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May 14, 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 Rebuttal Testimony of Richard A. Polich on Behalf of Energy Michigan. 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 for approval of net)
stranded cost recovery charges)
_____)

Commission Case No. U-13720

REBUTTAL TESTIMONY

OF

RICHARD A. POLICH

ON BEHALF OF

ENERGY MICHIGAN

May 14, 2004

Rebuttal Testimony of Richard A Polich
On Behalf of Energy Michigan
MPSC Case U-13720

1 Q. Please state your name and business address.

2 A. My name is Richard A. Polich. My business address is PO Box 3522, Ann Arbor,
3 Michigan

4 Q. By whom are you employed and what is your present position?

5 A. I am currently working as an independent consultant in a firm called Energy Options &
6 Solutions.

7 Q. Are you the same Richard A Polich who previously testified in this proceeding

8 A. Yes, I am.

9 Q. On whose behalf are you presenting rebuttal testimony in this proceeding?

10 A. The Rebuttal Testimony I am presenting in this case is on behalf of Energy Michigan

11 **Purpose of Rebuttal Testimony**

12 Q. What is the purpose of your Rebuttal Testimony in Consumers Energy's Case No. U-
13 13720?

14 A. My Rebuttal Testimony will address the testimony of the Michigan Public Service
15 Commission ("Commission") Staff witnesses Larry S. Bak and Daniel J. Blair. The
16 MPSC Staff included several items which should not be included in stranded cost
17 calculations because they were not recoverable under Consumers Energy's
18 ("Consumers") frozen rate structure in 2002. Any increases in plant in service or power
19 supply costs since enactment of Public Act 141 are not included in frozen rates and are
20 not recoverable from full service customers. Including these costs in the calculation of
21 stranded costs allows Consumers recovery of these costs from Retail Open Access
22 customers and violates the law. The second issue is in regards to the MPSC Staff's

1 treatment of the special contract discounts. The MPSC Staff should have included 100%
2 of the discounts in the Contribution to fixed costs because these discounts are associated
3 with generation related revenues.

4 I will also address the proposal by Constellation NewEnergy (“NewEnergy”)
5 Witness Philip R. O’Conner regarding calculation of stranded costs. While Energy
6 Michigan agrees with NewEnergy regarding the need for stability in Stranded Cost
7 Charges, the “lost revenue” approach proposed by NewEnergy will result in significant
8 stranded costs regardless of Consumers actual income and earnings on its production
9 asset rate base. This approach has been proposed numerous times by both Detroit Edison
10 and Consumers and rejected by the Commission. Energy Michigan has and continues to
11 oppose this approach to the calculation of stranded costs.

12 **Production Assets in Rate Base**

13 Q. Why is the calculation of revenue requirement for fixed costs of generation, as calculated
14 by MPSC Staff witness Mr. Blair, inconsistent with Consumers current rates?

15 A. Mr. Blair calculated the revenue requirement of fixed cost of generation using
16 Consumers’ year end 2002 net production plant, including Construction Work in Progress
17 (CWIP). The rate structure for Consumers’ customers is based upon Consumers’ Cost of
18 Service contained in Case U-10685. These rates have been subsequently modified by the
19 Commission to reflect securitization and rate reductions resulting from PA 141.

20 Consumers has not filed any request for the recovery of increased investment in fixed
21 production costs since the Commissions’ November 1996 order in Case U-10685. Thus,
22 any increase in Consumers’ net production plant is not reflected in current rates and
23 would not be recoverable under the PA 141 rate freeze. Since Consumers is not entitled
24 to additional revenue for increases in net production plant from its full service customers,

1 it should not be entitled to include the increased revenue requirement in its stranded cost
2 calculation.

3 Q. What is the effect of performing the Stranded Cost Calculation as proposed in Mr. Blair's
4 Exhibit S-___(LSB-1)?

5 A. The use of the 2002 net production plant including CWIP, shown on line 1 of Mr. Blair's
6 Exhibit S-___(LSB-1) effectively gives Consumers a rate increase. This rate increase is
7 shared by both bundled and Retail Open Access ("ROA") customers. The bundled
8 customers portion is paid by the sales increases since the Commission's Order in Case U-
9 10685. In the Commission's February 5, 1996 U-10685 Order, it established the
10 jurisdictional sales level at 33,151,660 MWh. Consumers' 2002 bundled sales was
11 33,975.327 MWh which is a 2.5% increase over the amount set in U-10685. Under Mr.
12 Blair's stranded cost calculation, this bundled sales increase would pay for a portion of
13 the rate increase due to use of 2002 net production plant. The remaining portion of the
14 rate increase in Mr. Blair's calculation would fall to stranded costs and would be paid for
15 by ROA customers.

16 Q. How much of a rate increase results from Mr. Blair's use of 2002 figures in calculation of
17 revenue requirement of fixed costs of generation?

18 A. Consumers' witness Michael A. Torrey calculates the revenue requirement for fixed
19 generation costs from the Commission's U-10685 Order as \$649,934,996 on line 13 of
20 his Exhibit A-___(MAT-2). Mr. Blair's Exhibit S-___(LSB-1) shows a figure of
21 \$696,900,000 for the fixed generation costs, after removal of clean air act revenue
22 requirement. Thus, Mr. Blair's calculation inadvertently gives Consumers an effective
23 rate increase of \$46,965,004.

24 Q. What changes should be made to Mr. Blair's calculation of revenue requirement of fixed
25 costs of generation?

1 A. The stranded cost calculation should use Consumers' 2000 production plant in service
2 figures because this represents Consumers' cost structure at the time of the rate freeze.

3 **Power Supply Cost Increases**

4 Q. What is Mr. Blair's position regarding inclusion of summer capacity costs?

5 A. Mr. Blair proposes to include \$12,437,000 of summer capacity costs in the stranded cost
6 calculations.

7 Q. What is the effect of this recommendation?

8 A. As with the use of 2002 production plant figures, the inclusion of the summer capacity
9 costs results in a rate increase for Consumers. These summer capacity costs cannot be
10 included in the PSCR because of frozen rates. By including them in the stranded costs
11 calculation, the Commission would be allowing Consumers to recover these costs
12 through stranded costs.

13 Q. What is your recommendation on the treatment of summer capacity costs?

14 A. The summer capacity costs should not be included in the stranded costs calculation
15 because these costs are not recoverable from bundled customers under the terms of the
16 rate freeze. In addition, summer capacity costs are a variable cost associated with serving
17 bundled customers. Summer capacity costs should not be included in the stranded costs
18 calculation for these reasons.

19 **NewEnergy's Stranded Cost Position**

20 Q. Do you agree with NewEnergy's proposed modifications to the calculation and treatment
21 of stranded costs?

22 A. No. The lost revenue method proposed by Philip R. O'Connor does not calculate real
23 stranded costs. The lost revenue method of calculating stranded costs would always
24 produce stranded costs regardless of utility sales level, revenue recovery or ROA sales.

1 The stranded cost methodology proposed by Mr. O'Connor, would seriously harm if not
2 eliminate the ROA program in Consumers service area.

3 Q. What is the cost of the "stability" included in the stranded cost calculation methodology
4 proposed by Mr. O'Connor?

5 A. The cost is the setting of transition charges which have no relationship to actual market
6 prices of power. The result would be lower customer participation and higher returns to
7 the utility when wholesale power prices increase. This would cause increased costs for
8 all customers as Consumers would be forced to purchase additional capacity in the
9 wholesale market.

10 Q. What is your recommendation concerning Mr. O'Connor's proposal?

11 A. The Commission should reject this method as it has done so numerous times in previous
12 stranded cost cases.

13 Q. Does this conclude your testimony?

14 A. Yes, it does.

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_____)

Case No. U-13720

PROOF OF SERVICE

Monica Robinson, duly sworn, deposes and says that on the 14th day of May, 2004 she served a copy of Rebuttal Testimony of Richard A. Polich on Behalf of Energy Michigan 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 14th day of May 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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