



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

May 26, 2005

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

Re: Case No. U-14148

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

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 approval of recovery of costs pursuant)
to MCL 460.10d(4).)
_____)

Case No. U-14148

REPLY BRIEF OF ENERGY MICHIGAN, INC.

May 26, 2005
Eric J. Schneidewind
Varnum Riddering Schmidt & Howlett LLP
Counsel for Energy Michigan, Inc.
201 N. Washington Square, Suite 810
Lansing, MI 48933
517/482-6237

TABLE OF CONTENTS

I. Introduction and Summary of Position 1

 A. Introduction 1

 B. Summary of Position 1

II. Treatment Regarding Return Of and On Non-Clean Air Act
Generation Capital Investment In Excess of Depreciation From 2000-2003 3

 A. Background 3

 B. Consumers’ Position Requires ROA Customers to Pay 100%
of 2000-2003 10d(4) Non-Clean Air Act Generation Costs Above
Depreciation Generating Costs. 5

 C. Energy Michigan Position. 5

 D. Reply to Consumers Rebuttal of Energy Michigan 8

III. Sales Levels Used Calculate the Proposed Regulatory Adjustment
Asset Recovery Surcharge and To Allocate Costs Between Customer Groups 10

 A. Consumers’ Position On the Sales Levels Used to Calculate Charges 10

 B. Energy Michigan Position 12

IV. Conclusion and Prayer for Relief 13

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
for approval of recovery of costs pursuant)
to MCL 460.10d(4).)
_____)

Case No. U-14148

REPLY BRIEF OF ENERGY MICHIGAN, INC.

This Reply Brief is filed on behalf of Energy Michigan, Inc. ("Energy Michigan") by Varnum Riddering Schmidt & Howlett LLP. The Energy Michigan Reply Brief responds to arguments raised in the Briefs of Consumers Energy Company ("Consumers") and the MPSC Staff ("Staff" or "MPSC Staff"). Failure to respond to arguments of other parties should not be taken as agreement with those arguments.

I. Summary of Position

A. Treatment of Non-Clean Air Act Generation Expenses Above Depreciation For the Period 2000-2003.

PA 141 § 10d(4) mandates that all capital expenditures in excess of depreciation levels incurred from June 2000 through December 31, 2005 be accrued and deferred starting January 1, 2004 for collection in a 10d(4) proceeding. Consumers Energy has followed this mandate in Case U-14148 with one glaring exception: non-Clean Air Act generation costs above depreciation incurred during the period June 2000 through December 31, 2003.

Instead of following the law, Consumers attempted to collect these 10d(4) costs from ROA customers as stranded costs and then failed to present these 10d(4) costs for collection in this proceeding. The result is to shift 100% of a significant Consumers Energy generating cost from payment by all customers (retail customers as 10d(4) costs and ROA customers as stranded

costs) to 100% collection only from ROA customers. This is both illegal and unfair as is demonstrated in the Energy Michigan Brief and this Reply Brief.

The Commission can correct this situation by including June 2000 through 2003 non-Clean Air Act generation costs above depreciation as a collectible amount in this proceeding. Once such an order is issued, the amounts collected can be added to a recomputation of the stranded cost amounts owed by ROA customers for the years 2000 through 2003. This approach will bill each customer group (retail and ROA) for its fair share of Consumers' fixed generation costs.

B. Miscellaneous Issues.

1. Historical sales.

It appears that there is general agreement (at least between MPSC Staff, Consumers and Energy Michigan) that historical, not projected sales, should be the basis of cost allocation. While Energy Michigan proposed use of actual 2004 sales, Staff proposed to use historical 2003 sales contained in the Consumers 2003 Cost of Service Study from Case U-14347. That approach is acceptable to Consumers and Energy Michigan.

2. Cap on recovery of costs.

Staff responded to Energy Michigan's proposal to cap 10d(4) cost recovery by stating that the projection of 2005 costs makes specification of an exact amount of cost to be recovered impossible at this time. Staff claims that its proposal for reconciliation of costs should be adopted instead. However, under the Staff proposal, the decision to file a reconciliation is basically left to the discretion of Consumers. Energy Michigan opposes a discretionary reconciliation and instead believes that a mandatory reconciliation must be ordered.

II. Reply to MPSC Staff and Consumers Energy Regarding
Treatment of 2000-2003 Non-Clean Air Act Generation
Costs Above Depreciation

A. Energy Michigan Position.

Energy Michigan has shown that, alone among all 10d(4) costs presented by Consumers which are eligible for recovery starting in 2000, only non-Clean Air Act generation costs above depreciation for the period 2000 through 2003 are excluded from recovery in this case. Instead, Consumers attempted to recover those costs from Retail Open Access customers in Cases U-13720, U-13380 and U-14098 as stranded costs. Having pursued this avenue of recovery, Consumers is not proposing to collect any of these June 2000-2003 generation related costs from retail customers as part of this proceeding. Consumers Brief, p. 16.

Energy Michigan, through its witness Richard Polich argued that Commission precedent requires generation costs benefiting retail customers to be recovered through this proceeding so that retail customers will pay their share of generating costs with any unrecovered amount being billed to ROA customers as stranded costs. Energy Michigan Brief, p. 6-7. As precedent, Energy Michigan cites recent Commission decisions in Detroit Edison Case U-13808 ordering recovery of non-Clean Air Act generation costs from retail customers as part of a regulatory asset recovery charge. U-13808, November 23, 2004, p. 63 and U-13715, October 14, 2004, p. 10.

B. Staff and Consumers' Position.

MPSC Staff and Consumers claim that the decisions of the Commission in Cases U-13720 and U-14098 have resolved this issue by including non-Clean Air Act generation costs above depreciation incurred by Consumers from 2000 through 2003 in the calculation of stranded costs. Consumers Brief p. 16-17; Staff Brief, p. 44.

MPSC Staff also argues that 2000 through 2003 generation costs cannot be recovered from customers in this case because, "The return of and on non-Clean Air Act generation capital investment in excess of depreciation does not even begin to accrue under Section 10d(4) until

January 1, 2004. Therefore any such returns calculated for years prior to 2004 cannot be included in this case's Section 10d(4) recovery." Staff Brief, p. 44.

C. Energy Michigan Reply to Staff and Consumers.

1. Reply regarding precedent established by Cases U-13720 and U-14098.

There are four major arguments against the Staff contention that the Commission has already decided to recover non-Clean Air Act generation costs above depreciation incurred from 2000 through 2003 as stranded costs and cannot consider such costs to this proceeding:

1) Energy Michigan witness Polich has recommended that the 2000 through 2003 non-Clean Air Act costs be included in this proceeding for recovery from retail customers. By including recovery in this proceeding and then taking these authorized revenues into account in a recalculation of the stranded cost case for 2000 through 2003, the Commission can determine the share to be paid by ROA customers. If so, both ROA and retail customers are effectively billed their fair share of the subject generation costs.

2) As Consumers and Energy Michigan have stated, the provisions of Section 10d(4) are not voluntary, they are mandatory. See Consumers Brief, p. 3.

Section 10d(4) requires that the return of and on capital expenditures in excess of depreciation incurred from 2000 through 2003 be recovered in a specified way: pursuant to the procedures in Section 10d(4). The word "shall" is used throughout this section and does not allow the Commission or Consumers or the Staff to determine that an alternative method of recovery (e.g. from ROA customers as stranded costs) may be utilized.

The Consumers Initial Brief eloquently argues this point, albeit in opposition to Staff's interpretation of Section 10d(4) rather than in support of Energy Michigan. Consumers noted that when it attempted to recover non-Clean Air Act costs from ROA customers in

Case U-13380 the Commission, at Staff's urging, rejected this proposal using the following language,

The Staff argues that the appropriate vehicle for Consumers to recovery federal Clean Air Act related costs is the mechanism provided in Section 10d(3) [now 10d(4)] pursuant to which recovery may not start until after January 1, 2004. Because that mechanism provides for deferral of recovery those costs, the Staff submits that they should not be included in Consumers' stranded cost calculations in the present case. Order U-13380, July 10, 2003, p. 3-4.

In its ruling, the Commission accepted the Staff position that 10d(4) costs (Clean Air Act costs in this case) must be recovered in a 10d(4) proceeding and not as stranded costs. The Commission used the following language,

Recovery of capital expenditures for compliance with the Clean Air Act and other statutory regulatory requirements is expressly provided for in Section 10d(3) [now (4)]. Contrary to Consumers' arguments, the language of that section is mandatory with respect to such costs. The Commission is not persuaded that it may legitimately read into the statutory framework a legislative intention to provide an alternative means of recovering costs that might fit in two categories. Rather, the statute provides that expenses incurred by electric utilities described in Section 10d(3) [now (4)] shall be accrued and deferred for recovery. That section specifically deals with the costs at issue in the Staff's Application for Leave to Appeal, unlike the general provision governing recovery of stranded costs. Even if these costs were to be considered stranded costs, Section 10d(3)(3) provides for special treatment for them which the Commission is bound to follow. July 10, 2002 Order, p. 9 (emphasis supplied).

Consumers goes on to note that this precedent was followed in the U-13880 Final Order and Clean Air Act costs were removed from the stranded cost calculation.

3) The ALJ should also note that the Commission reached exactly the same conclusion urged by Energy Michigan when it authorized a method of collecting non-Clean Air Act generation costs above depreciation incurred by Detroit Edison. In Case U-13808, the Commission approved a Regulatory Asset Recovery Surcharge only applicable to retail customers which recovered, among other things, non-Clean Air Act generation costs above depreciation. U-13808, p. 63.

4) Consumers has admitted that it attempted to bill ROA customers for 100% of 2000 through 2003 non-Clean Air Act generation costs above depreciation. Consumers Brief, p. 16. However, the language of PA 141 § 10d(4) mandates that the Commission correct this error by including these 10d(4) costs in the current proceeding and recovering them from retail customers, not ROA customers. To the extent that such 10d(4) costs cannot be recovered or that recovery is still not sufficient to offset all stranded costs for the years 2000 through 2003, recalculation of the Commission's previous stranded cost Orders in Cases U-13380 and U-14098 will ensure that ROA customers pay their fair share of such costs through approved stranded cost mechanisms.

To repeat Consumers' own argument, the Commission cannot use two separate theories to recover Section 10d(4) costs. It must use Section 10d(4) first and then allow any unrecovered capital costs or expenses related to generation to be recovered from ROA customers as stranded costs in other proceedings.

2. Reply to Staff argument that non-Clean Air Act costs incurred prior to 2004 cannot be included in Section 10d(4) recovery in this proceeding. Staff Brief, p. 44.

Staff's argument that pre-2004 non-Clean Air Act generation costs cannot be recovered in this case appears to rest upon Staff's rather novel interpretation of PA 141 § 10d(4). Under Staff's interpretation, 10d(4) expenses are incurred during the three periods which Staff alleges are described in PA 141 § 10d(2): Staff claims that one period appears to end January 1, 2004 for customers with demand greater than 15 kW, one period ends January 1, 2005 for customers less than 15 kW, and one period ends January 1, 2006 for residential customers.

Staff's interpretation of 10d(4) also contends that the accrual of 10d(4) costs does not even begin until January 1, 2004 for non-Clean Air Act generation costs. Staff Brief, p. 44. Thus Staff seems to be saying that 2000-2003 non-Clean Air Act generation costs cannot be recovered in this case because the accrual period both begins and ends January

1, 2004. An alternate interpretation of Staff's position is that for the typical ROA customer which has more than 15 kW of demand, the 10d(4) accrual period ends January 1, 2004 and thus generation costs incurred before 2004 cannot be recovered from large customers. Staff does not address the issue of recovery from ROA customers with less than 15 kW of demand.

It is difficult to know where to start. First, Staff seems to have confused non-Clean Air Act expenses with Clean Air expenses. Section 10d(4) specifically allows recovery of capital expenditures in excess of depreciation levels during the period commencing before the periods or periods described in Section 10d(2). Staff maintains that the begin date for this language would be June 2000 and Energy Michigan agrees. It is only for expenses mandated by State or federal actions (such as Clean Air Act expenses) that the recovery period starts in the time frame during the period described in (2). Thus, non-Clean Air Act generation costs above depreciation certainly can be accrued from June 2000 through December 31, 2003 and then recovered subsequent to that date. Only Clean Air Act costs would be prohibited for recovery prior to December 31, 2003.

Second, Staff's argument regarding the end date for accrual must be addressed. Staff maintains that that end date is in fact three end dates, one for each of the load groups described in Section 10d(2).

Consumers Energy has advanced the best and most correct response to Staff's argument: Staff's entire interpretation of 10d(4) rests upon the assumption that the end date for accrual and deferral is three separate periods described in Section (2): (January 1, 2004 for large customers, January 1, 2005 for small business customers and January 1, 2006 for residential customers). However, the language of PA 141 § 10d(4) for both capital expenditures in excess of depreciation and for expenses incurred as a result of change in taxes permits recovery during the "period" described in subsection (2) not the "periods" described in (2). Energy Michigan will leave it to other parties to argue that the Commission is bound to use the plain meaning of words when interpreting a statute. In this instance it is quite clear that the plain meaning of Section 10d(4) is that accrual and

deferral may continue through the entire period described in subsection (2) and that period ends January 1, 2006, not as three separate periods ending on three separate dates.

Moreover, the interpretation argued by Staff would lead to an absurd result. Under Staff's interpretation, each of the three customer classes would have significantly different responsibilities for generation facilities which are designed to serve all groups equally. Staff's interpretation of 10d(4) would result in smaller customers paying a far greater share of generation expenses than large customers. In the next rate case, these smaller customers would find the unrecovered costs lumped together and these remaining costs would be billed yet again to all customer classes on a cost based basis despite the greater contribution made by the smaller customers. This result makes no sense whatsoever and is precluded by the more logical interpretation that Section 10d(2) contains one "period" extending through January 1, 2006.

III. Miscellaneous Issues

A. Sales Levels.

The Reply Briefs have confirmed that at least Energy Michigan, MPSC Staff and Consumers are on the same page regarding the sales levels to be used when allocating costs among customer classes. Staff has proposed to use the 2003 historical sales levels contained in the Consumers U-14347 rate case 2003 Cost Of Service Study. Consumers has agreed with this approach and Energy Michigan agrees as well. This approach avoids use of projected data which, in the case of Consumers Energy, has proved wildly inaccurate as demonstrated in the Energy Michigan testimony and Initial Brief. See Energy Michigan Brief, p. 12 – 13.

B. Reconciliation of 10d(4) Revenues.

1. Staff position.

The Staff Brief continues to argue that the cap on recovery of 10d(4) costs urged by Energy Michigan cannot be used because certain data including 2005 expenses are

projected and thus a specific dollar amount of expense cannot be used as a cap. Staff also argues that its reconciliation process would solve the problem. Staff Brief, p. 43.

2. Energy Michigan reply.

The reconciliation process proposed by Staff proposes reconciliation filings which would be made "at the discretion of Consumers Energy". 2 Tr 143. Thus, as pointed out by ABATE, Consumers would have absolutely no incentive to file a reconciliation if it over collected 10d(4) amounts. ABATE Brief, p. 4.

Energy Michigan joins ABATE in urging the Commission at the very least to require a mandatory reconciliation in order to protect the interests of Consumers' customers.

IV. Conclusion and Prayer for Relief

WHEREFORE, Energy Michigan respectfully requests that the Commission:

- A. Add 2000 through 2003 non-Clean Air Act generation costs above depreciation in the amount of \$42 million to the sums to be collected from retail customers in this proceeding;
- B. Utilize historic 2003 sales levels as a basis for allocating approved costs among customer classes; and
- C. Order Consumers to file a reconciliation of sums collected pursuant to this proceeding no later than the final date of collection.

Respectfully submitted,

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

May 26, 2005

By: _____

Eric J. Schneidewind (P20037)
The Victor Center, Suite 810
201 N. Washington Square
Lansing, Michigan 48933
(517) 482-6237

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
for approval of recovery of costs pursuant)
to MCL 460.10d(4).)
_____)

Case No. U-14148

PROOF OF SERVICE

Monica Robinson, duly sworn, deposes and says that on this 26th day of May, 2005 she served a copy of Energy Michigan, Inc.'s Reply Brief upon the individuals listed on the attached service list by e-mail and regular mail at their last known addresses.

Monica Robinson

Subscribed and sworn to before me
this 26th day of May, 2005.

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

U-14148 SERVICE LIST

Hon. Barbara A. Stump
Michigan Public Service Commission 6545
Mercantile Way, Suite 14
P.O. Box 30221
Lansing, MI 48909-8195

Jon R. Robinson
Consumers Energy Company
One Energy Plaza Rm EP11-224
Jackson, MI 49201

Kristen M. Smith
MPSC Staff
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

James Selecky
1215 Fern Ridge Parkway
Suite 208
St. Louis, MO 63141

Charles W. King
1220 L. Street, NW
Suite 410
Washington, DC 20005

John Dempsey
Jennifer Frye
Dickinson Wright PLC
101 S. Washington Square, Ninth Floor
Lansing, MI 48933

David C. Gregory
Kelley Cawthorne & Ralls
120 N. Washington Square
Lansing, MI 48933

David Shaltz
Diane Royal
2379 Woodlake Drive
Suite 480 B
Okemos, MI 48864