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July 1, 2004

Ms. Mary Jo Kunkle
Michigan Public Service Commission
6545 Mercantile Way
P.O. Box 30221
Lansing, MI 48909

Re: Case No. U-13720

Dear Ms. Kunkle:

Enclosed for filing in the above captioned matter please find the original and four copies of Energy Michigan's Reply Brief . Also enclosed is the original Proof of Service indicating service on counsel.

Please date stamp one copy of the above entitled document for my records and return it in the self-addressed stamped envelope provided.

Thank you for your assistance in this matter.

Very truly yours,

VARNUM, RIDDERING, SCHMIDT & HOWLETTLLP

Eric J. Schneidewind
Signature Not Verified
Digitally signed by Eric J. Schneidewind
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EJS/mrr

cc: ALJ
parties

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of CONSUMERS ENERGY COMPANY for determination of net stranded costs for the year 2002 and approval of net stranded cost recovery charges.	))))))	Case No. U-13720

REPLY BRIEF OF ENERGY MICHIGAN, INC.

July 1, 2004

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REPLY BRIEF OF ENERGY MICHIGAN, INC.

I. Introduction and Summary of Position

A. Introduction

This Reply Brief is filed on behalf of Energy Michigan, Inc. ("Energy Michigan") by Varnum Riddering Schmidt & Howlett LLP in response to Briefs filed by Consumers Energy Company ("Consumers" or "Consumers Energy"), the Michigan Public Service Commission Staff ("MPSC Staff" or "Staff"), Ada Cogeneration Limited Partnership and the Michigan Power Limited Partnership (the "QF"s), the Midland Cogeneration Venture ("MCV") and Attorney General Michael Cox ("AG"). Failure to respond to any position or argument advanced by a party should not be taken as agreement with that argument or position.

B. Summary of Position: The Consumers Request Violates Legal Criteria for Recovery of Stranded Costs

The Commission has issued a series of case decisions which specifically define the term "stranded costs". In Case U-11290, the Commission issued what is perhaps its most detailed explanation regarding the specific definition of stranded costs. To summarize the points made by the AG in his Initial Brief, the categories of stranded costs approved for recovery in U-11290 which are relevant to this case include:

1) Regulatory assets: These costs were approved by the Commission and collection is deferred to a future timeframe.

Consumers has not requested recovery of such costs in this case.

2) Capital costs of existing power supply facilities (Clean Air Act and Generating Plant additions): These costs can be treated as stranded costs. Capital costs of nuclear plants have largely been securitized and are being collected through the securitization bond mechanism. However, while the Commission said it was theoretically possible to collect the costs related to fossil fuel Generating Plants, it also stated, "As a general rule it is not necessary to recognize capital costs of hydroelectric, coal, oil or gas power production facilities that are owned by the utility because they should be at market value by the end of the transition period. U-11290, June 5, 1997, p. 7-14.

Also, PA 141 § 10d(4) provides that power plant capital costs incurred during the PA 141 rate freeze can be recovered through special proceedings in which the Company provides evidence demonstrating the reasonableness and prudence of the investments. See PA 141, § 10d(4).

Consumers has presented claims in this case for recovery of capital costs related to its fossil fuel plants but has not presented proof that the investments were reasonable and prudent (PA 141 test) or that such plants have above market costs. (U-11290 test).

3) Long term purchase power agreements (seasonal and QF power costs): These costs can be treated as stranded costs "…which have been approved by the Commission, less the estimated near term value of that capacity in an open access environment." The vast majority of these agreements are with Qualifying Facilities that are federally mandated, etc., etc….

Consumers has requested recovery of seasonal power cost and certain QF costs as stranded costs but most of these costs were either not approved by the Commission in the case of seasonal power costs or in the case of both QF and seasonal power purchases, the

costs have not been shown to be above market prices and were excluded from the Consumers PSCR clause in effect during 2002.

4) The fourth category of stranded costs includes employee related restructuring costs which are not at issue in this case.

5) The fifth category of stranded costs includes open access implementation costs which also are not at issue in this case. U-11290, June 5, 1997, p. 7-14.

Thus, for the purposes of this case, the capital costs related to fossil generating facilities including Clean Air Act and other Generating Plant capital improvements, longer term seasonal power purchases, and QF contracts are all at issue in this case and theoretically could be covered by categories 2 and 3 of the types of costs described above for which the Commission will grant stranded cost recovery pursuant to Order U-11290 and PA 141. However, in none of these cases has Consumers demonstrated that the cost of these Generating Plants are now above market rates, that the capital improvements were reasonable and prudent or have been approved or that seasonal power costs were above market or reasonable and prudent, much less included in approved recovery mechanisms such as the PSCR clause.

The result of Consumers' request is that hundreds of millions if not billions of dollars of cost increases above levels frozen in 2000 by PA 141 for seasonal power, QF power and fossil plant refits are presented in this case for recovery from ROA customers while these very same costs are not recovered nor have they been approved for recovery from retail customers via the appropriate vehicles: the PSCR clause for QF and seasonal power, base rates for fossil improvements and special deferred accounts for Clean Air Act costs. Moreover, none of these cost increases have been designated as regulatory assets by Consumers with the attending accounting treatment which would let the costs be recovered at a later date from retail customers.

The Consumers strategy in this case, put in its most simple terms, is to assemble categories of power and capital cost increases above levels in frozen rates which could not be recovered from retail customers due to the PA 141 rate freeze and attempt to obtain recovery of these cost

increases from ROA customers by relabeling them stranded costs without gaining any form of Commission approval or even requesting proper accounting treatment.

Consumers' request to recover unapproved seasonal power, QF and generating capital cost increases should be rejected as an attempt to circumvent the PA 141 rate freeze and to destroy competition by burdening it with costs that should be paid, if at all, by retail customers.

II. Consumers Energy Has Not Met The MPSC Criteria For Recovery of Alleged "Stranded Costs"

A. SEASONAL POWER COSTS

1. Consumers position.

Consumers claims that $43 million of seasonal power costs should be collected from ROA customers as stranded costs largely because such costs were not included in the PSCR clause starting June 2000 and therefore cannot be recovered from the retail customers who use the power. Consumers claims that these seasonal power costs are stranded and argues that the costs should be paid by ROA customers. Consumers Brief, p. 5-9. Consumers objects to the Staff's recommendation that only multi-year power purchases should be included as stranded costs on the grounds that single year purchases were avoidable. P. 6-9. Consumers claims that the seasonal purchases must be made years in advance of the actual need and thus cannot be avoided. Id.

2. Staff position.

Staff supports inclusion of only multiyear seasonal purchases (and exclusion of single year purchases) saying these purchases cannot be avoided. There is no other support for Staff's position. Staff Brief, p. 7.

3. Energy Michigan reply.

a. The Commission has not approved recovery of seasonal power costs from any Consumers' customers.

Staff Witness Blair agreed that all of the $43.5 million of seasonal power costs presented by Consumers for recovery are above [not included in] the frozen PSCR which was in effect for retail customers from June 2000 through December 31, 2003 including the 2002 test year covered by this case. 2 Tr 198. Consumers witness Kurzynowski agreed with this assessment. 2 Tr 154-55.

Ms. Kurzynowski also testified that the vast majority of Consumers seasonal purchases occurred after the PA 141 rate freeze. Tr 152-53. Finally, Ms. Kurzynowski testified that the majority of these seasonal power contracts were not even approved by the Commission for reasonableness and prudence per MCL 460.6j(13)(b) much less approved for inclusion in the PSCR factor. 2 Tr 158. Finally, there is no record of Consumers requesting accounting treatment to defer recovery of these costs or place them in a category of regulatory assets. Yet in this case, Consumers is requesting that the seasonal power costs which are not included in the PSCR as a legitimate power purchase cost be treated as a stranded cost recoverable from ROA customers. Tr 155.

Finally, there is no testimony on record to demonstrate that the proposed seasonal costs were above market levels and thus not recoverable through sale into the marketplace.

b. The Commission should reject Consumers' request to recover all seasonal power costs as stranded costs and Staff's proposal to allow recovery of multiyear seasonal purchases.

There are six reasons to reject Consumers' request and Staff's proposal to recover seasonal purchases from ROA customers as stranded costs:

i. PA 141 § 10d(1) provides that, "Notwithstanding any other provision of law or Commission order" a rate freeze was in effect from June 2000 through December 31, 2003. Purchases of power after the rate freeze which tended to increase rates above the frozen levels resulted in a refusal by the Commission to allow rate increases to recover any such costs, e.g. see Order U-12366 dated June 19, 2000. To thus immunize retail customers from cost increases related to power purchased for their own benefit but attempt to pass on 100% of these costs to ROA customers as a stranded cost is to frustrate the intent and the letter of the PA 141 § 10d(1) rate freeze.

ii. Most if not all of the power purchases claimed for recovery by Consumers were not approved by the Commission as reasonable and prudent pursuant to MCL 4601.6j(13)(b). On cross examination, Ms. Kurzynowski could not cite the Commission orders approving these purchases and Consumers has not supplied the Hearing Room Request to identify which orders, if any, approved the purchases. In other words, not only were these purchases rejected for inclusion in the PSCR recovery mechanism, but most, if not all, of the purchases were never reviewed or approved by the Commission as reasonable and prudent. 2 Tr 158. Therefore the Commission has no record to justify the reasonableness of the costs proposed for recovery from Choice customers. [1]

iii. Consumers has never requested appropriate accounting or other regulatory treatment to convert these unrecovered costs into regulated assets or other appropriate assets that qualify as stranded costs.

iv. The record demonstrates that virtually all of these seasonal purchases were made after the enactment of PA 141. Therefore, Consumers was on notice that these avoidable costs could be rendered

[1] A review of relevant cases shows that of the 1092 MW of seasonal capacity purchased by Consumers in 2002 (Exhibit A-10) the only approval took place in Case U-13162 for a 92 MW purchase. U-13162, December 10, 2001.

unnecessary due to customer migration to Choice programs because they were incurred subsequent to the passage of PA 141. Polich, 2 Tr 215-17. To the extent that Consumers desired to add temporary power supplies to its obligations but was rendered unable to collect costs of these supplies from the benefited retail customer, this is the responsibility of Consumers, not ROA customers. Id.

v. The purchases were made directly for the benefit of retail customers and were rendered uncollectible by the force of law (the PA 141 § 10d(1) rate freeze) not by customer migration to competition. If anything, the amount of necessary purchases was reduced by competition. Polich, 2 Tr 215-17. Thus, Consumers was on notice that any seasonal purchases which it made for retail customers would be made by the Company, not its customers.

vi. Consumers has made no showing that the costs of seasonal power were above market and therefore that the costs were unrecoverable in a competitive market. There is no demonstration whatsoever that Consumers has attempted to collect as stranded costs only those power purchase costs which are above market levels. Therefore, the seasonal power costs have not been shown to be stranded.

For all these reasons, the Commission should reject Consumers' request to recover $43.5 million of seasonal purchases as stranded costs payable by ROA customers.

Tab A shows that the Staff case with single year and multiyear seasonal capacity excluded (vertical column 3) but QF costs included results in a stranded cost of $1.89 million.

B. QF POWER COSTS

1. Staff, Consumers, MCV and QF position.

Neither Consumers' nor Staff's Brief discuss recovery of $13.7 million of QF costs. Consumers should not be allowed to sandbag on this issue and bring out new arguments to support its purchases on Reply rather than presenting these arguments as it should have in its Initial Brief.

Like Consumers, the Staff Initial Brief gives no reason at all for its position on recovery of incremental QF costs.

The QF and MCV Intervenors did not present testimony or evidence in this case. The QFs do not necessarily support Consumers' designation of these costs as stranded but do argue that the Commission must allow Consumers to recover monies paid under contract to QFs. QF Brief, p. 2-7; MCV Brief, p. 1-2.

The QFs and MCV also make the following arguments:

a. State law (PA 141 § 10a and § 10a(8) and MCL 460.6j(13)(b) "PA 81") and Federal law 16 USC § 2601 (PURPA) mandate that Consumers be allowed to recover all QF payments (including the $13.7 million presented by Consumers in this case) as stranded costs. QF, p. 2-4, 5-7; MCV, p. 3.

b. The Commission orders issued prior to PA 141 show intent to allow recovery of incremental QF costs. MCV, p. 3-5; QF, p. 4-5.

2. Energy Michigan reply.

Consumers, Staff, MCV and the QFs have not made an appropriate showing under PURPA, PA 141 or Commission precedent in Cases U-12639 and U-11290 for recovery of $13.7 million of QF costs as stranded costs. The Commission should reject their request on the following grounds:

a. As to the QFs and MCV there has been no showing that Consumers exercised the regulatory out" in their Power Purchase Agreements and has failed to pay them for all power delivered by their projects in 2002 including $13.7 million owed to the Ada and the MPLP projects. If the refusal of the Commission to include $13.7 million of QF costs in the 2002 PSCR could trigger a refusal of Consumers to pay these costs to the QFs, why didn't it happen? If the QFs got paid, what is there substantive complaint? The QFs received their money two years ago. They are not credible when they claim to fear that they will not get paid.

Absent a showing that the QFs did not get paid, the Commission is entitled to assume that the QF projects were paid contracted amounts and are merely raising theoretical future concerns regarding invocation of a regulatory out clause. To repeat, there is no evidence on this record that Consumers refused to pay Ada, MCV and MPLP the $13.7 million of increased costs despite the fact that Consumers has been denied recovery of these costs through the PSCR clause since 2000. See U-11180R, March 14, 2000; January 11, 2001 denying the QF increases and the U-12366 Order, June 19, 2000 denying resumption of the PSCR mechanism which would have allowed collection of the QF increases.

b. The $13.7 million of QF contract costs were never approved by the Commission for inclusion in or recovery through the PSCR. The Commission repeatedly rejected Consumers' claims that incremental QF costs which were not in the PSCR at the time of the PA 141 rate freeze (Section 10d (1)) could be recovered from retail customers. In Case U-11180R dated March 14, 2000 and July 11, 2001, the Commission rejected such requests. In Case U-12366 dated June 19, 2000 the Commission rejected reinstitution of the PSCR clause with inclusion of the $13.7 million of QF costs claimed in this proceeding. The reason for denial was that the PA 141 rate freeze had prevented inclusion of increased costs in the Consumers PSCR clause subsequent to June 2000. Another party appealed the U-11180R Order to the Court of Appeals and the Commission Order

was affirmed. Court of Appeals, U-11180R, Case 224687, November 27, 2001. Consumers did not appeal the either of these orders.

The basis of the Commission's rejection is simple, the PA 141 § 10d(1) rate freeze took effect "Notwithstanding any other provision of law or Commission Order…" That language supercedes or takes precedence over all other Michigan laws or MPSC cases cited by the QFs or MCV.

Moreover, PA 141 and PA 142 do contain mechanisms to allow full recovery of incremental QF costs after termination of the Section 10d(1) rate freeze. PA 142 allows securitization and recovery from all customers of stranded costs including above market QF costs. PA 142, § 10h(g) and § 10i(1). Consumers has not used this option.

Even if Consumers not have a Federal PURPA right to recover QF costs despite the PA 141 rates freeze, Consumers waived that right when it failed to appeal Orders U-11180R and U-12366 which rejected collection of these incremental costs during the PA 141 rate freeze.

Yet in this case, Consumers is attempting to pass along a similar rate increase to ROA customers to effectively avoid the prohibition contained in PA 141 § 10d(1) which prevented recovery from retail customers.

This case is really a collateral attack on two orders (U-11180R and U-12366) which Consumers failed to appeal.

c. Consumers has not presented proof that the requested incremental QF costs are above market levels and therefore are unrecoverable in the open market. Nor has Consumers presented proof that it has subtracted the market value of the QF capacity and is only attempting to pass along to ROA customers the increment that is unrecoverable in a competitive market. Thus, we have the spectacle of Consumers procuring QF power and delivering that power to its retail customers

for their exclusive benefit (2 Tr 94) yet attempting to pass literally 100% of the increased QF costs above PSCR levels to ROA customers even though those costs might be recoverable in a competitive market. This outcome does not conform with the U-11290 definition of stranded costs nor with the intent of the PA 141 § 10d(1) rate freeze.

d. Consumers claims that unrecoverable QF costs are stranded costs yet it has not pursued the accounting treatment or measures which are necessary to designate unrecovered seasonal power or QF costs as collectible stranded costs. Consumers has not presented requests to the Commission for deferred accounting treatment or other types of accounting treatment that would designate these incremental QF costs as recoverable stranded costs. Without such a determination the Commission cannot unilaterally and without record support designate these seasonal power or QF costs as recoverable from ROA customers but not retail customers.

The Commission should reject Consumers' request to recover $13.7 million of QF costs from customers because these costs were excluded from the PSCR clause. Also, without demonstrating that these QF costs are above market or that market value has been subtracted from the amount requested for recovery, the Commission cannot properly determine that all or any part of these costs are stranded in the current market. Moreover, by failing to obtain proper Commission approvals for inclusion in the PSCR or even to designate these costs as stranded for accounting purposes, there is no record which would allow the Commission to pass along the costs to ROA customers as resulting from a stranded asset.

Tab A, vertical (column 4), shows that the Staff case with all seasonal costs included but with incremental QF costs excluded yields stranded benefits of $3.16 million. If seasonal costs and QF costs are excluded, stranded benefits are $11.8 million.

C. CLEAN AIR ACT AND NON-CLEAN AIR ACT CAPITAL COST ADDITIONS

1. Consumers position.

Consumers has opposed Energy Michigan's proposal to exclude post-2000 capital cost investments above levels contained in rates upon passage of PA 141. Consumers Brief, p. 15-17. Consumers does not differentiate between post-PA141 investments in Clean Air Act equipment on fossil fuel plants and other forms of generation investment above levels contained in the pre-PA 141 frozen rates. Id.

2. Energy Michigan reply.

a. CLEAN AIR ACT CAPITAL COSTS:

Virtually every other party to this case recognizes and accepts that PA 141 clearly provided for a mechanism to collect Clean Air Act costs outside of the stranded cost process. PA 141 § 10d(4) allows utilities to both defer and collect from all customers a return on and of capital expenditures in excess of depreciation levels incurred during and before the PA 141 rate freeze and to get the same treatment for expenditures (such as Clean Air Act expenditures) mandated by government action. PA 141 § 10d(4).

Thus, when Consumers attempted to collect Clean Air Act costs from ROA customers during 2003, the Commission forcefully ordered Consumers to remove such costs from the case because collection was a violation of PA 141. U-13380, December 20, 2002, p. 2. More specifically, the Commission found in Case U-13715 that it is inappropriate to collect Clean Air Act costs from ROA customers because such costs were incurred for the benefit of retail customers and that collection from ROA customers who had to pay similar costs to their own suppliers would be anti-competitive. U-13715, June 2, 2003, p. 59-60.

The appropriate path for Consumers to recover these costs is to utilize provisions of PA 141 § 10d(4) to accrue and defer the Clean Air Act costs for recovery until

they file a general rate case whereupon the costs can be recovered in as few as five years. Detroit Edison has pursued this course and it is available to Consumers as well. See U-13808.

Additional reasons for rejecting this request include Consumers' failure to prove the investments are both uneconomic or unrecoverable in a competitive market, that they have netted or removed costs which are recoverable in a competitive market and that they have secured MPSC approval for these costs as reasonable and prudent, a prerequisite for recovery.

Removal of Clean Air Act costs is assumed in Tab A Staff "Base Case" (columns 2, 3, 4, 5) and the Energy Michigan Case (column 6).

b. NON-CLEAN AIR ACT GENERATING CAPITAL COSTS.

Consumers has incorrectly characterized the Energy Michigan proposal as objecting to Consumers' recovery of all generating costs incurred after passage of PA 141.

Energy Michigan merely objects to Consumers' attempt to recover its capital costs which are above the depreciation levels in effect when PA 141 was passed. Note, that PA 141 provides specifically that, "Beginning January 1, 2004 annual return or and on capital expenditures in excess of depreciation levels incurred during and before the time frame described in subsection (2) [the rate freeze through December 31, 2003] … shall be accrued and deferred for recovery. After notice and hearing the Commission shall determine the amount of reasonable and prudent costs, if any, to be recovered and the recovery period which shall not exceed five years and shall not commence until after the expiration of the period described in subsection (2)." PA 141 § 10d(4). (Emphasis supplied).

There is literally no evidence on this record which demonstrates the reasonableness and prudence of the increased Generating Plant costs or depreciation levels which Consumers is attempting to recover in this case in the form of stranded costs. Thus, Consumers'

attempted recovery of such costs is both a violation of the criteria set forth in PA 141 § 10d(4) and it is a violation of normal rate making practice in which the utility must prove the reasonableness and prudence of its investments.

Finally, PA 141 gives Consumers a logical and rational avenue to recover both increased Generating Plant production costs and Clean Air Act related costs. Consumers could appropriately calculate the costs which are above depreciation levels or even in the case of government mandated costs, the amount of all such costs, accrue and defer these costs and then present them for recovery in the context of a general rate case which would collect the costs from all classes of customers not just from ROA customers. This is the framework set forth in PA 141 § 10d(4). Instead, Consumers has attempted to recover these costs exclusively from ROA customers outside the mandated PA 141 procedural framework.

In addition to these procedural failings, Consumers has not met the U-11290 criteria for recovery of stranded costs by demonstrating that any or all of these costs have rendered the Generating Plants uneconomic in the market or that Consumers has attempted to remove the amount of costs which are economic leaving only uneconomic costs as potential stranded costs. Energy Michigan witness Polich testified that Michigan utilities were put on notice that competition was coming and they would need to be competitive. If these investments were not recoverable in a competitive market, they should not have been made and the subject power plant should have been retired. If the investments are recoverable in a competitive market, they are not stranded and the full price should be recovered from the retail customers who benefit from the investment. Polich, 2 Tr 211.

Finally, Consumers attempted to justify recovery of its fossil plant costs from ROA customers on the grounds that ROA customers can return to Consumers for tariff service and thus the plant upgrade investments were of benefit to ROA customers. Torrey, Tr 95.

Consumers Witness Torrey claimed to be unaware of the fact that more stringent return to service measures have been presented to the Commission for the Consumers system in Case U-13715. However, the Commission may consider measures which lessen the

value of the return to service option and therefore justify freeing ROA customers from the burden of paying for Consumers' Generating Plant investments.

The Commission should also be aware that Consumers' recent summer capacity plan filing makes it abundantly clear that Consumers has not purchased capacity nor built capacity which is sitting idle waiting to be used by ROA customers returning to utility service. See Tab B, p. 1. Rather, Consumers is currently short of power as shown by their summer 2004 capacity plan on Tab B, p. 2. It is clear that Consumers would serve returning customers through power purchases in the open market rather than with its own Generating Plants which are sitting idle waiting to serve returning customers. Thus, Consumers incurs no cost of standing ready to serve ROA customers. See Tab B.

D. SPECIAL CONTRACT REVENUE

1. Consumers position.

Alone among the parties, Consumers proposes that the Commission's long standing practice of attributing special contract revenue at tariff rates rather than discounted rates be changed. Consumers Brief, p. 9-10. Consumers requests that it be allowed to report special contract revenue at discounted rates which in effect produces a revenue deficiency relative to the monies needed to pay for its fixed generation assets, This revenue deficiency creates a short fall between Production Fixed Costs and the revenue to pay for those costs. This deficiency then becomes a stranded costs payable by ROA customers.

Consumers claims that the Commission's long standing policy regarding revenue treatment should be changed because it has demonstrated that its special contract terms are justified based on cost of service and that the benefits to non-participating customers outweigh the costs in the form of higher transition charges or higher retail rates to subsidize discounts given to other customers. Consumers Brief, p. 9-10.

2. Energy Michigan reply

a. The Consumers special contract rates are not based upon true cost of service.

Consumers Witness Brockett concludes that the Company's existing special contract rates are based upon cost of service because the amount of revenue generated by the special contracts is equal or greater than the tariff rates minus over $22 million of what Consumers alleges are inappropriate costs contained in those tariff rates. Consumers Brief, p. 11. In other words, Consumers can't deny that the special contracts are offered at rates substantially below tariff levels, nor has Consumers produced a new cost of service study demonstrating that its special contracts generate revenue equal to costs. Rather, Consumers has merely looked at its existing retail rates and then compared these rates with a self-serving filing it made in Case U-12970 which was never approved by the Commission as to the merits. Consumers then bootstraps this self-implemented statement about its costs into a demonstration that the true cost of service under its tariff rates should be substantially lower than tariff levels and that the special contract revenue exceeds this lower amount invented by Consumers.

This confusing trail of suppositions, assumptions and downright misrepresentation cannot substitute for the fact that Mr. Brockett never did introduce a full blown cost of service study demonstrating that special contract rates generate an amount of money necessary to pay special contract service costs. Energy Michigan Witness Polich testified criticizing the Consumers methodology and concluded that the Consumers' analysis did not show the impact on other customer classes due to redistribution of costs and that the allocation factors used in their study were inappropriate. Polich, 2 Tr 212-15.

Consumers' second conclusion that other customers benefit from the special contracts is easily refuted. First, Mr. Polich testified that the primary purpose of the Consumers special contracts was to discourage competition and specifically competition from cogeneration. 2 Tr 245-46. Second, it is abundantly clear that ROA customers derive no benefit from the Consumers special contracts because

they do not use the contracts and the Consumers proposal would result in higher stranded costs which would be paid by ROA customers to their detriment. This doesn't sound much like the customer benefit which the Commission had in mind as a necessary element to approve special contract rates.

In summary, Consumers has given the Commission no reason to change its long standing and extensive tradition of requiring a utility to report special contract revenues at tariff rates as a means of avoiding the requirement that competitors subsidize the very program against which they are competing.

III. Consumers' Misleading Proposal to Terminate the Securitization Charge Offset Should Be Rejected

A. Consumers Position

Consumers has come up with a dangerously confusing recommendation to terminate the securitization charge offset and allegedly return excess securitization savings to commercial and industrial customers. Consumers Brief, p. 17-19. To summarize: Consumers has correctly stated that its securitization of Palisades nuclear costs produced savings sufficient to fund both a 5% reduction for residential customers and to create additional "excess savings" of approximately $12.321 million per year. Consumers has also correctly said that the Commission ordered that 50% of these "excess savings" be allocated to reduce distribution charges of all commercial and industrial customers (including ROA) and 50% of savings should be used to reduce the transition charge paid by ROA customers. Consumers Brief, p. 17. See U-12505, October 24, 2000, p. 43-44. Also, U-12505, January 4, 2001, p. 6-8. Consumers also claims that the mechanism which they have utilized to deliver the excess savings to ROA customers as an offset to securitization charges is likely, although not certain, to produce an amount of savings ($14.677 million) through the end of 2004 which is less than the projected amount needed to offset securitization charges which Consumers believes will be $15.322 million. Consumers Brief, p. 18. Thus, Consumers claims that it will terminate the offset when the $14.677 million of available excess savings has been fully utilized. Id, p. 19. Exhibit A-19, page 1 of 4, seems to illustrate this point through 2004.

What follows is dangerous and confusing. Consumers then presents a proposal to distribute the remaining 50% of excess savings to commercial and industrial customers (including ROA customers) by determining and distributing the amount of savings that will be available through the end of 2005 and stating that that amount is $25.525 million. Consumers Brief, p. 19.

However, a look at Exhibit A-9 shows that the 50% of savings intending by the Commission to go to commercial and industrial customers as a distribution charge reduction equals only $14.677 million by the end of 2004 and, at the accumulation rate of roughly $6 million a year would only equal about $20 million at the end of 2005. It is quite clear from this exercise that Consumers basically wishes to stop giving ROA customers their transition charge reduction at the end of 2004 and add the amount of money that should have gone to ROA customers in 2005 as a transition charge reduction (about $6 million) to a pool of monies that has been accumulating for all commercial and industrial customers (retail and ROA) as a distribution charge reduction. This enlarged pool would be distributed to all commercial and industrial customers but would frustrate the Commission's intent that two forms of distribution be maintained: 50% of savings to ROA customers as an offset to securitization and 50% savings distributed to all commercial and industrial customers including ROA customers as a reduction (an additional reduction for ROA customers). Consumers offers no legal rationale why the Commission should implement this radical change in policy.

B. Energy Michigan Reply

Disguised as a fairly confusing accounting exercise, Consumers essentially is proposing that the 50% of excess securitization savings dedicated to ROA transition charge reductions (offsets of securitization charges) be prematurely terminated at the end of 2004. The roughly $6 million of funds that would normally go to these ROA securitization offsets on 2005 would be pooled with accumulating excess savings and all of the funds would be delivered pro rata to every commercial and industrial customer (both retail and ROA) as a one time distribution charge reduction.

There are several reasons to reject this Consumers proposal and, instead, terminate the ROA securitization reduction at a point in 2004 when Consumers has demonstrated that funds have run out but resume the reduction in 2005 with the more than $6 million of "excess savings" which will be available in 2005:

1. Excess securitization savings will continue to accumulate in amounts that would fund both commercial and industrial reductions and ROA transition charge reductions until Consumers files a base rate revision case similar to that filed by Detroit Edison in U-13808. Consumers Witness Torrey, 2 Tr 95. Thus, a revision of the Commission policy set forth in U-12505 (that two forms of reduction occur) is not appropriate until a revision of all base rates has taken place to fold in or incorporate these excess savings into the base rate structure. Such a revision cannot take place until a filing has been submitted which addresses all rate classes, not just the ones that are currently unfrozen. Mr. Torrey has admitted this fact on the record. Id.

2. The Commission's policy to continue both the ROA trasition charge reduction and the commercial and industrial distribution charge reduction to the extent of available funds has not been revised by the Commission. This structure was authorized and mandated in an irrevocable order contained in Case U-12505. October 24, 2000, p. 43-44 and January 4, 2001, p. 6-8. Consumers did not appeal those orders. Consumers well understands that the irrevocability of these orders precludes a change until a base rate case has been filed. However, Consumers has presented no reason on this record to justify a change in Commission policy before a base rate case. Thus, the Consumers position in his case is in effect a collateral attack on the U-12505 final order which Consumers did not appeal.

The prudent and reasonable course of action on this complex issue is to simply stay the course until a base rate case has been filed by Consumers with testimony and evidence supporting a long term change of policy. There is no proof that excess savings will be insufficient to continue funding offset of ROA customer securitization charges. However, if funds do run out before the end of 2004, an order can be crafted to terminate the offsets at that time upon a showing by Consumers that funds have run out. However,

the recommendation should also include a resumption of the credits in 2005 and continuation of credits until funds run out once again. This pattern is consistent with Commission policy, unlike Consumers' proposal.

3. The remaining 50% of securitization savings which have been accumulated should be refunded to all commercial and industrial customers, including ROA, and refunded on the basis of a plan similar to that proposed by Consumers for a one time refund.

If Energy Michigan has misconstrued the intent of Consumers Energy, no harm has been done. The securitization offset given to ROA customers can be continued through 2005 or considered in Case U-14098 (the 2005 Consumers transition charge case which also brings up this issue) for future resolution. However, if Consumers' true intent is to terminate the ROA customer offset funded by excess savings in 2004, that is a policy that should be rejected as contrary to the MPSC's stated wishes in Case U-12505 and a change that is premature given Consumers' own failure to file a base rate case which would allow permanent use of excess savings in the retail rate structure.

IV. Reply to Constellation 'Illinois Plan' Proposal

A. Constellation Position

Constellation NewEnergy proposes a stranded cost methodology which it claims is based on a model used in Illinois. Constellation Brief, p. 3-11. In describing this model, Constellation uses the term "lost revenue" several times (e.g., see p. 3) to describe their plan. The Constellation model essentially calculates the margin between the retail market and the ROA market and grants all of that margin minus the market value of "freed up" power as a stranded cost to be collected by the utility except for a small (8-10%) shopping credit which is supposed to give the alternate supplier a profit and the customer a savings. Id. The size of the "shopping credit" margin that will determine the success or failure of the ROA market appears to be totally subjective and unrelated to anything other than political judgment.

B. Energy Michigan Reply

The Constellation proposal should be rejected because it is based on the discredited "lost revenue" method. The Commission has repeatedly rejected the "lost revenue" method for calculating stranded costs. See Case U-12639, p. 11; U-13350, p. 12. Recently in the current Detroit Edison Rate Case U-13808, the Commission stated that the "lost revenue" approach "…clearly produces excessive transition charges". See U-13808, Interim Order, February 20, 2004, p. 59.

On substantive grounds, the Constellation presentation was not accompanied by a detailed financial analysis or a recommendation of specific stranded costs as was the presentation of Energy Michigan. Thus, the Commission was not given a factual basis that would support adoption. As observed by the Attorney General, the Constellation proposal is extremely complex and should be rejected for that reason alone. Attorney General Brief, p. 7.

V. Prayer for Relief

Based upon the evidence and argument presented in this case, Energy Michigan requests that the Commission adopt the following adjustments to Consumers' stranded cost request:

1. Reject Consumers claims that $43 million of incremental seasonal capacity costs which were not included in the frozen 2002 PSCR factor paid by retail customers should be recovered only from ROA customers as stranded costs.

2. Reject Consumers' claim that over $13.7 million of incremental QF capacity costs which were not included in the 2002 PSCR factor should be recovered only from ROA customers as stranded costs.

3. Reject treatment as stranded costs for over $46.7 million of Clean Air Act costs which have been ruled by the Commission to be unrecoverable from ROA customers and are recoverable from retail customers in either retail rate increases or securitization bond payments.

4. Reject Consumers request for recovery, as stranded costs, of post-2000 Generating Plant capital improvements to Generating Plants since these improvements were not included in the rates paid by retail customers as of the PA 41 rate freeze which took effect June 2000.

5. Reject Consumers request to report special contract revenues at discounted rates rather than increasing these revenues to retail levels to prevent requiring ROA customers to subsidize competitive offerings.

6. Reject Consumers' proposal to terminate the rate credit for ROA customers funded by excess securitization savings.

7. Reject the request of Constellation NewEnergy that the Commission adopt the "Illinois" lost revenue method of calculating stranded costs.

Respectfully submitted,

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Attorneys for Energy Michigan, Inc.

July 1, 2004

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Energy Michigan Reply Brief
Case U-13720
July 1, 2004

TAB A

Consumers Energy
Calculation of 2002 Stranded Cost
STAFF Exhibit

Line No.	Description	[1] Consumers	[2] Staff Case With Multi-Year Options and QFs Included	[3] Staff Case Multiyear Options Excluded, QF Included	[4] Staff Base Case Options Included & QF Excluded	[5] Staff Case Options & QF Capacity Excluded	[6] Energy Mich Positon
	Direct Costs						
1	2000 Net Production Plant	$1,524,386	$1,524,386	$1,524,386	$1,524,386	$1,524,386	$1,034,060
2	Pre-Tax Rate of Return	10.63%	10.63%	10.63%	10.63%	10.63%	10.63%
3	Return Required	$162,042	$162,042	$162,042	$162,042	$162,042	$109,921
4	Depreciation	$56,979	$56,979	$56,979	$56,979	$56,979	$56,979
5	Property Taxes	$42,720	$42,720	$42,720	$42,720	$42,720	$42,720
6	Insurance	$858	$858	$858	$858	$858	$858
7	PPA Capacity Charges	$481,001	$481,001	$481,001	$467,301	$467,301	$472,983
8	Revenue Required of Fixed Gen.	$743,600	$743,600	$743,600	$729,900	$729,900	$683,461
9	Net Cost of Summer Capacity (Options)	$43,119	$21,404	$12,752	$21,404	$12,752	$0
10	Total						
11	**Total Generation Related Reg Assets**	**$786,719**	**$765,004**	**$756,352**	**$751,304**	**$742,652**	**$683,461**
12	**Remove Clean Air Act Rev Req**	**($46,700)**	**($46,700)**	**($46,700)**	**($46,700)**	**($46,700)**	
13	**Total Revenue Requirement**	**$740,019**	**$718,304**	**$709,652**	**$704,604**	**$695,952**	
	Fixed Generation Related Revenue						
14	Total Revenue from Sales to Ultimate Customers	$2,411,253	$2,411,253	$2,411,253	$2,411,253	$2,411,253	$2,411,253
15	2002 Special Contract Revenue	$0	($145,749)	($145,749)	($145,749)	($145,749)	($145,749)
16	2002 Special Contract Revenue under Standard Tariffs	$0	$165,618	$165,618	$165,618	$165,618	$165,618
17	Tariff Based 2002 Revenue	$2,411,253	$2,431,122	$2,431,122	$2,431,122	$2,431,122	$2,431,122
18	Generation as Percent of Sales	29.10%	29.10%	29.10%	29.10%	29.10%	29.10%
19	Fixed Generation Related Revenues	$701,790	$707,573	$707,573	$707,573	$707,573	$707,573
20	From: Third Party Sales	$190	$190	$190	$190	$190	$191
21	**Total Contribution to Fixed Generation Costs**	**$701,980**	**$707,763**	**$707,763**	**$707,763**	**$707,763**	**$707,764**
22	**Total Stranded Costs**	**$38,039**	**$10,541**	**$1,889**	**($3,159)**	**($11,811)**	**($24,304)**
23	ADD: Clean Air Act Revenue Requirement	$46,700	$0	$0	$0	$0	
24	**Final Stranded Costs/(Benefits)**	**$84,739**	**$10,541**	**$1,889**	**($3,159)**	**($11,811)**	

Energy Michigan Reply Brief
Case U-13720
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TAB B

CONSUMERS ENERGY COMPANY

ASSESSMENT OF THE GENERATION AND TRANSMISSION CAPACITY AND PLAN FOR MEETING SUMMER 2004 PEAK LOAD DEMAND

On January 22, 2004, the Michigan Public Service Commission, in its Order in Case U-14005, ordered Consumers Energy Company ("Consumers") to file with the Commission "an assessment of the ability of the utility to meet customers' expected electric requirements in 2004". This assessment is in response to that order.

OVERVIEW

Consumers has adequate generation resources and long term contracts to meet loads that are expected to occur over the calendar year 2004. Unusual events such as extreme weather combined with generation unavailability can create capacity shortages at any time.

Because Consumers is in the process of finalizing its specific summer capacity plans and power supply arrangements, and because of uncertainty about economic recovery and the uncertainty in the timing and amount of Retail Open Access ("ROA") load to be served by others, the forecasted peak loads, planned capacity additions and associated reserve margins are provided as estimates rather than specific final values.

PEAK LOAD FORECAST

The Company forecasts peak hourly load using appropriate statistical and regression analysis of factors that significantly affect electricity sales in its service territory. Consumers has forecasted the expected weather normalized load in its traditional service area to peak during Summer 2004 at 8,758 MW, including the load associated with the ROA program. This increase of approximately 4.5% from the 2003 weather adjusted peak load of 8,383 MW[1] reflects changes in Consumers' service territory due to economic growth and increased air conditioning use.

Based on assumed commitments to the ROA program, Consumers' planning assumption is that the estimated nominal load to be served by others this summer is approximately 873 MW, with a coincident peak of 694 MW[2], leaving the Company to serve 8,064 MW. The actual load to be served by others under the ROA program could be higher or lower than the amount assumed by Consumers. Exhibit 1 provides the probability distribution of potential load values, under various assumptions that reflect the variability of the load demand due to economic and environmental factors.

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[1] Consumers' actual year 2003 peak load occurred on August 21, 2003 at 7,721 MW. The total system load, including 449 MW of coincident peak ROA load served by others, was 8,170 MW. Consumers believes that the total system load would have been 8,383 MW had normal seasonal high temperature weather been experienced on that day.

[2] Consumers estimates that 873 MW of nominal ROA load will be served by others by August 2004. The coincident peak summer load of 694 MW for ROA is projected to occur in August.

Comparison of Summer 2004 Load and Capacity

	MW
Load	
Interruptible	5
Firm	8,059
Projected Peak Load Demand MW)	8,064
Capacity	
Utility-Owned Generation	6,440
Non-Utility Generators	1,657
Sub - Total (MW)	8,097
Current Summer Capacity Plans (Power Supply Call Options, Self-Generation Contracts, Load Shift Contracts and Other Seasonal Purchases)	856
Total (MW)	8,953
[redacted]	[redacted]

* Assuming a nominal retail open access load of 873 MW is supplied by others.

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

****

In the matter of the application of CONSUMERS ENERGY COMPANY for determination of net stranded costs for the year 2002 and approval of net stranded cost recovery charges.	))))))	Case No. U-13720

PROOF OF SERVICE

Monica Robinson, duly sworn, deposes and says that on the 1st day of July, 2004 she served a copy of Energy Michigan's Reply Brief in the above captioned matter upon those individuals identified in the attached service list by e-mail and regular mail at their last known addresses.

Signature Not Verified
Monica Robinson
Digitally signed by Monica Robinson
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Monica Robinson, Deponent

Subscribed and sworn to before me
this 1st day of July 2004.

Signature Not Verified
Eric J. Schneidewind
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