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June 22, 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 Initial 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

EJS/mrr

cc: ALJ
parties

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

ENERGY MICHIGAN, INC. INITIAL BRIEF

June 22, 2004

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ENERGY MICHIGAN, INC. INITIAL BRIEF

I. Introduction and Summary of Position

A. Introduction

In Order U-12639 the Michigan Public Service Commission ("Commission") directed Consumers Energy Company ("Consumers" or "Consumers Energy") to file proposals each year to calculate and collect stranded costs and any resulting transition charges. The Commission further ordered that stranded costs be calculated using a method proposed by MPSC Staff which compares the Production Fixed Costs ("PFC") of a utility's generating plants with the revenue available to pay those fixed costs (PFC revenue) during a historical period for which one year of MPSC or FERC reported data is available. Since the U-12639 formula uses historic data, this case calculates 2002 stranded costs to develop charges to collect such costs, if any, in 2004.

Energy Michigan, Inc. ("Energy Michigan") presented direct testimony in this matter covering calculation and collection of stranded costs and securitization related fees in a manner consistent with the basic approach adopted by the Commission. The Energy Michigan position on implementing the basic formula adopted by the Commission is discussed in III. of this Brief.

B. Summary of Energy Michigan Position on Calculation of 2002 Stranded Costs to Develop a 2004 Stranded Cost Charge

Listed below are the major components of the Energy Michigan position opposing Consumers' proposal to collect over \$84 million of stranded costs relating to the year 2002:

1. Consumers has overstated the Production Fixed Costs of its power supply which are recoverable in this case.

2000 PA 141 § 10d(1) imposed a rate freeze on Consumers Energy from the June 5, 2000 date of passage of PA 141 until December 31, 2003. During this period, Consumers was legally prohibited from raising retail rates to collect increased costs. Id. Nonetheless, Consumers proposes to recover, from ROA customers, its increased capital, purchased power and purchased summer capacity expenses which exceed levels recovered from retail customers in its 2002 frozen rates. To recover these increases Retail Open Access customer rates would be raised by means of a transition charge.

Consumers proposed transition charges should be rejected because the charges represent an attempt to circumvent the PA 141 rate freeze. To stop these violations of the PA 141 rate freeze the Commission should:

- a. Reject Consumers' request to collect, from ROA customers, over \$43 million of seasonal purchased power capacity costs above levels recovered from retail customers in the 2002 frozen PSCR levels.

All of these increased seasonal capacity costs were incurred to serve retail customers but none of the cost increases could be collected through the 2002 PSCR due to the PA 141 rate freeze. Instead, Consumers proposes to violate the rate freeze by relabeling these purchases as "stranded costs" and collecting all of the costs from ROA customers.

b. Reject Consumers' request to collect, from ROA customers, over \$13.7 million of increased costs of Qualified Facility contracts which were not placed in the 2002 frozen PSCR factor due to the 2000 rate freeze.

Commission Orders U-11180R dated March 14, 2000 and July 11, 2001 refused permission for Consumers to modify its frozen PSCR to include \$13.7 million of increased costs of purchases from the Ada, MCV and MPLP co-generation projects. Order U-12366 dated June 19, 2000 refused Consumers' request to reinstate an increased PSCR factor which included these QF increases. Instead, Consumers has attempted to recover uncollectible QF increases from ROA customers as stranded costs. Under this approach, ROA customers would be the only class who would see an increase in their rates to pay for these 2002 QF purchases.

c. Reject Consumers' request to recover over \$46.7 million of capital cost improvements to its generation plants which are necessary to comply with Clean Air Act ("CAA") requirements.

The Commission's Orders in Case U-13380 December 20, 2002, p. 2 and in U-13715, June 2, 2003, p. 59-60 directed Consumers to recover CAA costs from retail customers rather than from ROA customers.

d. Reject Consumers proposal to calculate Production Fixed Costs eligible for recovery from ROA customers using capital additions to generation plants after passage of PA 141 2000.

PA 141 § 10d(4) provides that PFC fixed costs above depreciation levels in effect June 2000 cannot be collected from any customer until a proceeding to determine these costs. Such a proceeding has not been held.

2. Consumers has understated the amount available to pay for Production Fixed Costs.

Contrary to numerous Commission orders starting with U-10646 decided March 23, 1995, Consumers reported revenue from special contracts at the discounted contract rates which are below retail rate levels. This practice reduces the revenue available to pay stranded costs and thus increases stranded costs. Staff and Energy Michigan support reporting special contract revenue at tariff levels which would increase overall revenue by \$19.87 million and decreases stranded costs by 29.105% or roughly \$5.8 million of stranded costs. Consumers' position is also contrary to the Commission's rulings on the same issue in stranded cost Cases U-12639, U-13350 and U-13380.

3. Consumers Energy has \$24.3 million of stranded benefits.

Based upon the modifications of Consumers' position described above, Consumers' Production Fixed Costs revenue exceed its Production Fixed Costs revenue requirement by approximately \$24.3 million in calendar year 2002. See Tab A. Given this conclusion, Consumers has no stranded costs and indeed Production Fixed Cost revenue exceeds Production Fixed Costs thus creating over \$24 million of stranded benefits. This excess of revenue necessary to pay stranded costs should be carried forward to offset stranded costs in future years.

Detailed Discussion

II. The U-12639 Method of Determining Stranded Costs

In Case U-12639, the Commission adopted a method of calculating stranded costs which compares the revenue requirement of the fixed costs of producing power with the revenue available to pay those fixed costs. Any deficiency is a stranded cost, any surplus is a stranded benefit. U-12639, December 20, 2001, p. 20-21.

1. The basic formula.

The formula may be stated as:

$$\begin{array}{r} \text{Production Fixed Costs Revenue} \\ - \text{Production Fixed Costs} \\ \hline \text{Stranded Cost/Benefit} \end{array}$$

2. The formula used to estimate Production Fixed Cost revenue.

Revenue available to pay production fixed costs consists of an estimated percentage of revenue from total sales of power to retail customers which is available to pay Production Fixed Costs of power generation. To this revenue is added revenue from power sales to third parties minus variable costs and credits already given to retail customers. Id.

Under the Staff method, it was assumed that a certain percentage of utility revenues (the Allocation Percentage) was available to pay the fixed costs of generation. That Allocation Percentage was developed by reviewing cost data from the last Consumers rate Case U-10685 to determine overall power supply fixed cost in dollars of generation and dividing that number by total revenue in dollars. In this case, Staff and Consumers calculated that 29.1048% of retail revenues were available to pay the fixed costs of power supply. The revenue available in the current case to pay Production Fixed Costs was to be estimated by applying the Staff percentage factor (29.1048%) times Consumers' year 2002 production (generation) related revenues which would yield a total dollar contribution from retail sales which was available to pay Production Fixed Costs.

III. The Energy Michigan Stranded Cost Recommendation

This section sets forth the Energy Michigan position regarding appropriate calculation of Consumers' 2002 stranded costs/benefits. This presentation is divided into III.A which discusses the appropriate components of the Production Fixed Costs revenue requirement associated with

Consumers' fixed generation assets and III.B. which discusses the Production Fixed Costs revenue available to pay for Consumers' PFC revenue requirements.

A. Recommended Adjustments to Consumers Proposed PFC Revenue Requirements

In the stranded cost calculation described above, PFC revenue requirements must be compared with PFC revenue. If a deficit exists there is stranded cost which must be collected by means of transition charges. If a surplus exists, there are stranded benefits which Energy Michigan recommends be carried forward to pay for future stranded costs. Following are revisions to the PFC revenue requirements recommendations of Consumers Energy which were part of the Energy Michigan calculation of stranded costs presented as Exhibit I-15 and attached as Tab A.

1. **INCREMENTAL QF COSTS:** Energy Michigan opposes recovery of QF costs above levels contained in Consumers 2002 frozen PSCR factor.

Consumers Energy witness Matthew Torrey (and MPSC Staff witness Larry Bak) recommended that Consumers' PFC revenue requirement include \$481 million of purchased and interchanged capacity costs associated with the purchase of power from external generating sources such as Qualified Facilities, other utilities and independent generating plants. Exhibit A-4, line 7; Exhibit S-13, line 7. Contained in the amount requested for recovery is approximately \$13.7 million associated with payments to the Ada Cogeneration, MCV and MPLP cogeneration projects which the Commission refused to include in the 2002 PSCR factor collected from Consumers' retail customers. Torrey Direct, p. 13; Staff Response to Energy Michigan Discovery Exhibit I-14.

Briefly, a ruling in PSCR Case U-11180R dated August 31, 1999 authorized Consumers permission to increase its PSCR to recover \$13.7 million of cost increases for the Ada, MCV and MPLP QF projects when Retail Open Access service reached a target of 150 MW of capacity. However, Consumers did not reach the 150 MW target before PA 141 was enacted (see Section 10d(1)) which froze all existing Consumers rates until December 31, 2003). Thus, Consumers was prevented from increasing its PSCR factor to

include increases due to incremental costs of power from the Ada, MCV and MPLP QF projects.

Consumers requested changes to the August 31, 1999 U-11180R Order which were denied March 14, 2000. In a July 11, 2001 order in the same matter, the Commission denied a Consumers "Motion for Clarification". July 11, 2001, U-11180R.

On March 31, 2000, Consumers filed an application to reinstate its PSCR clause effective July 1, 2000 through June 2001 which would have increased customer PSCR rates to pay \$13.7 million of increased costs for the Ada, MCV and MPLP QF projects. But on June 5, 2000 PA 141 took effect. Based on the enactment of PA 141, the Commission found that, "The reinstatement of Consumers' PSCR clause, which is designed to adjust rates for changes in the cost of fuel and purchased power, is inconsistent with Subsection 10d(1) [of PA 141]." U-12366, June 19, 2000, p. 2.

By these rulings, the Commission prevented Consumers Energy from increasing its PSCR rate to incorporate, among other things, \$13.7 million of increases associated with MCV, Ada and MPLP capacity payments which were not being recovered from retail customers as of the passage date of PA 141. Testimony in this case shows that the Ada, MCV and MPLP QF capacity is being delivered to retail customers and used by retail customers but the cost increases for those QF projects are not being included in the PSCR factor paid by retail customers. 2 Tr 92-93. In effect, Consumers' proposal to recover \$13.7 million of increased QF costs as stranded costs requires ROA customers to pay for a power supply cost increase which was unrecoverable during 2002 from the retail customers who benefited from the power supply. This proposal is nothing more than an attempt to break the PA 141 price freeze by collecting a power supply increase from ROA customers when those same costs could not be legally collected from retail customers. Polich Direct, Tr 218-19. The Energy Michigan Exhibit I-15, line 7 reflects removal of these costs. See Tab A.

2. **SEASONAL POWER COSTS:** Consumers' seasonal capacity costs above frozen 2002 PSCR levels should not be collected from ROA customers.

During the summer of 2002 Consumers claims to have incurred roughly \$43.05 million of expenses for seasonal (Summer and Winter) capacity purchases above levels contained in the frozen 2002 PSCR clause. 2 Tr 154. Despite the fact that Consumers was prohibited from recovering these costs from retail customers due to operation of law (the PA 141 rate freeze), Consumers desires to collect the increased cost of these power supplies from ROA customers as stranded costs. See Exhibit A-4, line 9.

Energy Michigan witness Polich testified that seasonal capacity purchases are avoidable costs which could be rendered unnecessary by ROA load and which in any event were largely incurred subsequent to the passage of PA 141. Polich, 2 Tr 215-17. To the extent that Consumers desires to add temporary power supplies to its obligations but is rendered unable to collect costs of these supplies from the benefited customer, this is the responsibility of Consumers, not ROA customers. Id.

These seasonal capacity costs and the incremental QF costs discussed in III.A.(1) are not uncollectible due to increased ROA participation which, if anything, reduced the amount of seasonal capacity that Consumers was required to purchase without compensation. Rather, the PA 141 mandated rate freeze prevented collection of these costs from retail customers. Rejection of these seasonal power as stranded costs above frozen PSCR levels reduced Mr. Polich's recommended revenue requirement by over \$43 million. See Exhibit I-15, line 10. See Tab A.

3. **CLEAN AIR ACT COSTS:** Consumers is attempting to collect Clean Air Act improvements from ROA customers contrary to MPSC rulings in Cases U-13380 and U-13715.

In Cases U-13380, December 20, 2002, p. 2 and U-13715, June 2, 2003, p. 59-60. The Commission rejected Consumers' attempts to collect Clean Air Act capital improvements

to generating plants from ROA customers as stranded costs. The Commission found "...that the costs incurred for Clean Air Act compliance are not eligible for stranded cost recovery but are subject instead to the provisions of Section 10d(3) of 2000 PA 141." U-13380, December 20, 2002, p. 2. The Commission has taken the position that Consumers may recover these costs from its retail customers as securitized costs or presumably as part of the rate base after the rate freeze. See Detroit Edison Case U-13808. In this case, Consumers has taken the position that if it does not securitize these costs it may collect them as stranded costs to the tune of \$46.7 million. See Exhibit A-4, line 19.

Also, Energy Michigan witness Polich testified that the Clean Air Act costs are benefiting Consumers production facilities which are price and cost competitive with the market and therefore are not likely to be stranded assets. 2 Tr 215.

Both Staff and Energy Michigan removed Clean Air Act costs from the Consumers request. See Exhibit S-13, line 22 and I-15, line 9 (Tab A).

4. **POST 2000 CAPITAL COSTS:** Consumers should not recover Generating Capital Investments incurred after passage of PA 141.

Both MPSC Staff and Consumers Energy calculated the Production Fixed Costs revenue requirement including all of Consumers' generating plant capital costs through 2002 including investments which had been made after passage of PA 141 in June 2000. See Exhibit A-4, line 1 and I-13, line 1.

PA 141 § 10d(4) provides that PFC costs above depreciation levels in effect when PA 141 was passed cannot be collected from any customer until a proceeding to determine these costs. Such a proceeding has not been held.

Mr. Polich accomplished this adjustment by reducing the production plant rate base from the 2002 levels used by Staff and Consumers to a year 2000 net production plant level. See Exhibit I-15, line 1.

Energy Michigan witness Polich testified that generating plant investments above levels in place at passage of PA 141 should be excluded because Michigan's utilities were put on notice that competition was coming and they would need to be competitive. Polich, 2 Tr 211. If these investments were not recoverable in a competitive market, they should not have been made and the power plant should be retired. If the investments are recoverable in a competitive market, they are not stranded and the full price should be recovered from retail customers who benefit from the investment.

B. Adjustments to Consumers' Proposed Revenue Available to Pay Production Fixed Costs

In the stranded cost calculation, Production Fixed Costs revenue requirement must be compared with the Production Fixed Costs available to pay these costs. Staff and Energy Michigan made only one adjustment to Consumers' calculation of Production Fixed Cost Revenue.

1. **SPECIAL CONTRACT REVENUE:** Special contract revenue should be reported at retail rates to avoid requiring ROA customers to pay for discounts offered by competitors.

Once again, Consumers requests that the Commission use discounted revenue rates from special contract customers to calculate the amount of revenue available to pay stranded costs. However, ever since the mid-1990s, the Commission has required both Detroit Edison and Consumers Energy to report special contract revenues as though the special contracts were billed at retail rates for purposes of determining how much revenue the company has available to pay for production (generating) costs. As recently as January 29, 2004, the Commission stated:

The policy [of treating special contract revenue as if it were at tariff rates] that [Consumers] seeks to undo was established by the March 23, 1995 order in Case U-10646, an application by Detroit Edison for special contract approval. In that landmark decision, which was developed in a fully litigated proceeding, the Commission determined that any attempt to reallocate the discounts granted by a utility to a

special contract customer to other ratepayer classes would require "a compelling showing" to overcome the "substantial burden" of the presumption that such discounts should be recovered from utility shareholders. The inability to impute the special contract discounts revenues in any proceeding affecting Consumers' rates would mean an increase in the cost of service for bundled and unbundled customers not party to the contract absent the "compelling showing" required by the Commission's prior orders. Moreover, it would constitute the abandonment of longstanding and consistently followed precedent.

[A Consumers contract provision prohibiting imputation of revenues at tariff rates] is contrary to dozens of prior Commission orders approving special contracts. The procedures set forth in the March 23, 1995 order in Case No. U-10646 were reaffirmed in the October 25, 1996 order in Case U-10961, a special contract application for Consumers. Further, in 1997 alone, the Commission applied this policy in approving 39 special contracts, including 14 for Consumers. See, the February 5, 1997 orders in Cases Nos. U-11299 and U-11312, the April 10, 1997 order in Case No. U-11353, the April 29, 1997 orders in Cases U-11341 and U-11342, the May 7, 1997 order in Case No. U-11360, the May 30, 1997 orders in Cases Nos. U-11254, U-11256, U-11257, U-11258, U-11259, U-11260, U-11261, U-11262, U-11263, U-11264, U-11266, U-11267, U-11268, U-11269, U-11313, U-11317, U-11318, U-13343, U-11384, U-11385, U-11386, U-11387, U-1188, U-11389, U-11390, U-11391, U-11392, U-11393, U-11394, U-11395 and U-11386, the June 25, 1997 order in Case U-11336, and the July 31, 1997 order in Case No. U-11447. Conspicuous by its absence is any citation of contrary authority by Consumers to support its position. U-13989, January 29, 2004, p. 13.

The Commission decisions listed above avoid the obvious inequity of allowing Consumers to compete with cogeneration or ROA service through rate discounts while calculating stranded costs by using a revenue stream which is deliberately reduced in order to compete with ROA service. To adopt the Consumers position would be to allow the utility to reduce its rates on the one hand to compete with ROA and on the other hand pass along the revenue shortfall resulting from those reduced rates to ROA customers as stranded costs. This would occur because discounted rate revenue was insufficient to cover Consumers' Production Fixed Costs.

To refute Consumers' contention that its special contracts did not harm competition, Mr. Polich testified that the primary purpose of Consumers' special contracts was to discourage competition from cogeneration. 2 Tr 245-46.

To refute Consumers' contention that it had met the tests posed by the Commission as a condition to refrains from imputation of special contract revenue at tariff rates, Mr. Polich also testified that the Consumers methodology in allegedly conducting cost of service studies to justify the discount rates was flawed, the analysis did not show the impact on other customer classes due to redistribution of costs and the allocation factor of 29.105% is not appropriate for this class of customers where a much higher percent of revenue is attributable to generating costs than would be the case for the other customers. Polich Direct, 2 Tr 212-15.

Both Staff and Energy Michigan agreed on this issue and followed long standing Commission precedent by increasing special contract revenue to impute the special contract revenue at tariff rates. See Exhibit I-15, line 14. Staff witness Blair made the same adjustment in Exhibit S-13, line 15. See Tab A.

C. Summary of Energy Michigan Revisions to the Consumers Proposal

With the revisions to the Consumers position outlined above, Energy Michigan witness Polich calculated that Consumers Energy had no stranded costs in 2002 and in fact, Production Fixed Costs revenue exceed PFC revenue requirements by more than \$24 million leaving this sum as a "stranded benefit" which should be available to offset future securitization charges. See Exhibit I-15, Tab A.

III. Conclusion and Prayer for Relief

Based upon the evidence and argument presented in this case, Energy Michigan requests that the Commission adopt the following adjustments to the 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 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 from retail 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 in 2002.

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.

Respectfully submitted,

VARNUM, RIDDERING, SCHMIDT & HOWLETTLLP
Attorneys for Energy Michigan, Inc.

June 22, 2004

By: _____
Eric J. Schneidewind (P20037)
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201 N. Washington Square
Lansing, Michigan 48933
(517) 482-6237

Energy Michigan Brief
Case U-13720
June 22, 2004

TAB A

ENERGY MICHIGAN
Consumers Energy 2002 Stranded Cost Case
2002 Stranded Cost Analysis

Case No: U-13720
Exhibit No. I-15 (RAP-1)
Page No: 1 of 1
Witness: R.A. Polich
Date: 22-Jun-04

<u>Line No.</u>	<u>Description</u>	<u>Actual 2002</u>	<u>Source</u>
<u>Direct Costs</u>			
1	2000 Net Production Plant	\$1,034,060	RAP WP-1
2	Pre-Tax Rate of Return	<u>10.63%</u>	MA Torrey Exhibit (MAT-1)
3	Return Required	\$109,921	MA Torrey Exhibit (MAT-1)
4	Depreciation	\$56,979	MA Torrey Exhibit (MAT-1)
5	Property Taxes	\$42,720	MA Torrey Exhibit (MAT-1)
6	Insurance	\$858	MA Torrey Exhibit (MAT-1)
7	PPA Capacity Charges	<u>\$472,983</u>	2001 PPA Capacity Costs
8	Revenue Required of Fixed Gen.	\$683,461	Sum of Lines 3-7
<u>Fixed Generation Adjustments</u>			
9	Clean Air Act Revenue Requirement Removal	\$0	Already excluded
10	Seasonal Capacity Adjustment	<u>\$0</u>	
11	Total Generation Related Reg Assets	\$683,461	Sum of Lines 8-10
<u>Fixed Generation Related Revenue</u>			
12	Total Revenue from Sales to Ultimate Customers	\$2,411,253	MA Torrey Exhibit (MAT-1)
13	2002 Special Contract Revenue	(\$145,749)	SB Brocket Exhibit (SBB-1)
14	2002 Special Contract Revenue under Standard Tariffs	<u>\$165,618</u>	SB Brocket Exhibit (SBB-1)
15	Tariff Based 2002 Revenue	\$2,431,122	Sum of Lines 12-14
16	Generation as Percent of Sales	<u>29.10%</u>	MA Torrey Exhibit (MAT-1)
17	Fixed Generation Related Revenues	\$707,573	Line 12 * Line 13
18	From: Third Party Sales	\$191	MA Torrey Exhibit (MAT-1)
19	Total Contribution to Fixed Generation Costs	<u>\$707,764</u>	Sum of Lines 14 & 15
20	Total Stranded Costs	(\$24,304)	Line 11 minus Line 20

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_____)

Case No. U-13720

PROOF OF SERVICE

Monica Robinson, duly sworn, deposes and says that on the 22nd day of June, 2004 she served a copy of Energy Michigan's Initial 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.

Monica Robinson, Deponent

Subscribed and sworn to before me
this 22nd day of June 2004.

Eric J. Schneidewind, Notary Public
Eaton County, Michigan
Acting in Ingham County, Michigan
My Commission Expires: April 24, 2006

Service List U-13720

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