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May 10, 2006

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Michigan Public Service Commission
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Re: Case No. U-14526

Dear Ms. Kunkle:

Attached for paperless electronic filing is the Reply Brief of Energy Michigan, Inc.

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 2004 and approval of net)
stranded cost recovery charges.)
_____)

Case No. U-14526

ENERGY MICHIGAN, INC. REPLY BRIEF

May 10, 2006

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ENERGY MICHIGAN, INC. REPLY BRIEF

I. Introduction and Summary of Position

A. Introduction.

This Reply Brief is filed on behalf of Energy Michigan, Inc. ("Energy Michigan") by Varnum Riddering Schmidt & Howlett LLP in response to the Initial Briefs of Consumers Energy Company ("Consumers" or "Consumers Energy"), Michigan Public Service Commission Staff ("Staff" or "MPSC Staff") and Attorney General Michael Cox ("AG"). Failure to respond to any specific position or argument in the Briefs of these or other parties to this matter should not be taken as agreement with those positions or arguments .

B. Summary of Position.

There is general agreement that the calculation of stranded costs and the application of third party sales revenue to offset those costs as presented by Consumers Energy Witness Charles Belknap, Jr. was in accordance with the methodology prescribed in U-12639 and used by the Commission since passage of PA 141. See U-12639, December 20, 2001 and Exhibit A-1.

Staff, Consumers and Energy Michigan are in agreement that application of the traditional U-12639 methodology including the traditional offset of stranded costs with third party sales revenue would yield zero stranded costs. The AG and the Association of Businesses Advocating Tariff Equity ("ABATE") find zero stranded costs for other reasons.

Both Consumers and Energy Michigan favor use of at least \$24.126 million of third party sales revenue to offset stranded costs. MPSC Staff concede that this is one of two alternatives but propose a second alternative method which would use only \$1.5 million of third party sales revenue to offset about \$24 million of stranded costs.

The Staff's third party sales allocation alternative should be rejected for the following reasons:

1. The Staff alternative method of allocating third party revenue is a complete departure from long established Commission precedent. Application of that precedent has hurt the Retail Open Access ("ROA") program in the past to the tune of \$63 million of stranded costs awarded in Case U-13702 and U-14098 but now could result in zero stranded costs. It would be unfair (and in complete disregard of record evidence as discussed below) to change methodologies at this time and produce additional stranded costs.
2. The U-12639 methodology has been upheld on appeal to the Court system.
3. Commission decisions must be based on record evidence. The new Staff methodology to allocate third party sales stranded costs and calculate stranded costs was unsupported on this record and therefore may not lawfully be the basis for a Commission decision. See MCL 24.285 and MCL 462.26(8) (Commission decisions be reasonable, i.e. based upon some evidence).
4. The U-12639 precedent requires that third party sales revenue be used to mitigate stranded costs **where those Mwh were freed up by Choice**. The record evidence in this case demonstrates that this requirement has been met. Energy Michigan presented testimony demonstrating this fact. Also, the record evidence and data presented by Energy Michigan show that the jurisdictional percentage of third party sales increased from about 1.6% prior to Choice to about 7% or more with Choice. Clearly the vast majority of third party sales were due to the 4 million Mwh of ROA service that was no longer provided by Consumers.

Based upon MPSC and Court precedent significant recover evidence and the arguments contained in the Briefs, the Commission should offset all stranded costs found in this case with third party sales revenue.

II. Reply to MPSC Staff

A. Allocation of Third Party Sales Revenue.

1. Staff position.

Staff concedes that determination of the portion of third party sales revenue used to offset stranded costs will be determinative of whether or not any stranded costs and resulting transition charges will be assessed to ROA customers. With a traditional allocation of third party sales revenue to offset stranded costs the entire \$24.126 million of stranded costs determined by Consumers would be offset. Staff Brief, p. 4. If Mr. Belknap's calculation of offsets using the alleged Staff method is used, only \$1.5 million of third party sales revenue would be available to offset approximately \$24 million of stranded costs leaving net stranded costs of \$22.26 million using a method to calculate stranded costs which purports to follow Staff's theories but which was not supported on this record. Id., p. 5.

Staff presents these two alternatives as a policy decision for the Commission to make in the context of Case U-13917-R. Id.

2. Energy Michigan reply.

The Energy Michigan Initial Brief provides five (5) reasons to reject the new MPSC Staff theory of allocating third party sales revenue. These reasons are summarized below:

- a. Power Supply Cost Recovery ("PSCR") and base rate caps were in place during 2004 for 41% of customer sales, therefore pre-PA 141 ratemaking

techniques allocating all third party sales revenue to PSCR customers cannot be used.

During 2004 over 41% of Consumers' retail sales were to customers whose base rates and PSCR rates were capped or frozen. See Exhibit EM-5. Consumers could have filed base rate increases for the balance of its load but did not. The result of these caps is that substantial PSCR costs and base rate costs were unrecovered and appear as stranded costs chargeable to ROA customers.

It is incorrect to state that PA 141 § 10a(19) mandates a return to pre-PA 141 ratemaking techniques where all third party sales revenue was allocated to PSCR customers. In Case U-14148 the Commission determined that pre-PA 141 ratemaking techniques were not applicable to residential or small commercial customers during 2004. U-14148, December 22, 2005, p. 16-18. Therefore, pre-PA 141 ratemaking techniques are not applicable and will yield unreasonable results.

b. MPSC and Court of Appeals precedent mandate that all third party sales revenue freed up by Choice be used to offset stranded costs.

Starting with Case U-12639, the Commission has upheld use of allocation of all third party sales revenue to offset stranded costs in Cases U-13380, U-13720 and U-14098. Also see Court of Appeals Opinion No. 241990, November 28, 2003 upholding the U-12639 decision.

Thus, MPSC Staff has the burden of proof to overturn long standing Commission precedent. That burden was not met because Staff presented absolutely no evidence in this case.

c. The evidence of record demonstrates that third party sales revenue was created by Mwh freed up by the ROA program.

Energy Michigan provided direct testimony that third party sales revenue resulted from the sale of Mwh power freed up by the ROA program. 2 Tr 90. Discovery responses were placed on the record showing that there were approximately 2.48 million Mwh of third party sales and ROA sales were approximately 4 million Mwh. These facts support the basis for the Energy Michigan witness conclusion that all third party sales resulted from Mwh freed up by the ROA program. Id.

Energy Michigan Attachments A and B to its Initial Brief demonstrate that the percentage of Consumers sales to third parties has dramatically increased since implementation of the Choice program. Compare the 98.366% jurisdictional factor assumed in Case U-10685 in 1996 with the 93% of sales that were actually jurisdictional during the year 2004. See Energy Michigan Initial Brief, Attachment B. Thus in the pre-PA 141 era, only about 1.6% of total sales were non-jurisdictional but in 2004 about 7% of total sales were non-jurisdictional and only about 91% of the output of Consumers generating plant was jurisdictional. Energy Michigan Brief, p. 6. The 2004 non-jurisdictional sales and output were at levels far above pre-PA 141 levels.

These data collectively demonstrate beyond all reasonable doubt that the vast majority if not all of third party sales resulted from Mwh freed up by over 4 million Mwh of system sales departing for the ROA program. Contrast this body of proof with the Staff which placed no evidence on record to support their theory of third party sales allocation or stranded cost calculation.

d. Adoption of the Staff third party sales allocation methodology leads to absurd results.

Adoption of the Staff third party sales allocation theory in this case would require the Commission to allocate 98.366% of generating costs to ROA customers in the full knowledge that only 93% of total sales were to jurisdictional customers. In effect this means that the Commission stranded cost calculation would be based upon the theory that ROA customers should be responsible for 98.366% of

generating costs but only 93% of total revenue would be available to cover such costs. In distinction to the U-12639 methodology, the new Staff theory would lead to excessive stranded costs without any factual justification.

The Staff theory becomes absurd when applied to the current situation of Detroit Edison in which ROA customers are expected to bear slightly over 97% of system generating costs in 2004 yet in that same year only about 87.5% of Edison's system total sales were to jurisdictional customers and the balance was to third parties. U-13808-R, Exhibit A-24. Once again, Staff's theory would yield large stranded cost with no offset at a time when significant portions of the Edison generating fleet were used to serve the third party market not retail customers.

e. The Commission has no evidentiary basis to adopt the Staff position on third party sales allocation.

The Orders of the Commission must include findings of fact and conclusions of law. "Findings of fact shall be based exclusively on the evidence and on matters officially noticed." See MCL 24.285 § 85.

In an appeal of a Commission Order, the burden of proof is upon the appellant to show by clear and satisfactory evidence that the Order of the Commission complained of is unlawful or unreasonable. MCL 462.26(8).

There is no support on the record for adoption of the Staff's method of allocating third party sales revenue or for that matter for Staff's alleged method of calculating stranded costs which is more thoroughly discussed below. It may be, as claimed by the Staff, that the method of third party sales allocation will be decided in Case U-13917-R. However, there is no evidentiary basis in this case for adoption of the Staff's third party sales proposal.

Since there is no evidence for Staff's position on third party sales, any decision adopting that proposal or decision may be overturned as unreasonable. See

Associated Truck Lines, Inc. v Public Service Commission, 377 Mich 259; 140 NW 2d 515 (1996); Attorney General v Public Service Commission, 231 Mich Ap 76, 77-78; 585 NW 2d 310 (1998)

B. The Staff's Proposed Method of Calculating Stranded Costs Cannot Be Adopted.

1. Staff position.

At pages 5-6 of its Brief, Staff supports, as one alternative, Consumers Witness Belknap's calculation of stranded costs under a theory attributable to Staff. Staff claims that Mr. Belknap's calculation of both stranded costs and third party sales offsets in Exhibit A-8 could be adopted as one alternative to application of the U-12639 method contained in Mr. Belknap's Exhibit A-1. Staff Brief, p. 4-5.

2. Energy Michigan Reply.

The Energy Michigan Initial Brief at p. 4-5 demonstrates that there is utterly no evidentiary basis for adoption of the Staff method of calculating stranded costs set forth in Exhibit A-8, p. 1 and 2 of 2. See Energy Michigan Initial Brief, p. 4-5. Without testimony or evidence supporting the methodology applied by Mr. Belknap, parties to this case were deprived of the ability to file discovery and rebuttal or conduct cross examination regarding the theory itself or application of that theory to the facts at hand. For reasons fully stated in the Energy Michigan Initial Brief, there is no evidentiary basis to adopt Staff's method of calculating stranded costs.

The other points applicable to Staff's third party sales allocation theory apply to Staff's stranded cost calculation theory as well.

As noted above, the new Staff theory of calculating stranded costs would overturn substantial MPSC precedent and a Court of Appeals ruling upholding the U-12639 methodology.

As discussed in the Energy Michigan Brief, the new Staff stranded cost methodology would lead to absurd results. Energy Michigan Brief, p. 5-7. Any theory which allocates 98.366% of generating costs to ROA customers yet uses less than 93% of revenue to cover those costs is literally designed to create stranded costs under almost any foreseeable circumstance. Unlike the Staff third party sales allocation method, there never has been Staff testimony in any case whatsoever supporting the rationale behind a calculation of stranded cost using such inaccurate data. Without Staff supporting testimony, parties to this case were never able to show the irrational result that would occur if Staff's theory was implemented.

III. Reply to Consumers Energy

A. Calculation of Stranded Costs and Allocation of Third Party Sales Revenues.

1. Consumers position.

The Consumers Energy presentation generally advocates use of the traditional U-12639 methodology to both calculate stranded costs and offset these costs with third party sales revenue. Consumers Brief, p. 1-4. The Consumers presentation proposes zero stranded costs. Id.

Consumers' Brief also describes the results which would occur if the Staff concepts of calculating stranded costs and allocating third party revenue are utilized. But Consumers does not support those methods and, in fact, states its preference for use of the traditional U-12639 methodology for both calculation of stranded costs and allocation of third party revenues. Id., p. 9.

2. Energy Michigan Reply.

Energy Michigan agrees that Exhibit A-1 and A-2 calculate stranded costs and resulting offsets to those costs along lines authorized by the Commission in Case U-12639.

The Energy Michigan Initial Brief discusses an anomaly produced by application of the traditional U-12639 method in years when third party sales substantially exceed historical levels. In effect, there is a disparity between the percentage of generating plant and PSCR fixed costs paid by ROA customers and the percent of revenue available to pay those costs. This is simply another way of saying that when the ROA causes a significant reduction in the amount of jurisdictional sales and the corresponding increase in non-jurisdictional sales, ROA customers should not be held responsible for historical levels of jurisdictional generating plant cost through the stranded cost mechanism.

That anomaly can be addressed in two ways. One new alternative posed by Energy Michigan is to reduce the stranded cost responsibility by allocating a percent of generating plant consistent with jurisdictional sales and then using a smaller portion of third party sales to offset those costs. The other, more traditional, method of dealing with this anomaly would be to follow the original U-12639 method and recognize that the higher percentage on non-jurisdictional sales is caused by Mwh leaving the Consumers system for ROA service. Those Mwh freed up by ROA would be used to offset stranded costs pursuant to the U-12639 method. U-12639, December 20, 2001, p. 10.

Energy Michigan can support application of the traditional U-12639 methodology because it addresses both the substance and the theory envisioned by the Commission: if Consumers Energy experiences a loss of revenue to cover Production Fixed Costs due to the ROA program, it is only fair to use revenues from the sale of those freed up Mwh to offset unrecovered costs. The proposal advocated by Consumers would do this and yield zero stranded costs.

B. Offset of Securitization and Nuclear Decommissioning Charges.

1. Consumers position.

Consumers commented that the "new stranded cost methods" presented by Energy Michigan were irrelevant to the proper scope of this case and hence that it would be

unlawful for the Commission to alter its method of calculating stranded costs as proposed by Energy Michigan. Consumers Brief, p. 7.

2. Energy Michigan reply.

Consumers Energy had the opportunity to file a Motion to Strike Energy Michigan testimony to the extent that it believed the testimony was beyond the scope of this proceeding. Neither Consumers nor any other party filed such a Motion.

Moreover, the Supplemental Testimony filed by Consumers and the Brief of MPSC Staff propose fundamental revisions to the method for calculating stranded costs. If Staff, assisted by Consumers, can propose to modify stranded cost calculations within the scope of this proceeding, alternative proposals by Energy Michigan are equally relevant. The proposals offered by Energy Michigan apply to generation assets which were deemed to be stranded and thus payment of the securitization and association charges are in effect payment of alleged stranded costs. Proposals to alter calculation and collection of such charges are just as relevant to this case as the Staff's proposals to alter the method of calculating and collecting stranded cost charges.

Consumers has waived any claims regarding the relevance or scope of the Energy Michigan testimony because it failed to file Motions to Strike. The Energy Michigan proposals should be considered on their merits.

IV. Reply to the Attorney General

A. Attorney General Position.

The AG generally opposes collection of stranded costs on the grounds that such costs have not been shown because all alleged costs could have been recovered under traditional ratemaking techniques. AG, p. 6. However, the AG goes on to state that "No witness has described any evidence that shows CECO's third party sales revenues in 2004 resulted from sales that CECO could not have realized except under deregulation via third party sales that were freed up by the

migration of Choice customers." AG Brief, p. 7 citing AG Exceptions to PFD in Case U-13917-R, p. 12.

B. Energy Michigan Reply.

The Energy Michigan Initial Brief at p. 3-4 demonstrates that the Consumers third party sales revenue did result from Mwh freed up by the ROA program.

Moreover, that Initial Brief and this Reply Brief at page 5 demonstrate the significant increase in non-jurisdictional sales resulting from the Choice program. This analysis is a further demonstration of the fact that the ROA program resulted in a significant increase in third party sales.

Neither the AG nor any other party to this case presented evidence on this subject nor did they rebut Mr. Polich's conclusions summarized above.

Given the substantial evidence introduced on the record by Energy Michigan and the analysis contained in the Energy Michigan Brief, there has been a demonstration that third party sales revenue received by Consumers resulted from Mwh freed up by the ROA program. There is no substantial, credible evidence on this record to the contrary. Therefore, the position supported by Energy Michigan must be adopted.

V. Conclusion and Prayer For Relief

WHEREFORE, Energy Michigan respectfully requests that the Commission:

A. Reject the MSPC Staff proposal for allocation of third party sales;

B. Reject the calculation of stranded cost placed on the record by Consumers Energy at the request of MPSC Staff;

C. Reduce the calculation of stranded costs presented by Consumers Energy as set forth in the Energy Michigan Brief and completely offset any stranded cost with third party sales revenues. The balance of third party sales revenue should be used to reduce stranded costs awarded by the Commission in Cases U-13720 and U-14098; or

D. Adopt the calculation of stranded costs presented by Consumers in Exhibit A-1 and completely offset those costs with third party sales revenue; and

E. Order Consumers Energy to supply a Palisades power credit to ROA customers as described above or provide a credit to ROA customers in the amount of the market price of Palisades power minus variable costs.

Respectfully submitted,

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May 10, 2006

By: _____
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PROOF OF SERVICE

Monica Robinson, duly sworn, deposes and says that on this 10th day of May 2006 she served a copy of the Reply Brief of Energy Michigan, Inc. upon the individuals listed on the attached service list by e-mail at their last known addresses.

Monica Robinson

Subscribed and sworn to before me
This 10th day of May 2006.

Eric J. Schneidewind, Notary Public
Eaton County, Michigan
Acting in Ingham County, Michigan
My Commission Expires: April 24, 2012

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