edison, Consumers and I & M Claim That the Staff's Proposed New Code Will Prevent Realization of Scope and Scale Economies

Edison cites testimony of its witness Rodney Frame urging that economies of scope and scale be preserved and opposing the Staff Code of Conduct. Mr. Frame specifically opposes the recommended asymmetrical pricing provisions adopted by the Commission in Case U-11916 because Edison claims that decision denied utility customers benefits of scope and scale. *Brief, p. 7-9.* Edison

also urges that utility affiliates be allowed to use the Edison or DTE trade name and logo without cost and bases its position on a Freedom of Speech argument. *Id*, p. 11-14.

Consumers claims that the Staff's proposed Code and specifically the asymmetric pricing provision would deprive utilities of efficiencies of scope and scale as supported by their witness Morey. *Brief*, p. 18. Consumers witness Morey defends retention of scope and scale economies by both utilities and utility affiliates. *Id*.

I & M states that utilities and their affiliates should be able to retain any market advantages of scope and scale. *I & M Brief*, p. 4-5.

B. Energy Michigan Reply: The Staff Proposals to Prevent Discrimination Capture Economies of Scope and Scale for Regulated Utility Customers

1. Transfer Pricing and Economics of Scope and Scale

Sec. III.B. and particularly III.C. of the Staff's proposed Code of Conduct ensure that utility affiliates or their customers do not receive goods, services, products or property from a regulated entity at a subsidized price. III.C. in particular requires that an affiliate receiving services, products or property from the Michigan electric utility must pay the higher of fully allocated cost or market price. *T 420*. This asymmetric pricing provision is absolutely necessary so that regulated utilities and more important, their customers, receive full and fair compensation for all goods and services provided by a regulated utility to an affiliated entity. Staff's proposal to use asymmetric pricing prevents the majority of mischief and economic damage created by unfair utility affiliate competition and captures the full value of utility services for the customers of the regulated utility.

If a regulated utility charges a fair price for the goods and services which it provides to its affiliates, the revenues can be used to offset costs or expenses. The higher the level of

utility revenues, the greater the offset and the lower the amount of projected rate increases or the larger the amount of decrease that can be justified. These rate offsets should be used for regulated transmission and distribution service which would be utilized by both open access and bundled sales customers. In this way, the increased revenues resulting from appropriate transfer pricing could be used to help all utility customers including customers of utility affiliates who use open access service.

Conversely, however, if utilities provide goods and services to affiliates at prices below cost or market, the reduced levels of revenue may be responsible for utility rate increases to captive customers and will provide a subsidy to utility affiliates which can be used to achieve unfair price competition or to suppress or eliminate legitimate competition.

Note that the Commission has already adopted this position in the Affiliate Transaction Case U-11916 issued May 3, 2000 at page 10. However, if the Commission needed statutory authority to support asymmetric pricing, the language of Sec.10a(4) clearly authorizes measures which will prevent cross subsidization. Staff's proposed asymmetric transfer pricing measures accomplish this goal by requiring the affiliate to pay the higher of market or costs for any services received from its parent.

2. Use of Utility Name and Logo

The Staff's proposal for asymmetric pricing is a good solution to issues regarding use of utility name or logo. Utility affiliates should not be allowed to use the utility name or logo without issuing disclaimers or utilizing disclaimers that the affiliate is not a part of the regulated utility entity. Just as important, utility affiliates should be required to pay the fair market value of the use of the utility name and logo as an alternative to outright prohibition.

Thus, two solutions exist regarding use of the utility name and logo. The first solution is an outright prohibition which would require a utility affiliate to identify that it is not the

same entity as the parent utility and that it cannot speak on behalf of that utility. The second solution is to inform customers that the affiliate is not a part of the utility parent and to charge the affiliate a fair market price for use of the utility name and logo.

3. Conclusion

In conclusion, Consumers, and Edison have claimed that asymmetrical pricing, separation and other Code restrictions would deny affiliates and customers of regulated utilities the economies of scope and scale which occur if the regulated and unregulated entities are allowed to transfer goods or services at or above incremental cost.

This argument has two major defects:

a. From a factual perspective, transferring goods and services at incremental cost creates an overwhelming competitive advantage for a utility affiliate. A simple example brought out in the cross examination of Consumers witness Morey illustrates this point. If Consumers Energy pays 40 ¢ to mail a billing letter to its customer, the incremental cost of inserting promotional material for an affiliated marketing entity might be only 1 ¢. A competitor, however, would have to pay 40 ¢ to mail the same information to potential customers. *5 Tr 229-30*. The ability to use utility mailings at 1 ¢ per mailing would create an overwhelming cost advantage for a utility affiliate. However, witness Morey stated that such an outcome would not be cross subsidization under his theory of incremental pricing. *Id, p. 230*.

It does not take an active imagination to understand that Mr. Morey's incremental pricing theory would deal a crippling blow to competition. Mr. Morey's theory is also a glaring example of the cross subsidization directly prohibited by PA 141, 10a(4). Incremental pricing is also an example of preferential treatment because utility affiliate competitors are not given the same pricing as the utility affiliate. Once

again, this is a violation of PA 141.

b. Asymmetric pricing could give regulated utility services customers potential cost reductions or offsets and thus allow them to receive the full economics of scope and scale achieved by the regulated utility and its affiliates. If Consumers were required to charge the market value for mailing billing inserts it might gain 20 ¢, 30 ¢, or even 35 ¢ of revenue per letter instead of the 1 ¢ proposed by Mr. Morey. Asymmetric pricing in effect captures economies of scope and scale but does so for the benefit of regulated utility customers rather than for the benefit of the owners of an unregulated utility affiliate who would not share their earnings with utility customers who are paying for utility mailings at a full 40 ¢ per letter. The Commission can and should fashion a policy of capturing the receipts from asymmetric pricing and using them to offset the cost of regulated utility services which are used by all customers whether on open access or bundled sales. This can be done by dedicating asymmetric pricing receipts to the reduction of the transmission and distribution costs which are incurred by all utility customers.

Asymmetric pricing can capture the full value of utility assets which have been paid for by captive customers for over 100 years in some cases and use this value to reduce costs to those very customers who have supported the system for so long. In this way, full economies of scope and scale will be captured for the benefit of all regulated utility customers who have paid for these assets and competition can be preserved as mandated by PA 141.

V. CONCLUSION AND PRAYER FOR RELIEF

A. Conclusion

The record in this case demonstrates that a comprehensive new Code of Conduct is required

in Michigan. PA 141 authorizes the Commission to promulgate the new Code and the record in this case demonstrates beyond all doubt that existing Codes or even markups of those Codes will not suffice. Staff has lead the way in demonstrating that a comprehensive new Code is required based on the statutory authority of PA 141, the findings of the Public Service Commission in Case U-11290 1997, June 5, p. 5 that Consumers and Detroit Edison possess market power and the testimony in this record. The Energy Michigan Brief contains ample citations of testimony in this matter demonstrating the inadequacy of existing Codes and the benefits of Staff's proposed new Code.

2000 PA 141 authorizes a Code of Conduct that would apply to the electric utilities regulated by the Michigan Public Service Commission and the affiliates of those utilities including affiliated Alternate Electric Suppliers. This interpretation of the scope of PA 141 Code of Conduct authority means that the Code would be directed primarily at preventing Michigan jurisdictional electric utilities from exercising market power or providing the benefits of their market power to their affiliated Alternate Electric Suppliers. Under this interpretation, the Code would not be applicable to out-of-State electric utilities nor would it be used to regulate conduct between such out-of-State electric utilities and their affiliated Alternate Electric Suppliers doing business in Michigan. This is not to say that there would be no regulation of such out-of-State utilities and their affiliated Alternate Suppliers. Rather, as advocated by the Staff, the licensing process authorized in PA 141 can be used to regulate the relationship between out-of-State electric utilities and their affiliates and ensure that improper activity does not exist. Also, several provisions of 2000 PA 141 such as slamming and other customer protections apply directly to AESs which are affiliates of out-of-State electric companies.

Arguments that regulated utilities should be allowed to provide goods and services to affiliates at incremental costs to preserve economies of scope and scale are mistaken on two counts: First, allowing this pricing strategy would violate PA 141 prohibitions against cross subsidization and preferential treatment while destroying competition. Second, asymmetrical pricing provisions can capture economies of scope and scale for parent utilities and provide offsets to the regulated rates paid by all customers, sales or open access. Asymmetrical pricing can and should apply to any permissible use of the utility name or logo but such use should be accompanied by clear disclaimers

as well. Thus, the utility argument that discriminatory pricing may be allowed to preserve economies of scope and scale can be defeated by use of asymmetrical pricing and dedication of the revenues from that pricing to reductions in regulated cost of service paid by all customers.

For the reasons stated above the Staff Code of Conduct as modified by the recommendations of Energy Michigan witness Roy Boston should be adopted.

B. Prayer for Relief

WHEREFORE, Energy Michigan requests that the Commission:

1. Adopt the Staff proposed Code of Conduct together with the modifications proposed by witness Roy Boston.

Respectfully submitted,

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