



201 N. WASHINGTON SQUARE • SUITE 810  
LANSING, MICHIGAN 48933

TELEPHONE 517 / 482-6237 • FAX 517 / 482-6937 • WWW.VARNUMLAW.COM

ERIC J. SCHNEIDEWIND

E-MAIL [ejschneidewind@varnumlaw.com](mailto:ejschneidewind@varnumlaw.com)

July 23, 2004

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

Re: Case No. U-14098

Dear Ms. Kunkle:

Enclosed for filing in the above captioned matter please find the original and four copies of Qualifications and Direct Testimony of Richard A. Polich on Behalf of Energy Michigan. Also enclosed is an 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 Cost for )  
the year 2003 and for approval of net )  
stranded cost recovery charges )  
\_\_\_\_\_ )

Commission Case No. U-14098

**QUALIFICATIONS AND DIRECT TESTIMONY**

**OF**

**RICHARD A. POLICH**

**ON BEHALF OF**

**ENERGY MICHIGAN**

**July 23, 2004**

**Qualifications of Richard A Polich**  
**On Behalf of Energy Michigan**  
MPSC Case U-14098

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. Please state your educational background.

8 A. I graduated from the University of Michigan in Ann Arbor in August of 1979 with a  
9 Bachelor of Science Engineering Degree in Nuclear Engineering and a Bachelor of  
10 Science Engineering Degree in Mechanical Engineering. In May 1990, I received a  
11 Masters of Business Administration from the University of Michigan in Ann Arbor.

12 Q. Please describe your work experience.

13 A. In May of 1978 I joined Commonwealth Associates as a Graduate Engineer and worked  
14 on several plant modification and new plant construction projects. In May 1979 I joined  
15 Consumers Power Company as an Associate Engineer in the Plant Engineering Services  
16 Department. In April of 1980 I transferred to the Midland Nuclear Project and  
17 progressed through various job classifications to Senior Engineer. I participated in the  
18 initial design evaluation of the Midland Cogeneration Plant. In July 1987 I transferred to  
19 the Market Services Department as a Senior Engineer and reached the level of Senior  
20 Market Representative. While in this department I analyzed the economic and  
21 engineering feasibility of customer cogeneration projects. In July of 1992 I transferred to  
22 the Rates and Regulatory Affairs Department of Consumers Energy as a Principal Rate  
23 Analyst. In that capacity I performed studies relating to the development and design of

1 the Consumers' gas rates and retail/wholesale electric rates. During this period, I was  
2 heavily involved in the development of Consumers Direct Access program and in the  
3 development of Retail Open Access program. I also participated in the development of  
4 the Consumers' revenue forecast.

5 In March 1998, I joined Nordic Electric as Vice President in charge of marketing  
6 and sales. My responsibilities included all aspects of obtaining new customers and  
7 enabling Nordic to supply electricity to those customers. In May 2000, my  
8 responsibilities shifted to Operations and Regulatory Affairs. My responsibilities include  
9 management of supply purchases, transmission services, and development of new power  
10 projects. Regulatory Affairs responsibilities include overseeing regulatory and  
11 legislation issues.

12 In March of 2003, I started performing energy consulting through the business,  
13 Energy Options & Solutions. The primary focus of the business will be to help energy  
14 users develop solutions to energy problems.

15 Q. Are you a registered Professional Engineer in the State of Michigan?

16 A. Yes I am.

17 Q. Have you previously testified before this Commission?

18 A. Yes. I presented testimony on five occasions on behalf of Consumers Energy. In the  
19 remand phase of retail wheeling Case U-10143/U-10176 presenting the Consumers'  
20 method for design of future retail wheeling rates, the Consumers proposed Special  
21 Contract Rate Case U-10625 presenting methods to identify and qualify customers. I  
22 presented testimony in the Consumers' Electric Rate Case proceeding U-10335. I  
23 presented testimony in the initial phase of retail wheeling Case U-10143/U-10176 on the  
24 proposed cost and rate of retail wheeling and in Case U-10685 the Consumers Energy  
25 Electric Rate Case in November 1994. I presented testimony before the Commission on

1 several occasions on behalf of Energy Michigan, including Cases U-11915 (Supplier  
2 Licensing) and U-11956 (Edison True Up Case), U-12478 and U-12505 (Edison and  
3 Consumers Energy Securitization Cases), U-12639 (Stranded Cost Methodology Case),  
4 U-13380 (Consumers Energy Determination of Stranded Cost), U-13350 (Detroit Edison  
5 Stranded Cost Case), U-13715 (Consumers securitization of Clean Air Act Investments),  
6 U-13808 (Detroit Edison General Rate Case & Securitization Case), U-13989  
7 (Consumers Special Contract Case), U-13933 (Detroit Edison Low Income Energy  
8 Assistance Credit for Residential Customers) and U-13720 (Consumers Energy 2003  
9 Stranded Cost Case).

10 Q. On whose behalf are you presenting direct testimony in this proceeding?

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

12 **Direct Testimony of Richard A Polich**  
13 **On Behalf of Energy Michigan**  
14 MPSC Case U-14098  
15

16 **Purpose of Direct Testimony**

17 Q. What is the purpose of your Direct Testimony in Consumers Energy's Case U-14098?

18 A. I am presenting evidence that Consumers Energy's ("Consumers") calculation of 2003  
19 Stranded Cost is incorrect and the Commission should use the revised 2003 Stranded  
20 Cost analysis contained in this testimony. The stranded cost calculations presented in this  
21 testimony are based upon the Michigan Public Service Commission ("Commission")  
22 Staff's position as adopted by the Commission in Case U-12639. I will show how  
23 Consumers' 2003 Stranded cost analysis does not comply with the requirements of PA  
24 141 nor with the Commission's order in Case U-12639 and includes items not currently  
25 included in the rates paid by bundled service customers. Because Consumers' calculation  
26 of Stranded Cost contains serious flaws, it cannot be used by the Commission to  
27 determine Consumers 2003 Stranded Cost. The flaws in Consumers' 2003 Stranded Cost

1 Calculations and deviations from the Commission's U-12639 orders include the  
2 following:

- 3 • Seeks recovery of production plant investment and seasonal capacity purchases,  
4 which have not been approved by the Commission in a contested case proceeding.
- 5 • Seasonal capacity costs are variable costs associated with sales to full service  
6 customers and are not part of Stranded Cost under Commission Staff methodology  
7 (page 17 of U-12639 Order).
- 8 • Revenue Requirement associated with Clean Air Act (“CAA”) investments are not  
9 included in Consumers' bundled rates and should be excluded under the Commission  
10 Staff Methodology (page 10 of Order U-12639).
- 11 • Revenue from Sales to Special Contract Customers should include the revenue those  
12 customers paid under the full service rate, not the special contract revenues.
- 13 • Unrecovered Qualified Facility (“QF”) capacity costs should not be assigned to Retail  
14 Open Access (“ROA”) customers as Stranded Cost.

15 Q. What is the effect of Consumers' approach to 2003 Stranded Cost?

16 A. Consumers' 2003 Stranded Cost calculation results in the assignment of cost and revenue  
17 responsibility for new plant in service, special contract discounts, Seasonal Capacity  
18 Costs and QF Power Purchase Agreement (“PPA”) Contract Costs to Retail Open Access  
19 (“ROA”) customers. These costs were not currently included in the rates paid by bundled  
20 customers in 2003. The 2003 stranded cost calculation presented by Consumers in this  
21 case should be rejected by the Commission and should not be the basis for any type of  
22 interim relief.

23 Q. What would a calculation of 2003 Stranded Cost show if it was performed in accordance  
24 with PA 141 and the Commission’s Order in Case U-12639?

1 A. Performing a calculation of Consumers 2003 Stranded Cost in accordance with U-12639  
2 orders and Mr. Bailey's testimony in that case would show Consumers' retail customer  
3 contribution to fixed generation costs exceeds the revenue requirement by \$2.6 million  
4 for 2003, using Consumers 2003 Net Production Plant in Service. Using the 2000 net  
5 production plant in service, Consumers' 2003 Fixed Generation Revenue exceeded Fixed  
6 Generation Revenue Requirement by \$61.6 Million. Thus, Consumers does not have any  
7 Stranded Cost for 2003 and actual generation related revenues from bundled service  
8 exceed Commission authorized fixed generation cost recovery.

9 Q. Will you be addressing the issues raised by Consumers regarding discontinuation of  
10 Securitization Charge offsets using excess securitization savings?

11 A. Yes. Consumers' position to terminate the securitization and tax charge offset for ROA  
12 customers as soon as possible, is unnecessary and not the proper course of action. If the  
13 amount ROA transition charge credit is exceeding the 50% of total available excess  
14 securitization savings, then the credit needs to be reduced not eliminated. The  
15 Commission should set the transition charge credit for ROA customer by dividing the  
16 50% of excess securitization by the amount of 2005 ROA load.

17 Q. Are you sponsoring any Exhibits in this case?

18 A. Yes, I am sponsoring the following Exhibits:

19 Exhibit I-\_\_\_\_\_ (RAP-1) 2003 Stranded Cost Calculation

20 Q. Where these proposed exhibits prepared by you or prepared under your direction?

21 A. Yes.

1 **Recommended Production Costs To Be Used For Stranded Cost Calculation**

2 Q. On what production cost basis should the Commission make its stranded cost decision?

3 A. The enactment of PA 141 created frozen rates for all customers. PA 141, Section 10d.

4 (3) states:

5 “Annual return of and on capital expenditures in excess of depreciation  
6 levels incurred during and before the time period described in subsection (2),  
7 and expenses as a result of changes in taxes, laws, or other state or federal  
8 governmental actions incurred by electric utilities during the period  
9 described in subsection (2), shall be accrued and deferred for recovery. After  
10 notice and hearing, the commission shall determine the amount of reasonable  
11 and prudent costs, if any, to be recovered and the recovery period, which  
12 shall not exceed 5 years and shall not commence until after the expiration of  
13 the period described in subsection (2).”

14 Based upon this language, Consumers must defer recovery of any new capital  
15 expenditures until after January 1, 2004 and must request the Commission to  
16 approve the cost recovery of and return on those prior to including these costs in any  
17 rate or revenue recovery mechanism. These rules also effectively fix the net  
18 production plant investment during the rate freeze period to the 2000 amount. If  
19 there were no ROA sales, Consumers could only collect revenues based upon its  
20 rates at the time of the freeze. Any production plant investments or increases in  
21 production plant costs, not included in Consumers’ rates at the time of the rate  
22 freeze, are uncollectable because they were not included in rate base. The  
23 Commission recognized this fact when it denied Consumers’ request to increase the  
24 Power Supply Cost Recovery (“PSCR”) Surcharge in Cases No. U-11180R and U-



1 12633. The law states that Consumers must defer the return of and on capital  
2 expenditures until after the rate freeze. As such, the Commission should require the  
3 stranded cost calculation to be based upon those costs Consumers had included in its  
4 rate base at the time of the rate freeze. In Case No. U-12639, the Commission  
5 endorsed the Staff's recommended use of 2000 net plant investment as the basis of  
6 Stranded Cost calculation. Thus, the 2003 Stranded Cost calculation method should  
7 also be based upon the 2000 net production plant investment.

8 Q. How does PA 141 specify the treatment of return of and on capital expenditures  
9 during the rate freeze period?

10 A. Section 10d(3) of PA 141 specifies that utilities must defer the recovery of and on  
11 capital expenditures until after the rate freeze. In addition, the language indicates  
12 that utilities are only allowed to recover capital expenditures in excess of  
13 depreciation amounts incurred during the period of the rate freeze. The utility must  
14 request the recovery of the capital expenditures from the Commission and can only  
15 obtain recovery once the Commission deems the expenditures prudent. Thus, if  
16 during the rate freeze, the utility has \$500 million in capital expenditures and its  
17 depreciation is \$300 million, then the utility could request the Commission to allow  
18 it to recover the return of and on the \$200 million difference over a five-year period.  
19 The Commission would be required to conduct hearings and determine that the  
20 capital expenditures were prudently incurred.

21 Q. Have Consumers' capital expenditures exceeded depreciation levels incurred since  
22 enactment of PA 141?

23 A. No. In response to discovery Question 14098-EM-CE-20, Consumers has stated that its  
24 total investment in production plant from June 2000 through December 2003 was  
25 \$211,517,000 (excluding CAA costs). Its total amount of production related depreciation

1 expense from June 200 through the end of 2003 was \$236,517,000. The amount of  
2 production related depreciation expense recovered through frozen rates from June 2000  
3 through December 2003 was \$258,016,500. Thus, Consumers production capital  
4 expenditures have not exceeded its production plant investment during the rate freeze  
5 period. Consumers' non-CAA production capital expenditures are also less than the  
6 amount of depreciation expense included in base rates.

7 Q. Has Consumers requested a hearing on the recovery of and on new capital expenditures  
8 on production plant since June 2000?

9 A. No. Consumers has requested the securitization of CAA capital expenditures but has not  
10 requested the Commission to assess the prudence and rolling into rate base of any  
11 production related capital expenditures since its last general rate case. Thus, the  
12 Commission has not determined the prudence of the additional production plant capital  
13 expenditures included in line 1 of Mr. Torrey's Exhibit A-\_\_\_ (MAT-1R), Consumers  
14 Stranded Cost calculation.

15 Q. What is the implication and impact of including new production capital expenditures not  
16 included in the frozen rates, in the stranded cost calculation?

17 A. If the Commission allows Consumers to include, in the Stranded Cost calculation, new  
18 production capital expenditures not included in rate base, then the Commission would be  
19 effectively giving Consumers a rate increase without conducting hearings on the  
20 prudence of the costs. Any portion of the rate increase not recovered through increased  
21 bundled sales would become the responsibility of ROA sales. Under the frozen rate  
22 structure, none of the new production costs are included in rate base and these costs have  
23 not been approved by the Commission. By allowing the new production capital  
24 expenditures to be included in the Stranded Cost calculation, the Commission would be  
25 authorizing Consumers to recover those costs. Using Consumers' 2003 Stranded Cost

1 calculation, it could be shown that even without any ROA sales, Stranded Costs exist  
2 because production cost increases are larger then Consumers revenue from frozen  
3 bundled rates. Again, inclusion in the 2003 Stranded Cost calculation of new production  
4 costs not included in the frozen bundled rates, results in the transfer of cost responsibility  
5 to ROA customers.

6 Q. What year data should be used as the basis of calculating Stranded Cost?

7 A. The calculation of Stranded Cost should be based upon the production plant in service at  
8 the time of enactment of PA 141. Since PA 141 was enacted in June of 2000, the  
9 Michigan's utilities were put on notice that competition was coming and they would need  
10 to be competitive. Theoretically, it could be argued that any investment by the utilities  
11 after June of 2000 should be excluded from the stranded cost calculation. For simplicity  
12 and due to the availability of data, year-end 2000 should be used. It was not envisioned  
13 that as utilities made future investments in production plant, these post 2000 investments  
14 would be included in future Stranded Cost reconciliation.

15 Q. What Construction Work In Process ("CWIP") should be included in the Stranded Cost  
16 calculation?

17 A. In theory, any costs not included in rate base at the time of enactment of PA 141 and  
18 inception of the rate freeze, should not be included in the stranded cost calculation. We  
19 have chosen to include the CWIP incurred up through the end of 2000 to be consistent  
20 with previous decision on the stranded cost calculation. This was based upon Consumers  
21 FERC Form 1 data.

22 Q. How did you reflect the use of a 2000 production cost basis in your Stranded Cost  
23 calculation?

24 A. The Net Production Plant used for calculating the Return Requirement is based upon  
25 Consumers' 2000 figures. I have reflected this in Column d, on line 1, of my exhibit I-

1 \_\_\_\_ (RAP-1). This figure was developed in the same manner as Mr. Torrey's calculation  
2 on his workpaper MAT WP-1. The result is a 2000 Net Production Plant (including 2000  
3 CWIP) of \$1.034 billion.

4 **Unrecovered Qualified Facility Costs**

5 Q. Should Consumers' proposed increase in QF Contract costs be included in the Stranded  
6 Cost calculation?

7 A. No. Consumers' inability to increase its PSCR charge for recovery of these costs does not  
8 turn these costs into stranded costs to be recovered from ROA sales. These are costs that  
9 should be recovered from full service customers. The proposal by Consumers assigns  
10 100% of these costs to Stranded Cost. Until the PSCR charges are increased to reflect the  
11 increase in the QF Contract costs, such costs should not be included in the Stranded Cost  
12 calculations because the costs are not included in base rates. Any other treatment results  
13 in a pure subsidy for bundled customers by ROA sales.

14 Q. Has the Commission previously rejected the recovery of the QF increases?

15 A. Yes. In case U-11180R and U-12633, the Commission rejected the recovery of the  
16 increased QF costs until after the rate freeze. The basis of the Commission's decision  
17 was that rates were frozen and could not be increased until after the rate freeze, regardless  
18 of when the increase in rates was approved by the Commission. This decision should  
19 also apply to the Stranded Cost calculation because costs which are unrecoverable during  
20 a rate freeze should not be allowed to be recovered from ROA customers through the  
21 Stranded Cost calculation.

22 Including the increased QF costs in the stranded cost calculation will assign  
23 payment of these costs to the ROA sales. These costs were not included in the 2003  
24 PSCR and should not be included in the 2003 Stranded Cost calculation. Since PSCR

1 revenues are unable to cover the increases in Seasonal Capacity Purchases and increased  
2 QF costs, the responsibility for payment of these costs would fall to ROA customers  
3 through Transition Charges if the Commission allows Consumers to include these costs  
4 in the stranded cost calculation.

5 Q. What is your recommendation regarding the QF Costs impact on the stranded cost  
6 calculations?

7 A. Energy Michigan recommends the Commission only include Consumers' QF Costs  
8 included at the time its PSCR was frozen, in the Stranded Cost calculation. This  
9 adjustment is shown on line 7 of Exhibit I-\_\_\_(RAP-1).

10 **Seasonal Capacity Costs**

11 Q. Should seasonal capacity costs be included in the revenue requirement of the Stranded  
12 Cost calculation?

13 A. No. Seasonal capacity costs should be excluded from Stranded Cost calculations for the  
14 following reasons:

- 15 • The MPSC has not approved over two-thirds of the Seasonal Capacity purchases for  
16 reasonableness and prudence. (14098-EM-CE-14)
- 17 • These are variable costs to be recovered through the Power Supply Cost Recovery  
18 ("PSCR") mechanism.
- 19 • The Seasonal Capacity costs may already being recovered in Consumers' bundled  
20 rate revenues.
- 21 • These costs were incurred after enactment of PA 141 and after the rates were frozen.
- 22 • The Seasonal Capacity costs are variable costs and not fixed generation-related costs,  
23 per Case No. U-12639, page 17.
- 24 • These are costs associated with only providing service to bundled tariff customers.

1 • ROA load actually reduces Consumers' Seasonal Capacity.

2 Bottom line, if these costs are included in the Stranded Cost calculation, any resulting  
3 payment of these costs by ROA customers results in a subsidy for bundled service  
4 customers.

5 Q. How can Consumers recover increases Seasonal Capacity costs?

6 A. Changes in Seasonal Capacity costs from the amounts included in base rates at the time  
7 of the last general rate case are usually addressed in the PSCR cases. These costs are  
8 treated as variable costs because the contracts change over time and, as shown in  
9 Consumers discovery responses 14098-EM-CE-8 through 14098-EM-CE-16, expire at  
10 different times and are for different periods. During non-rate freeze periods, Consumers  
11 can recover increased Seasonal Capacity costs in the PSCR cases. It is uncertain if  
12 Consumers can treat these costs as a regulatory asset during the rate freeze and recover  
13 these costs in the its next general rate case.

14 Q. Has Consumers provided evidence that the amount of Seasonal Capacity costs calculated  
15 by Ms. Jeanne M. Kurzynowski in Exhibit I-\_\_\_(JMK-1) are included in the amount of  
16 Seasonal Capacity included in bundled rates?

17 A. No. Ms. Kurzynowski's calculation in Exhibit I-\_\_\_(JMK-1) does not include any offset  
18 for Seasonal Capacity costs already included in the bundled rates and PSCR surcharges  
19 paid by full service customers. Thus, Mr. Torrey's use of this figure in his Exhibit I-  
20 \_\_\_(MAT-1R), line 9 also contains the same error. Since the calculation of revenues  
21 contributing to fixed generation costs excludes variable costs, any revenues in the PSCR  
22 component of base rates associated with Seasonal Capacity costs are excluded from  
23 Consumers calculation of 2003 Stranded Costs.

1 Q. Could ROA customers end up paying for seasonal capacity that Consumers purchased to  
2 ensure service to bundled customers?

3 A. If the Commission allows Consumers to include seasonal capacity purchase in the  
4 Production Revenue Requirements, to the extent that revenues from increased sales to  
5 bundled customers do not cover these costs, the costs fall into Stranded Cost category.  
6 The only customers who pay Stranded Cost are ROA Customers. The rate freeze  
7 prevents Consumers from passing increased PSCR Costs to its bundled customers, even  
8 though the seasonal capacity purchase is made to provide electricity to those customers.  
9 Thus, bundled customers receive the benefit of ensured electrical supply while shifting  
10 the cost to ROA customers. It is kind of like giving bundled service customers free  
11 service.

12 Q. Has the ROA program reduced Consumers' need for Seasonal Capacity purchases?

13 A. Yes. Consumers would need to increase its 2003 Seasonal Capacity purchases by 220  
14 MW if ROA load were to return to bundled service (discovery response 14098-CE-EM-  
15 21). Thus, ROA has reduced Seasonal Capacity Purchases and reduced power supply  
16 costs.

17 Q. Should Seasonal Capacity purchases be treated as a long-term liability?

18 A. No. Although Consumers needs to procure this capacity prior to the season in which it is  
19 needed, it is an avoidable cost. In fact, if ROA sales were to increase, there would be no  
20 need for the seasonal capacity purchases. The real issue is the prudence of Consumers  
21 power purchase practices in uncertain markets.

22 Q. Does Consumers have other options to avoid the seasonal capacity purchases?

23 A. Yes. The first is exercising the right to interrupt customer load. Interruptible load can be  
24 treated as a replacement for a certain portion of peak power purchases. If Consumers is  
25 short electric supply due to insufficient capacity, the interruptible customers are requested

1 to curtail usage to some predetermine load level (Base Load). If the customer fails to  
2 curtail load, most contracts contain provisions to charge large penalties for the amount of  
3 electricity used in excess of the Base Load. The intent of this penalty provision is to  
4 compensate the utility for any high costs it incurs as a result of purchasing power on the  
5 spot or emergency market to serve the uncurtailed interruptible load. Consumers has  
6 about 380 MW of interruptible load that could have been used to avoid some of the  
7 seasonal capacity purchases. Most of this interruptible load is from customers, which  
8 were receiving significant discounts on their electric service under Special Manufacturing  
9 Contracts. These were contracts Consumers willingly entered to reduce the amount of  
10 load participating in the Rate DA, Direct Access Program. The decision of Consumers to  
11 purchase Seasonal Capacity to avoid interruption of customer loads, was an economic  
12 choice of Consumers and should not impact Stranded Cost paid by ROA Customers.

13 Q. How else can Customers reduce the amount of seasonal capacity purchases?

14 A. Consumers can promote methods that reduce its capacity commitments to its customers.  
15 This can be done through increased use of interruptible rates, promotion of self-  
16 generation and encouraging customer participation in Retail Open Access programs.

17 Q. What is your recommendation regarding the seasonal capacity impact on the stranded  
18 cost calculations?

19 A. Energy Michigan recommends the Commission exclude Consumers' 2003 seasonal  
20 capacity costs from the Stranded Cost calculation. This adjustment is shown on line 9 of  
21 Exhibit I-\_\_\_(RAP-1).



**Clean Air Act Investment Cost Recovery**

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Q. Should the Commission allow Consumers to include revenue requirement of Clean Air Act costs in its calculation of Stranded Cost?

A. No. The reason for rejection of inclusion of CAA costs in the stranded cost calculations is the same as was discussed in my testimony in Consumers Securitization of CAA costs in Cases U-13715 and U-13720. The Commission should recognize that the CAA costs being securitized are for Consumers' production facilities which are price and cost competitive with the market and therefore, are not likely to be stranded assets. Any payment for CAA costs funding by ROA customers is a subsidy being granted to Full Service customers by the Commission and will have the impact of reducing competition. The Commission must maintain the position contained in its earlier orders, which exempts ROA customers from CAA costs.

Q. What adjustments are needed to the Stranded Cost calculation?

A. The total revenue requirement needs to exclude the CAA Costs. I have excluded the CAA costs shown in Michael A Torrey's Exhibit A-\_\_\_(MAT-1), line 19 in the 2003 Stranded Cost calculations in Exhibit I-\_\_\_(RAP-1).

Q. Does Consumers have options for recovery of CAA costs?

A. Yes. The first option for recovery of CAA costs is under section 10d(3) of PA 141. This language would allow the company to request permission from the Commission to recover of CAA costs through a contested rate proceeding. Consumers has engaged in a second mechanism in its securitization case U-13715.

1 **Special Contract Revenues**

2 Q. Do you agree with Consumers' position regarding the use of actual special contract  
3 revenues in the 2003 Stranded Cost calculations instead of using the equivalent bundled  
4 rate revenues?

5 A. No. Consumers is again attempting to recover the cost of the special contract discounts  
6 through the Stranded Cost charges. Consumers' arguments in this case do not justify  
7 performing 2003 Stranded Cost calculations using actual special contract revenues  
8 instead of the full service tariff revenues associated with special contract sales. The  
9 rationale contained in Consumers' witness Michael A. Torrey's testimony is based upon  
10 providing evidence that the revenues from special contracts are above Consumers' cost to  
11 serve those customers. Mr. Torrey's analysis and evidence violates several fundamental  
12 cost of service and rate making principals:

- 13 • The analysis is done on the basis of an isolated group of customers and not the entire  
14 customer base.
- 15 • The analysis does not show the impact upon other customer classes due to the  
16 redistribution of costs, which would be shown in a full cost of service study.
- 17 • Special Contract Customers are not a separate rate class in Consumers' cost of service  
18 study.
- 19 • It is likely that all the "Rate Skewing" adjustments are also related to costs other than  
20 fixed generation-related costs.
- 21 • The allocation factor of 29.1048% for fixed generation related costs, is not  
22 appropriate for this class of customers for the same reasons mentioned in Mr.  
23 Torrey's testimony.

1 Q. How would the discounts associated with special contract sales be treated in a full cost of  
2 service study?

3 A. First, Consumers would need to establish a separate rate classification for those  
4 customers with special contracts. Second, Consumers would need to develop a rate  
5 design, qualification criteria, rules, regulation, etc. for that rate class. Third, Consumers  
6 would need to assign the sales and revenues to the new class. Fourth, a new cost of  
7 service study would need to be performed, which includes the new rate class, and which  
8 properly allocates Consumers' costs to all customer classes.

9 Q. Has Consumers conducted such a cost of service study?

10 A. No. In response to several discovery questions, Consumers has indicated it has not  
11 defined the rate class associated with the special contracts, performed a cost of service  
12 study including that rate class, nor determined how the costs would be shifted to other  
13 rate classes. The analysis discussed on pages 28 and 29 of Mr. Torrey's testimony and  
14 Exhibit A-\_\_\_(MAT-9) have been performed in isolation from all other rate classes and  
15 customers of Consumers. The special contract customers included in Mr. Torrey's  
16 analysis include accounts from several different rate classes, rate classes with  
17 significantly different load characteristics.

18 Mr. Torrey's calculation of cost to serve special contract customers is not valid  
19 because it does not look at the costs of service for all customers nor even all customers  
20 within a rate class. The method used by Mr. Torrey to show the cost to serve special  
21 contract customers could be done on any individual customer and would show very  
22 different results for each customer within a rate class. The analysis is highly depended  
23 upon customer contribution to peak load, duration of peak use, overall load factor,  
24 voltage service and other billing determinates. Performing an isolated cost to serve

1 analysis violates much of the statistical basis upon which cost of service analysis is  
2 performed.

3 Q. What would happen to the discounts Consumers is providing under its special contracts  
4 under this scenario?

5 A. If Mr. Torrey's analysis of the embedded cost of serving special contract load is correct,  
6 then the cost of service would reallocate approximately \$23 million of costs to other  
7 customer classes. These reallocated costs would be spread through out all the rate classes  
8 and in multiple cost categories (customer service, distribution, transmission, etc.). This  
9 would not necessarily mean a rate increase for other customer classes because not all  
10 rates are cost based. The changes in rates due to the distribution of the reallocated costs  
11 would be up to the Commission.

12 Q. How would this method of allocation of special contract discounts differ from  
13 Consumers' proposal to include the discounts in the Stranded Cost calculation?

14 A. Creation of a separate rate class for special contract sales would reallocate the production  
15 costs to other customer classes. If rates were set strictly based upon the cost of service  
16 study, bundled rate revenue from non-special contract customer classes would increase,  
17 increasing total revenues from sales to ultimate customers (line 13 of Mr. Torrey's  
18 Exhibit A-\_\_\_(MAT-1R)), and allowing recovery of the special contract discounts from  
19 bundled sales. The Stranded Cost calculation will be effected because of the increase in  
20 bundled revenues, thus reducing Stranded Costs. The Commission has repeatedly stated  
21 that a utility must demonstrate discounts to special contract sales must benefit "**all**  
22 **customers**" before they will allow recovery of those discounts. If the discounts benefit  
23 all customers, then the discounts must be allocated to all Consumers' bundled customers  
24 and not just ROA customers

1 Q. Do you agree with Mr. Torrey's position on page 28 of his testimony regarding the  
2 benefits to other Consumers customers regarding special contracts?

3 A. No. In response to several discovery questions, Mr. Torrey has indicated Consumers has  
4 not even defined the rate class and associated load characteristics for special contract  
5 customers. Without performing this initial step in design of rate classes, it is impossible  
6 to identify the costs to serve a rate class or the benefits of retaining customers within that  
7 rate class. In addition, Consumers has not conducted an overall cost of service study with  
8 the special contracts included, which would indicate the actual costs for each class and  
9 the distribution of those costs. The limited analysis provided by Consumers in Exhibit A-  
10 \_\_\_\_ (MAT-9) is invalid because it is an attempt to perform an isolated study on an  
11 undefined rate class. This type of analysis is not valid because it does not include proper  
12 identification and isolation of rate classes.

13 Q. Does Consumers have any evidence that special contract sales would engage in the use of  
14 alternative electric supplies?

15 A. No. In response to several discovery questions regarding loss of special contract load,  
16 Consumers stated that it has not performed any analysis that shows special contract  
17 customers would engage in self-generation or co-generation. Consumers has also stated  
18 in a discovery response that he loss of special contract load to ROA service is "...an  
19 assumption regarding load loss, not an analysis..." (discovery response 14098-EM-CE-  
20 33).

21 Q. Does Consumers use Special Contracts to compete against alternative energy suppliers?

22 A. Yes. In case U-10685, Consumer was allowed to provide special contracts for a portion  
23 of its load that was available to be served under Direct Access Service Rate DA. The  
24 Commission's order provided Consumers the ability to write special contracts which

1 resulted in a reduction in the amount of Rate DA load to be served by power marketers.

2 Many of Consumers current special contracts were a result of this competition.

3 Q. How should this effect the Commission's treatment of special contract discounts?

4 A. The Commission needs to recognize the use of special contracts as a competitive tool by

5 Consumers. In the real competitive world, when one company discounts its price to

6 retain sales, its competitor does not reimburse it for the discount. If the Commission

7 were to allow Consumers to exclude the special contract discounts from the stranded cost

8 calculation, then it would be assigning the recovery of the special contract discounts to

9 Consumers' competitors. The Commission cannot allow Consumers to compete with

10 alternative forms of power supply, including, ROA, cogeneration, self generation, etc.

11 and then reward it by allowing those discounts to be recovered from other customers.

12 This creates a zero risk option for Consumers in the issuance of discounted sales.

13 Q. What is your recommendation regarding the special contract impact on the stranded cost

14 calculations?

15 A. Energy Michigan recommends the Commission increase Consumers 2003 total revenue

16 by \$21.63 million to reflect the difference between special contract actual 2003 revenue

17 and the corresponding revenue under standard tariffs. This adjustment is shown on lines

18 15-17 of Exhibit I-\_\_\_(RAP-1).

19 Energy Michigan's 2003 Stranded Cost Calculation

20 Q. How is the 2003 Stranded Cost calculation, contained in exhibit I-\_\_\_(RAP-1) arranged?

21 A. I have arranged this Exhibit into two pages. The first column of each page shows

22 Consumers' 2003 Stranded Cost calculation and the second column shows the Energy

23 Michigan 2003 Stranded Cost calculation. The first page of Exhibit I-\_\_\_(RAP-1)

1 contains Energy Michigan's 2003 Stranded Cost calculation with only the following  
2 adjustments to Consumers' 2003 Stranded Cost calculation:

- 3 • PPA Capacity Charges reflect those contained in the frozen PSCR and do not include  
4 the unrecovered QF costs (line 7).
- 5 • Deletion of the Seasonal Capacity Costs (line 9).
- 6 • Elimination of the Special Contract Discounts (lines 15 and 16).

7 Net production plant and all other figures through line 6 are the same as Consumers. The  
8 resulting 2003 Stranded Cost calculation using only these adjustments shows Consumers  
9 revenues from bundled service exceeded the cost of providing that service by \$2.9  
10 million in 2003. Thus, Consumers did not incur stranded costs and in fact had revenues,  
11 which exceeded costs.

12 Q. What is the difference between Energy Michigan's 2003 Stranded Cost calculation on  
13 page 1 and page 2 of Exhibit I-\_\_\_(RAP-1)?

14 A. The Energy Michigan 2003 Stranded Cost calculation on page 2 includes all the proper  
15 adjustments made on page 1 plus the adjustments necessary to reflect year 2000  
16 Production Plant costs. The Energy Michigan 2003 Stranded Cost calculation on this  
17 page of the Exhibit is performed in accordance with PA 141 and the Commission order in  
18 Case U-12639. As discussed earlier, the net production cost figure in Column (c) reflect  
19 the year 2000 figure. In addition, since the depreciation cost included in Consumers'  
20 2003 Stranded Cost calculation include depreciation for Clean Air Act investments and  
21 other production plant capital expenditures made after 2000, I have included the  
22 depreciation figure from Consumers' 2000 Stranded Cost case.

23 Q. Why did you retain the property tax and insurance figures contained in Consumers' 2003  
24 Stranded Cost calculation?

1 A. These figures appear to be very close to the amounts contained in Consumers' bundled  
2 rates. These figures should reflect the same figures as contained in Consumers' bundled  
3 rates, as adjusted for any costs that were securitized.

4 Q. What is the result of the 2003 Stranded Cost calculation performed in accordance with  
5 PA 141 and Commission Order in Case U-12639?

6 A. The resulting Energy Michigan 2003 Stranded Cost calculation shown on page 2 of  
7 Exhibit I-\_\_\_\_(RAP-1) shows Consumers revenues from bundled service exceeded the  
8 cost of providing that service by \$61.6 million in 2003. Again, Consumers did not incur  
9 Stranded Costs and in fact had revenues, which exceeded costs.

10 **Excess Securitization Savings**

11 Q. Do you agree with Mr. Torrey's recommendation to suspend the securitization and tax  
12 offset charge to ROA customers?

13 A. No. Consumers has recommendation would result in Consumers being able to retain \$6.2  
14 million of excess securitization savings. Consumers should comply with the  
15 Commissions order in Case U-12505 by reducing the transition charge offset. A new  
16 securitization and tax offset charge should be set based upon dividing the \$6.2 million of  
17 excess securitization savings by the projected ROA sales. This is the same  
18 recommendation made by the Commission Staff in their Brief in Case U-13720.

19 **Payment of Securitization Surcharge**

20 Q. Mr. Polich, why should the payment of any securitization costs by ROA customers be  
21 linked to the Commission first determining Stranded Cost exist for the utility?

22 A. The majority of Consumers' assets, which were refinanced through securitization  
23 bonding, are production related assets/costs/revenue requirement. Prior to this case, all of  
24 these requests for securitization funding were associated with production assets placed



1 into service prior to enactment of PA 141. The ROA customer bears some responsibility  
2 for these costs because Consumers made the investments while the customer was still  
3 served under Full Service rates.

4 Q. If Consumers is fully recovering its fixed generation-related costs, should ROA  
5 customers still be responsible for Securitization Surcharges?

6 A. No. If there are no Stranded Cost, then Consumers is fully recovering its costs from all  
7 its bundled service customers. As was stated in my testimony in Case U-13715,  
8 securitization surcharge payments by ROA sales needs to be linked to demonstration that  
9 the utility has real Stranded Cost. Without this, ROA is subsidizing bundled service  
10 customers.

11 Q. Does this conclude your testimony?

12 A. Yes, it does.

STATE OF MICHIGAN  
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

\*\*\*\*\*

In the matter of the application of )  
CONSUMERS ENERGY COMPANY )  
for determination of net Stranded Cost for )  
The year 2003 and for approval of net )  
stranded cost recovery charges )  
\_\_\_\_\_ )

Commission Case No. U-14098

**DIRECT EXHIBITS**  
  
**OF**  
  
**RICHARD A. POLICH**  
  
**ON BEHALF OF**  
  
**ENERGY MICHIGAN**

April 23, 2004

**Consumers Energy**  
**Calculation of 2003 Stranded Cost**

Case No: U-14098  
 Exhibit No. I-\_\_\_\_\_(RAP-1)  
 Page No: 1 of 2  
 Witness: R.A. Polich  
 Date: 23-Jul-04

Line No.	Description (a)	<b><u>Energy Mich with CECo</u></b>		Source
		<b><u>Consumers</u></b> (b)	<b><u>Prod</u></b> (c)	
<b><u>Direct Costs</u></b>				
1	Net Production Plant	\$1,528,950	\$1,528,950	MA Torrey Exhibit (MAT-1R)
2	Pre-Tax Rate of Return	10.63%	10.63%	MA Torrey Exhibit (MAT-1R)
3	Return Required	\$162,527	\$162,527	MA Torrey Exhibit (MAT-1R)
4	Depreciation	\$63,048	\$63,048	MA Torrey Exhibit (MAT-1R)
5	Property Taxes	\$42,421	\$42,421	MA Torrey Exhibit (MAT-1R)
6	Insurance	\$3,056	\$3,056	MA Torrey Exhibit (MAT-1R)
7	PPA Capacity Charges	<u>\$499,869</u>	<u>\$472,983</u>	2000 PPA Capacity Costs
8	Revenue Required of Fixed Gen.	\$770,921	\$744,035	Sum of Lines 3-7
9	Net Cost of Summer Capacity (Options)	\$30,395	\$0	
10	Total			
11	<b>Total Generation Related Reg Assets</b>	<b>\$801,316</b>	<b>\$744,035</b>	Sum of Lines 8-10
12	<b>Remove Clean Air Act Rev Req</b>	<b>(\$51,440)</b>	<b>(\$51,440)</b>	
13	<b>Total Revenue Requirement</b>	<b>\$749,876</b>	<b>\$692,595</b>	
<b><u>Fixed Generation Related Revenue</u></b>				
14	Total Revenue from Sales to Ultimate Customers	\$2,321,440	\$2,321,440	MA Torrey Exhibit (MAT-1R)
15	2003 Special Contract Revenue	\$0	(\$132,394)	MA Torrey Exhibit (MAT-8)
16	2003 Special Contract Revenue under Standard Tariffs	<u>\$0</u>	<u>\$154,019</u>	MA Torrey Exhibit (MAT-8)
17	Tariff Based 2002 Revenue	\$2,321,440	\$2,343,066	Sum of Lines 12-14
18	Generation as Percent of Sales	29.10%	29.10%	MA Torrey Exhibit (MAT-1R)
19	Fixed Generation Related Revenues	\$675,650	\$681,945	Line 12 * Line 13
20	From: Third Party Sales	\$13,553	\$13,553	MA Torrey Exhibit (MAT-1R)
21	<b>Total Contribution to Fixed Generation Costs</b>	<b><u>\$689,203</u></b>	<b><u>\$695,498</u></b>	Sum of Lines 14 & 15
22	<b>Total Stranded Costs</b>	<b>\$60,673</b>	<b>(\$2,902)</b>	Line 11 minus Line 20
23	ADD: Clean Air Act Revenue Requirement	<u>\$51,440</u>		
24	<b>Final Stranded Costs/(Benefits)</b>	<b>\$112,113</b>		

**Consumers Energy**  
**Calculation of 2003 Stranded Cost**

Case No: U-14098  
Exhibit No. I-\_\_\_\_\_(RAP-1)  
Page No: 2 of 2  
Witness: R.A. Polich  
Date: 23-Jul-04

<u>Line No.</u>	<u>Description</u> (a)	<u>Consumers</u> (b)	<u>Energy Michigan</u> (c)	<u>Source</u>
<b><u>Direct Costs</u></b>				
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2	Pre-Tax Rate of Return	<u>10.63%</u>	<u>10.63%</u>	MA Torrey Exhibit (MAT-1R)
3	Return Required	\$162,527	\$109,921	MA Torrey Exhibit (MAT-1R)
4	Depreciation	\$63,048	\$56,979	
5	Property Taxes	\$42,421	\$42,421	MA Torrey Exhibit (MAT-1R)
6	Insurance	\$3,056	\$3,056	MA Torrey Exhibit (MAT-1R)
7	PPA Capacity Charges	<u>\$499,869</u>	<u>\$472,983</u>	2000 PPA Capacity Costs
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12	<b>Remove Clean Air Act Rev Req</b>	<b>(\$51,440)</b>	<b>(\$51,440)</b>	
13	<b>Total Revenue Requirement</b>	<b>\$749,876</b>	<b>\$633,920</b>	
<b><u>Fixed Generation Related Revenue</u></b>				
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24	<b>Final Stranded Costs/(Benefits)</b>	<b>\$112,113</b>		

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 2003 and approval of net )  
stranded cost recovery charges. )  
\_\_\_\_\_ )

Case No. U-14098

PROOF OF SERVICE

Monica Robinson, duly sworn, deposes and says that on this 23rd day of July, 2004 she served a copy of Qualifications and Direct Testimony of Richard A. Polich on behalf of Energy Michigan upon the individuals listed on the attached service list by e-mail and regular mail at their last known last known.

\_\_\_\_\_  
Monica Robinson

Subscribed and sworn to before me  
this 23rd day of July 2004.

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

U-14098 SERVICE LIST

Hon. Barbara A. Stump  
Administrative Law Judge  
MPSC  
6545 Mercantile Way  
P.O. Box 30221  
Lansing, MI 48909

Jon R. Robinson  
Consumers Energy Company  
One Energy Plaza  
Jackson, MI 49201

Kristin M. Smith  
Assistant Attorney General  
MPSC  
6545 Mercantile Way, Suite 15  
Lansing, MI 48911

Don Erickson  
MI Dept of Attorney General  
525 W Ottawa St Fl 6  
PO Box 30212  
Lansing, MI 48909-7712

Bob Strong  
Clark Hill  
255 S. Woodward Avenue, Suite 301  
Birmingham, MI 48009

Stewart A. Binke  
Howard & Howard Attorneys, PC  
222 N. Washington Square, Ste. 500  
Lansing, MI 48933

Gary Pasek  
Midland Cogeneration Venture  
100 Progress Place  
Midland, MI 48640

Thomas J. Waters  
Fraser, Trebilcock, Davis & Dunlap  
124 W. Allegan, Suite 1000  
Lansing, MI 48933

John M. Dempsey  
Dickinson Wright, PLLC  
215 W. Washington Square, Suite 200  
Lansing, MI 48933

David E.S. Marvin  
Fraser Trebilock, Davis & Dunlap  
124 W. Allegan, Suite 1000  
Lansing, MI 48933

Becky Merola  
Constellation NewEnergy, Inc.  
250 E. Broad Street, Suite 1400  
Columbus, OH 43215

Craig G. Goodman  
Stacey L. Cantala  
National Energy Marketers Association  
3333 K Street, NW, Suite 425  
Washington, DC 20007