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June 27, 2006

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

Re: Case No. U-14526

Dear Ms. Kunkle:

Attached for paperless electronic filing is Energy Michigan's Replies to Exceptions. Also attached is the original Proof of Service indicating service on counsel.

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)	Case No. U-14526
stranded cost recovery charges.)	
_____)	

ENERGY MICHIGAN, INC. REPLIES TO EXCEPTIONS OF THE
MPSC STAFF, ATTORNEY GENERAL AND CONSUMERS ENERGY COMPANY

I. Introduction

Energy Michigan, Inc. ("Energy Michigan") by Varnum Riddering Schmidt & Howlett LLP hereby files Replies to the Exceptions of Attorney General Michael A. Cox (the "Attorney General" or "AG"), the Consumers Energy Company ("Consumers" or "Consumers Energy") and the Michigan Public Service Commission Staff ("Staff" or "MPSC Staff") filed June 20, 2006. Failure to reply to any other Exception to the Proposal For Decision issued June 6, 2006 (the "PFD") should not be taken as agreement with that Exception.

II. Reply to MPSC Staff

A. The Staff's Exception Supporting Either Of Two Theories Of Calculating Stranded Costs Does Not Address The Issue Of Allocating Third Party Sales Revenue.

The Exception of the MPSC Staff seems to support use of either the "traditional U-12639 method" of calculating stranded costs which would yield stranded costs of \$24 million or the theory of the Attorney General that Consumers has not proven that its revenue deficiency was caused by competition and therefore has no stranded costs. Staff Exceptions, p. 1-3 citing PFD, p. 2. The Staff Exception does not address the fact that under the "traditional U-12639 method",

third party sales revenues above the amounts included in the base PSCR factor are used to offset stranded costs. Id.

The Staff's Exception analyzes the theory of stranded cost calculation presented by the AG and adopted by the ALJ. In Staff's view, the AG's theory is summarized as stating that the first step in determining stranded costs was to perform a calculation of revenue deficiency pursuant to U-12639 criteria as described in that case by Staff Witness Carlson. Staff states that the AG then adds a second step which disallows stranded cost recovery if the revenue shortfall was caused by "...reasons other than a loss of customers due to retail open access." Staff Exceptions, p. 1-2, citing PFD, p. 13 discussing Staff Witness Paul Carlson Testimony in Case U-12639. Use of the AG's theory in this case results in zero stranded costs because Consumers made no showing that its revenue deficiency was caused by competition. This was the finding of the PFD. PFD, p. 13-15.

As an alternative, Staff claims that the traditional U-12639 calculation of revenue deficiency without the second step of determining whether the revenue deficiency was caused by competition could be used to calculate stranded costs. Id., p. 2. Staff has taken the position in this case that the question of allocating third party sales revenue to cover the stranded costs should be decided in Reconciliation Case U-13917-R, not this case.

B. Energy Michigan Reply: The Staff's Position Is Incomplete and Therefore Inconsistent.

The Commission should be aware that the consequence of Staff's position in this case is to defer to the Staff's recommendations in U-13917-R which use only 3% of third party sales revenue or about \$1.5 million to offset stranded costs. Consumers Exceptions, p. 11, Exhibit A-8. Also, Staff does not mention the fact that its calculation of the amount of third party sales revenue used to offset stranded costs is a radical departure from U-12639 practice and has been vigorously opposed on the record of that case.

The Staff's seemingly ambivalent position should not obscure one basic fact: The Commission may choose either the Attorney General's new theory of calculating stranded costs or the

"traditional U-12639 method" which includes allocating available third party sales revenue to offset the calculated stranded costs.

Virtually all MPSC precedent regarding the calculation of stranded costs for Consumers Energy or Detroit Edison combines calculation of stranded costs pursuant to the revenue requirement method first used in U-12639 together with using available third party sales revenues above the amount included in the PSCR base to offset any calculated stranded cost. See Cases U-12639, U-13380, U-13720 and U-14098. Also see the Court of Appeals case confirming the U-12639 method of calculating stranded costs: Case No. 241990, PSC LC No. 00-012639, November 18, 2003.

There is a similar, consistent body of precedent for Detroit Edison which addresses the same subject: calculation and offset of stranded costs and applies the "U-12639" method including offset of stranded costs with available third party sales revenue. See Commission decisions in Case U-12639, U-13350, U-13808 and Court of Appeals decision No. 1625331, LC No. 00-013350.

If MPSC and Court precedent dictates use of the traditional U-12639 revenue requirement method to calculate stranded costs then that same precedent dictates use of all third party sales revenue above the amount assumed in the PSCR base to offset any calculated stranded cost.

Finally, the records of both this case and U-13917-R include Testimony by Energy Michigan Witness Richard Polich to the effect that all third party sales revenue above the amount included in the PSCR base should be used to mitigate stranded costs because all such sales were caused by the ROA program which freed up literally all the Mwh used for third party sales. 2 Tr 90. Mr. Polich also testified that neither the Commission Staff nor other parties provided testimony which supports any other conclusion regarding the cause of third party sales revenues. 2 Tr 103.

Thus, any Commission decision which is based upon a methodology or conclusion that third party sales revenue was not caused by the ROA program is unsupported by facts. A Commission decision may be overturned if it is unlawful or unreasonable. MCL 462.26(8) For that reason,

any MPSC Order adopting the Staff position would be unreasonable because Staff's position is unsupported by evidence on the record. Associated Truck Lines, Inc v Public Service Commission, 377 Mich 259; 140 NW 2d 515 (1966); Attorney General v Public Service Commission, 231 Mich Ap 76, 77-78; 585 NW 2d 310 (1998). In this case the Commission would truly lack any substantial justification for allocation of third party sales proposed by MPSC Staff since there is literally no testimony supporting that method on this record.

Conclusion

For these reasons, Energy Michigan believes that the Commission must adopt the entire U-12639 stranded cost methodology which includes both calculation of stranded costs and the assumption that such costs must be offset by any available third party sales revenue above levels incorporated into the PSCR base.

III. Reply to the Attorney General Exception

A. The Attorney General's Summary of Testimony Is Incomplete and Therefore Inaccurate.

The Attorney General claims that third party sales revenue should not be used to mitigate stranded costs because "Consumers Energy did not present any testimony satisfying the standard determining mitigation of stranded costs". AG Exceptions, p. 2.

B. Energy Michigan Reply.

The Commission standard for use of third party sales revenue to mitigate stranded costs is that the revenue must come from Mwh "freed up" by the ROA program. U-12639, December 22, 2001.

The Attorney General implies that there is no testimony satisfying this standard for determining mitigation of stranded cost because Consumers did not present such testimony. AG Exceptions, p. 2. However, the AG's statement ignores evidence placed on this record and on the record of

U-13917-R by Energy Michigan proving that available third party sales revenues were caused by the sale of Mwh freed up by the ROA program.

In this case 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.

In U-13917-R Mr. Polich testified that all third party sales revenue was caused by sale of Mwh freed up by the ROA program. U-13917-R, 3 Tr 331.

The record evidence demonstrates 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.

No other party placed testimony or evidence on the record refuting the testimony of Mr. Polich.

Thus, there is no testimony or evidence supporting the claim of Staff or the Attorney General or any other party that somehow the Commission should depart from precedent established in six cases covering two utilities to the effect that third party sales revenue should be used to mitigate stranded costs. On the other hand, this record and the record of Case U-13917-R contain

testimony and evidence supplied by Energy Michigan to the effect that the third party sales revenues were caused by the sale of Mwh freed up by the ROA program.

If the Commission does not adopt the theory of the AG that there is zero stranded cost, the Administrative Procedures Act requires that the Commission use the U-12639 method to both calculate stranded costs and offset those costs with available third party sales revenue because that is the only "traditional U-12639" outcome that is supported by record evidence.

IV. Reply to Consumers Energy

A. The Consumers Exception To Adoption Of The AG Theory Of Calculating Stranded Costs Is Incomplete And Inconsistent.

The overwhelming portion of Consumers Exception #1 is taken up with a critique of the Attorney General's new theory of calculating stranded cost: the applicant must prove both that the amount of revenue deficiency and prove that revenue deficiency was caused by competition. Consumers claims that this theory is not supported by Commission precedent, that PA 141 and particularly the rate freeze portion of that Act prevented full cost recovery, that Clean Air Act costs were improperly excluded from the calculation process and that PA 141 requires an award of stranded costs. Consumers Exceptions, p. 1-10. Consumers concludes by stating that if the Commission decides that further evidence is required beyond calculation of the revenue deficiency it should reopen the record. Id., p. 10.

B. Energy Michigan Reply.

The Consumers Energy Exception No. 1 contains four debatable assumptions which are applied inconsistently to the facts in this case:

1. Case Precedent.

Consumers first states that literally all of the MPSC precedent supports calculation of stranded costs through the "traditional U-12639 revenue requirements" method which, applied to the facts of this case would yield about \$24 million of stranded costs. Consumers Exceptions, p. 2-6. Energy Michigan agrees with this conclusion but notes that Consumers failed to mention that the same precedent supports use of literally all third party sales revenues (above the revenues assumed in the frozen PSCR base) to mitigate stranded costs. Consumers Exception #2 on pages 10 through 11 treats use of third party sales revenue as debatable or optional rather than as precedent of the Commission regarding calculation of stranded costs¹.

2. If The Consumers Revenue Deficiency Was Caused By Competition, The Third Party Sales Revenue Which Offsets That Deficiency Was Also Caused By Competition.

Consumers' second assertion is that even if the Attorney General's theory were utilized, the entire \$24 million revenue deficiency was caused by competition. To support this conclusion Consumers merely cites the fact that but for the 4 million Mwh of ROA sales, the Consumers Energy revenues would have been significantly larger. However, Staff and the Attorney General have failed to recognize that those same 4 million Mwh of ROA sales allowed Consumers to avoid significant PSCR increases due to purchase of additional power. 2 Tr 90. Also, the Mwh freed up by ROA were sold into the market and provided revenues which are more than sufficient to offset stranded costs. Id.

Consumers and Staff are attempting to have it both ways: they use the existence of competition to justify collection of stranded costs but they do not completely agree or commit to the idea that the ROA program is responsible for increased revenue due to sale of freed up Mwh and reduced PSCR costs to retail customers. Staff's theory which awards 97% of third party sales revenue to retail customers is particularly egregious when it is recognized that all small business and residential customers were protected from PSCR and base rate increases by the PA 141 competitive framework and rate

¹ See discussion of MPSC precedent on this point in the Reply to Staff on page 3 above.

freeze. See PA 141 § 10d(2) (Consumers Exeptions, p. 11). Staff would saddle ROA customers with 100% of revenue shortfalls of Consumers during this period but award those ROA customers only 3% of third party sales revenue despite the fact that the competitive framework protected all residential and small commercial customers from any increases during 2004.

There is a simple answer to this inconsistency: The "traditional U-12639" method of calculating and offsetting stranded costs must be embraced in its entirety as regards the cost and use of third party sales revenue to mitigate those costs. Piecemeal implementation as recommended by Staff and inferred by Consumers is inaccurate, inconsistent with longstanding Commission precedent, and completely unfair to the ROA program.

3. Clean Air Costs Are Not An Issue.

Consumers' discussion of the treatment of Clean Air Act costs attempts to revisit an issue that has long since been decided by the MSPC. This is not the place to relitigatethe Clean Air Act issue nor is the record provided by Consumers adequate to do so. PFD, p. 9.

4. PA 141 Gives the Commission Latitude When Calculating \$24 Million of Stranded Costs.

Finally Consumers' discussion of MCL 460.10a(1) merely expresses an opinion regarding interpretation of that section. However, Consumers ignores the obvious response that the same provision of law gives the MSPC wide latitude to set the actual formula used to determine stranded costs. PFD, p. 9-10. See Section 10a(17)(c).

Conclusion

Use of the "traditional U-12639" methodology requires application of that formula to both calculation of revenue deficiency and use of available third party sales revenues to mitigate or

offset that deficiency. Loss of retail sales to ROA service clearly produces retail revenue reductions but just as clearly avoids some PSCR costs and produces additional revenue from the sale of power not needed by retail customers. The Commission should reaffirm this fact and order the complete application of the U-12639 theory and precedent to both calculating stranded costs and using third party sales revenues to mitigate those costs. The parties and participants in the ROA market have relied upon this framework and are entitled to consistent application of that framework at least through termination of the PA 141 rate freeze on December 31, 2005.

V. Conclusion and Prayer for Relief

WHEREFORE, Energy Michigan respectfully requests that the Commission issue an Order consistent with the Replies to Exceptions above.

Respectfully submitted,

Varnum, Riddering, Schmidt & Howlett LLP
Attorneys for Energy Michigan, Inc.

June 27, 2006

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Case No. U-14526

PROOF OF SERVICE

Monica Robinson, duly sworn, deposes and says that on this 27th day of June 2006 she served a copy of the Replies to Exceptions of Energy Michigan, Inc. upon the individuals listed on the attached service list by e-mail and first class mail at their last known addresses.

Monica Robinson

Subscribed and sworn to before me
This 27th day of June 2006.

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

U-14526 SERVICE LIST

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