STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **CONSUMERS ENERGY COMPANY** for authority to increase its rates for the generation and distribution of electricity and for other relief.	)	Case No. U-15245

At the June 10, 2008 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. Orjiakor N. Isiogu, Chairman
Hon. Monica Martinez, Commissioner
Hon. Steven A. Transeth, Commissioner

OPINION AND ORDER

I. History of Proceedings

On March 30, 2007, Consumers Energy Company (Consumers) filed an application requesting a $143.5 million rate increase above the retail electric base rates established in the December 22, 2005 and January 10, 2006 orders in Case No. U-14347.[1] Consumers asserted that its request for rate relief reflects: 1) an examination of relevant items of investment and revenues; 2) various

[1]Consumers submitted its application before completion of its proposed sale of the Palisades Nuclear Power Plant (Palisades), thus the $143.5 million revenue deficiency included the revenue requirement for Palisades. In its application, Consumers calculated that the effect of the removal of Palisades costs from base rates would be to reduce the base rate revenue requirement from current levels by approximately $167.1 million. The net effect on base rates of the $143.5 million increase and the $167.1 million reduction is a reduction in the base rate revenue requirement below current levels for the 2008 test year in the annual amount of approximately $23.6 million.

changes to base rates that result from the sales of Palisades[2] and Big Rock interim spent fuel storage installation (ISFSI); 3) the effect on rates of the sale of Palisades and the cost of power purchased under the Power Purchase Agreement (PPA) approved in Case No. U-14992; 4) ongoing investments in Clean Air Act compliance; 5) continuing efforts to strengthen its capital structure and balance sheet; and 6) increased operations and maintenance (O&M) costs.

Consumers requested additional authorizations associated with the sale of Palisades, and authority to recover $13 million associated with a return on certain Big Rock related investments.[3] Consumers requested recovery of transaction costs for the sale of Palisades and Big Rock ISFSI of approximately $60 million. Consumers requested to continue the use of equalization mechanisms for pensions and other post employment benefits (OPEB) that were approved in Case No. U-14347 and requested that the tracker for tree trimming and forestry expenses be discontinued.

Consumers also sought authority to revise its electric rules, regulations, and tariffs to include a number of new rates including a new market-based energy rate, a new low income rate, a new educational institution rate, a new senior citizen credit, and rates that the company stated will better reflect service voltage and load factors. Furthermore, Consumers proposed that the Commission design rates to reduce the skewing of the company's rate structure by approximately 20% per year over a five-year period.

Consumers proposed that its rates be based on 2006 financial information, updated to reflect known and measurable changes, to arrive at a projected level of costs and revenues for the 2008 test year. Consumers asserted that this method would allow the rates established in this case to

[2]The Commission's March 27, 2007 order in Case No. U-14992 addressed Consumers' sale of Palisades to Entergy Nuclear Palisades, LLC (Entergy).

[3]This proposal and other related issues are discussed in Part VII. F. *infra* (Nuclear Legacy Costs).

more closely reflect the conditions that will exist at the time that the rates will be in effect. Consumers also requested that the rates approved by the Commission reflect a rate of return on common equity of 11.25%, which will result in an overall rate of return of 7.10%.

On May 10, 2007, a prehearing conference was conducted by Administrative Law Judge Mark E. Cummins (ALJ) at which he granted the petitions to intervene submitted by Attorney General Michael A. Cox (Attorney General), The Kroger Company (Kroger), the Association of Businesses Advocating Tariff Equity (ABATE), and the Michigan Retailers Association (MI Retailers). At a second prehearing conference on May 31, 2007, the ALJ granted the petitions to intervene filed by the Michigan Environmental Council and the Public Interest Research Group in Michigan (MEC/PIRGIM), the Midland Cogeneration Limited Partnership (MCV), AARP Michigan (AARP), Dow Corning Corporation and Hemlock Semiconductor Corporation (Dow/Hemlock), Energy Michigan, the National Energy Marketers Association (NEMA), Constellation New Energy (CNE), and Phil Forner.[4] The Commission Staff (Staff) also participated in the proceedings.

On July 3, 2007, Consumers amended its March 30, 2007 application and also submitted a motion for partial and immediate (P & I) rate relief. Among other things, the amended application sought an immediate final determination on a request for rate relief in the amount of $84 million associated with Consumers' proposed acquisition of a 946 megawatt (MW) gas-fired generating plant located in Zeeland, Michigan (Zeeland Generating Station). In addition to the annual rate increase sought in conjunction with the Zeeland Generating Station purchase, Consumers' motion for P & I rate relief requested a rate increase in the net annual amount of an additional $77 million. Consumers proposed to offset these rate increases by utilizing the additional $127 million of

[4]On August 31, 2007, the Michigan Municipal League (MML) filed a delayed petition for leave to intervene. The ALJ granted the petition on September 10, 2007.

Palisades' proceeds above the level determined in Case No. U-14992, until issuance of a final order in this case or the exhaustion of the $127 million. Consumers' amended application included a request for approval of a $24 million energy efficiency (EE) program, a request for approval of certain rate modifications designed to eliminate the disincentive for Consumers to offer an EE program, and a request for a performance incentive mechanism that will adjust the company's rate of return on common equity based on its performance of the EE program.

Finally, Consumers requested authority to remove the costs associated with its former ownership and operation of Palisades by removing $169 million of costs from its rates with the contemporaneous elimination of the power supply cost recovery (PSCR) crediting mechanism of $167 million approved in Case No. U-14992.

On November 20, 2007, Consumers filed a withdrawal of its request for recovery of a $13 million nuclear legacy investment surcharge for Big Rock decommissioning and site restoration costs and costs associated with the Big Rock ISFSI.

On December 18, 2007, the Commission issued an order concerning Consumers' request for P & I relief in which it: 1) denied Consumers' request for P & I relief; 2) found the company's proposed purchase of the Zeeland Generating Station to be reasonable and prudent and that the costs associated with purchasing, owning, and operating the Zeeland Generating Station should be recovered in rates; 3) authorized Consumers to increase its rates by $69.5 million annually through the application of an equal percentage surcharge effective the first day following the closing of the Zeeland transaction; 4) deferred all determinations regarding the use of Palisades' proceeds to the final order in this case; and 5) denied Consumers' request to immediately shift recovery of Palisades' plant costs from rate base to the PSCR process.

Evidentiary hearings on Consumers' request for final rate relief were held on December 3-7 and 10, 2007. The complete record in this case consists of 2,469 pages of transcript in 14 volumes and 338 exhibits admitted into evidence.

On January 14, 2008, Consumers, the Staff, the Attorney General, ABATE, CNE, NEMA, Energy Michigan, Kroger, Dow/Hemlock, the MML, AARP, MEC/PIRGIM, and Mr. Forner filed briefs regarding Consumers' request for final rate relief. Except for AARP, these parties filed reply briefs on January 31, 2008.

On March 31, 2008, the ALJ issued his Proposal for Decision (PFD). Consumers, the Staff, the Attorney General, ABATE, CNE, NEMA, Energy Michigan, Dow/Hemlock, the MML, AARP, MEC/PIRGIM, and Mr. Forner filed exceptions on April 22, 2008, and on May 7, 2008, Consumers, the Staff, the Attorney General, ABATE, CNE, NEMA, Energy Michigan, Dow/Hemlock, the MML, and MEC/PIRGIM filed replies to exceptions.

II. Test Year

A test year is the starting point for establishing just and reasonable rates for both the regulated utility and its customers. A test year is employed by the Commission to establish representative levels of revenues, expenses, rate base, and capital structure for use in the rate-setting formula. Because Michigan has no statutory mandate to use a particular type of test year, the selection of an appropriate test year is within the Commission's broad ratemaking power and expertise. The Commission may select any reasonable method that comports with the objectives of determining the level of investment on which the shareholders of the utility are entitled the opportunity to earn a fair rate of return and the level of expenditures that the utility is entitled the opportunity to recover.

In this proceeding, Consumers proposed to base its rates on 2006 historical data adjusted for known and measurable changes occurring before and during a 2008 projected test year. The Staff essentially relied on the same approach, albeit with some differences in revenue requirements and expenses that are discussed below. Initially, Consumers proposed using slightly different inflation factors for 2007 and 2008, but subsequently supported the Staff's more recent inflation factors of 2.28% and 2.30% for 2007 and 2008 respectively. The Attorney General argued that there was no reason to adopt the Staff's inflation figures and that Consumers' lower estimates should be used to adjust most costs and revenues. The ALJ recommended that the Commission adopt the Staff's inflation factors because these factors were more recent and hence more accurate than the figures used by Consumers. There were no objections to the ALJ's recommendation regarding the test year and inflation factors to be used in setting rates.

Because the Commission finds that the test year and inflation factors are reasonable, the Commission adopts the ALJ's recommendation that Consumers' rates be set based on 2006 historical data, adjusted for known and measurable changes, to arrive at a 2008 projected test year.

III. Rate Base

A utility's rate base consists of the capital invested in used and useful plant, less accumulated depreciation, plus the utility's working capital requirements. Consumers initially identified a 2008 total projected rate base of $5,120,480,000 that it subsequently revised to $5,126,762,000. In this case, rate base specifically includes net utility plant, U.S. Department of Energy (DOE) liability for spent nuclear fuel (SNF) disposal, and working capital requirements. In this part of the PFD, the ALJ also addressed an issue raised by the Attorney General and MEC/PIRGIM that related to the sale of various parcels of vacant land adjacent to Consumers' Ludington plant.

A. Net Utility Plant

In its initial filing, Consumers calculated a net utility plant of $4,881,120,000. Subsequently, Consumers accepted the Staff's jurisdictional net plant of $4,848,102,000. Because there were no other proposals and no disagreement between the parties on this issue, the ALJ recommended that the Commission adopt the proposal agreed to by Consumers and the Staff. The Commission agrees and adopts a jurisdictional net plant amount of $4,848,102,000.

B. DOE Liability

Pre-1983 DOE liability for SNF is part of rate base and long-term debt in the utility's capital structure. Consumers and the Staff agreed that as of December 31, 2006, the principal amount to be excluded from rate base was $44,286,000 and that accumulated interest as of the end of 2006 was $107,768,000 ($106,317,000 jurisdictional). However, Consumers updated the interest portion of the DOE liability to the 2008 test year and calculated a total of $119,288,000 ($117,678,000 jurisdictional) and accounted for this amount in rate base, but not in the long-term debt portion of the utility's capital structure.

The Staff argued that it was inappropriate to use the updated interest figure to compute rate base without also updating the company's capital structure, which Consumers failed to do. In its brief, Consumers asserted that the most appropriate way to address the mismatch was to simply include the updated 2008 interest figure in both rate base and capital structure. Consumers noted that there was no evidence that its calculation of the projected 2008 DOE liability was incorrect. The ALJ agreed and recommended that the DOE liability figure proposed by Consumers be included in rate base and that the $11,520,000 difference between 2006 and 2008 accumulated interest figures proposed by the parties should be added to long-term debt in Consumers' capital structure.

The Staff agreed that the ALJ's recommendation was straightforward, but maintained that the adjustment was inappropriate. The Staff pointed out that had the mismatch been left uncorrected, Consumers would have benefited from the error.[5]

The Commission agrees with the ALJ that updating the capital structure in the manner he recommends is a workable solution. The Commission also finds that the Staff's argument on principle is well taken. Consumers submitted its case on March 30, 2007 and included the updated figure for interest on DOE liability in rate base only. The Staff's testimony and exhibits were submitted on November 6, 2007. In her testimony, Susan J. Sims, an audit specialist with the Commission, pointed out that the Staff's proposed DOE liability corresponded with the DOE liability included in the Staff's proposed capital structure for the 2008 test year. Ms. Sims further testified that "The Company updated the DOE Liability included in its determination of 2008 rate base from the historical level of $107,768,267 to the 2008 13-month average of $119,288,388 but did not update its proposed capital structure to reflect this change." 11 Tr 1754. Subsequently, Consumers filed rebuttal testimony, in which it had the opportunity to correct the mistake pointed out by Ms. Sims, but it failed to do so. It was not until Consumers filed its initial brief that it finally recognized the problem and suggested a correction.

The Commission adopts the recommendation in the PFD, but nevertheless takes a dim view of the way Consumers appears to have addressed this issue. Consumers is a sophisticated enterprise and it is difficult to believe that the company failed to properly adjust its capital structure as well as rate base after calculating updated DOE liability in preparing its initial filing. Even after the error was pointed out by the Staff, Consumers failed to make a correction in its rebuttal testimony. In the future, the Commission expects Consumers to exercise much more care in the preparation of

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[5]MEC/PIRGIM's arguments on its recommended treatment of pre-April 1983 SNF liability to DOE is discussed below in Section VII.F.

its rate case filings and expects the company to thoroughly review and respond to the issues or errors pointed out by the Staff and other intervenors.

C. Working Capital

Working capital requirement is determined by "an analysis of all the assets of the utility to determine which are used to provide service and an analysis of all of the utility liabilities to determine the extent to which assets are funded by capital that is tied to the earnings of the utility." June 11, 1985 order in Case No. U-7350, p. 4. Consumers initially calculated a total working capital requirement of $156,318,000 ($154,584,000 jurisdictional). The Staff made several adjustments to Consumers' 2006 historic working capital and to the company's projected 2008 net working capital that reduced test year working capital requirements to $49,019,000 ($48,100,000 jurisdictional.) Consumers accepted all of the Staff's adjustments except a proposed $115,031,969 reduction for accounts receivable financing.

The Staff argued that Consumers had failed to fully utilize its accounts receivable (AR) financing option in 2006 and thus had a 13-month average balance of electric AR assets of $258,705,462. The Staff reduced this amount by $115,031,969 and added approximately $5.7 million to AR discount expense.

In rebuttal, Mr. Dhenuvakonda V. Rao, Consumers' Senior Director of Financial Planning, testified that the Staff's analysis implied that Consumers was required to use AR financing even when the company had sufficient cash on hand. According to Mr. Rao:

> Under this scenario, there will be a negative arbitrage since Company will be raising cash using the A/R facility even when there is adequate cash and reinvesting the cash at a rate lower than cost of A/R facility. The A/R program is a working capital facility designed to provide a short-term source of funds during the months when cash is required and Consumers has accordingly utilized it in a most efficient manner in 2006.

9 Tr 1291.

Mr. Rao testified that he expected the future level of AR sales to be consistent with the 2006 level and that therefore the Staff's proposed adjustment was inappropriate and should be rejected.

In its reply, the Staff argued that the issue of the use of AR financing was addressed recently in Case No. U-14547, where the Commission found that AR financing is the most cost-effective source of short-term capital requirements and that therefore the company should maximize its use of this resource. The Staff agreed that AR financing was not efficient if the company had sufficient cash on hand but maintained that Consumers had failed to provide any evidence to justify its assumption that it would have ample cash available in the 2008 test year as it had in 2006. The Staff noted that a $350 million equity infusion in 2006 may have had a significant effect on the use of AR financing but that Consumers had failed to show that similar infusions were likely to occur in 2008.

The ALJ found that the Staff's position was not supported by the November 21, 2006 order in Case No. U-14547, noting that the discussion on the issue centered on whether AR financing should be included in working capital or short term debt and not whether Consumers should necessarily maximize its use of AR financing. Further, the ALJ found that the Staff's claim that the level of AR financing would differ dramatically in 2008 from 2006 historical levels was unsupported in the record. Finally, the ALJ pointed to Mr. Rao's testimony that Consumers' use of AR financing in 2008 should be consistent with its use of AR financing in 2006.

The Staff took exception and argued that the facts in this case are similar to those in Case No. U-14547, where the Commission "effectively endorsed the concept of imputing the most cost effective amount of A/R financing." According to the Staff, Consumers failed to meet its burden to show why it should deviate from the procedures for the use of AR financing adopted in Case No. U-14547.

In the November 21, 2006 order in Case No. U-14547, p. 48, the Commission observed, "Consumers indicated to the Staff that it planned to fully use its accounts receivable financing option in 2006. Thus, the Staff reduced Consumers' working capital requirement by $139 million and added the $6,711,000 discount expense." Because the issue of working capital versus AR financing was not in dispute in that case,[6] the Commission did not extensively discuss the degree to which the company was expected to use AR financing. The Commission therefore agrees that the language in the November 21, 2006 order, by itself, does not fully support the Staff's assertion that Consumers should have calculated its test year working capital requirements on the basis that AR financing was fully utilized. Nevertheless, the Staff's contention that AR financing is the most cost effective means to meet short-term capital needs is correct, and it is the approach that the Commission generally supports in determining working capital requirements and in setting just and reasonable rates. *See, e.g.,* January 21, 1994 order in Case No. U-10102. The Staff's argument that Consumers' limited use of AR financing in 2006 was anomalous and may have been the result of significant equity infusions that year is well taken. However, rather than addressing the Staff's adjustment to working capital, Consumers' rebuttal testimony merely stated the obvious: that the use of AR financing is not economical when the company has sufficient cash on hand. But Consumers failed to explain why the company expected to have a source of funds in 2008 that would be more economical than AR financing.

Because the Commission's expectations regarding the use of AR financing were made clear in Case No. U-14547 and Case No. U-15190, Consumers was on notice of the Commission's position, namely that the sale of customer accounts receivable to third parties at a discount is generally the lowest cost means to cover short-term financial needs. Therefore, the Commission

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[6]The Staff proposed a similar reduction in working capital and increase in discount fees for AR financing in Case No. U-15190, which was partially settled on August 21, 2007.

agrees with the Staff's position and approves a working capital requirement of $49,019,000 ($48,100,000 jurisdictional) with a corresponding increase in O&M expense for discounts on accounts receivable sales.

D. Ludington Land Sale Proceeds

In 2006, Consumers sold several parcels of land located near the Ludington Pumped Storage Facility. In this case and in its 2006 PSCR reconciliation case, Case No. U-14701-R, Consumers proposed to divide the proceeds of the sale on a 50/50 basis with customers. Consumers argued that its proposal was equitable because, although rates have included a return on the land, customer rates have never included a return of the investment in the land itself because land is not a depreciable asset.

The Attorney General, ABATE, and MEC/PIRGIM objected to Consumers' proposal for various reasons and argued that the Ludington land sale proceeds should be allocated 100% to ratepayers. The ALJ recommended that the Commission adopt Consumers' proposal for several reasons including that the allocation of Ludington land sale proceeds had been addressed in the PFD in Case No. U-14701-R and that the issue would likely be moot by the time the order in this case was issued. The Attorney General and MEC/PIRGIM filed exceptions reiterating their arguments.

The Commission issued an order in Case No. U-14701-R on April 22, 2008 in which it agreed that although ratepayers had paid a return "on" the land investment, they had not paid a return "of" the investment and that therefore an equal division of the sale proceeds, as proposed by Consumers, was appropriate. Because the Commission decided this issue in Case No. U-14701-R, it is moot.

E. Rate Base Summary

In light of the preceding discussion, the Commission finds that Consumers' jurisdictional 2008 test year rate base is set at $5,013,880,000, comprised of net utility plant of $4,848,102,000, DOE liability of $117,678,000, and a working capital allowance of $48,100,000.

IV. Rate of Return

The criteria for establishing a fair rate of return for public utilities is rooted in the language of the landmark United States Supreme Court cases *Bluefield Water Works Co v Public Service Comm of West Virginia*, 262 US 679; 43 S Ct 675; 67 L Ed 1176 (1923) and *Federal Power Comm v Hope Natural Gas Co*, 320 US 591; 64 S Ct 281; 88 L Ed 333 (1944). The Supreme Court has made clear that in establishing a fair rate of return, consideration should be given to both investors and customers. The rate of return should not be so high as to place an unnecessary burden on ratepayers, yet should be high enough to ensure investor confidence in the financial soundness of the enterprise. Nevertheless, the determination of what is fair or reasonable, "is not subject to mathematical computation with scientific exactitude but depends upon a comprehensive examination of all factors involved, having in mind the objective sought to be attained in its use." *Meridian Twp v City of East Lansing*, 342 Mich 734, 749; 71 NW2d 234 (1955). With these principles in mind, the Commission turns to the factors that form the basis for determining the rate of return for Consumers.

A. Capital Structure

In developing its test year capital structure, Consumers began with its actual capital structure balances as of December 31, 2006 and adjusted for: 1) a $400 million equity infusion made in May 2007 by CMS Energy Corporation (CMS), Consumers' parent company; 2) a $250 million equity infusion made in June 2007; and 3) $75 million in retained earnings. Consumers' proposed capital structure also reflected the removal of maturing debt and the addition of Zeeland-related debt to long-term debt. Consumers' proposed capital structure for the 2008 test year is shown in Exhibit A-92, which reflects a permanent capital structure comprised of 49.42% long-term debt, 49.99% common equity, and 0.60% preferred stock.[7]

In determining Consumers' 2008 capital structure, Kirk Megginson, a financial analyst for the Commission, began with second quarter 2007 balances, adjusted for known and measurable changes, both with and without the purchase of the Zeeland Generating Station. Mr. Megginson likewise recognized the total $650 million equity infusion and projected $40 million in retained earnings for 2008. The Staff's initial proposed capital structure is shown in Exhibit S-5, Schedule D-1 and reflects a permanent capital structure, including the Zeeland Generating Station, comprised of 49.77% long-term debt, 49.63% common equity, and 0.60% preferred stock.

In response to the Staff's proposal, Consumers noted that the primary difference between the company's proposed capital structure and that proposed by the Staff was the difference in common equity balance, which arose from the difference in the amounts attributable to retained earnings. Consumers claimed that the Staff included projected retained earnings for 2008, but had failed to include retained earnings for part of 2007. In Exhibit A-150, Consumers adjusted the Staff's capital structure to include the omitted retained earnings for 2007. Exhibit A-150; Consumers' initial brief, p. 12.

In reply, the Staff argued that the best way to reconcile the common equity balances and differences in retained earnings would be to review Consumers' actual common equity balance each month to the end of November 2007. Using that figure projected to 2008, the Staff argued that result would be very close to the Staff's original result. Staff's reply brief, pp. 4-5.

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[7]These numbers do not foot due to rounding.

The Attorney General and ABATE recommended using Consumers' second quarter figures reported to the Securities and Exchange Commission (SEC) on Form 10Q. The Attorney General and ABATE argued that this approach is more accurate than the 2008 projected capital structure supported by Consumers and the Staff. According to the Attorney General and ABATE, Consumers' capital structure reported on SEC Form 10Q was comprised of 53.21% long-term debt, 46.23% common equity, and 0.56% preferred stock. *See*, Exhibit ABAG-1R.

The ALJ found that the Attorney General and ABATE's proposal should be rejected because: 1) all costs and revenues in the case are based on a 2008 test year, therefore it is consistent to use 2008 numbers for the capital structure; 2) the SEC report does not reflect a ratemaking capital structure; and 3) the SEC filing may not capture all of the pertinent changes to the 2008 test year capital structure.

The ALJ observed that none of the witnesses had testified regarding Consumers' 2007 retained earnings and the Staff had not entered its updated capital structure analysis in the record. The ALJ recommended adoption of the capital structure in Exhibit A-150, with the adjustment for DOE liability of $11,520,000 added to long-term debt. The resulting permanent capital structure recommended by the ALJ was comprised of 49.58% long-term debt, 49.82% common equity, and 0.60% preferred stock.

The Staff takes exception and argues that it has been consistent in its capital structure development and logically estimate retained earnings only in the test year. The Staff asserts that the ALJ overlooked the fact that Consumers "is in effect requesting that the Commission decide on the Company's 2007 common equity balance that was not known and factual at the time and is not part of the considered test year . . . this would suggest that the Company is asking the Commission to make a decision on its common equity balances for both 2007 and 2008." The Staff recommended that the Commission reject the ALJ's finding and adopt the method and capital structure proposed by the Staff in its initial brief.

The Commission agrees with the ALJ that without the evidence in the record necessary for the alternative proposed by the Staff, it would be improper for the Commission to approve the capital structure recommended by the Staff in their initial brief and exceptions. The Commission therefore adopts the ALJ's recommendation and finds that rates for the 2008 test year should be based on a permanent capital structure comprised of 49.58% long-term debt, 49.82% common equity, and 0.60% preferred stock.

B. Cost Rates

1. Common equity

The utility's cost of common equity is the return investors expect, or require, in order to provide the utility with capital. The cost of capital is an opportunity cost; in order to induce investors to purchase common stock or bonds, there must be the prospect of receiving earnings that are sufficient to make the investment attractive compared with other investment opportunities.

When the common stock of a public utility is not publicly traded, as is the case with Consumers, indirect or proxy approaches are used to calculate an appropriate rate of return on common equity (ROE). Because no method perfectly simulates the operation of the market, multiple models are typically used. In determining the cost of common equity, Consumers used the discounted cash flow (DCF) method, the capital asset pricing model (CAPM), a risk premium model, Value Line expected return data, and authorized ROE data. The DCF and CAPM methods are widely used by regulatory agencies in deciding the appropriate rate of return to permit regulated utilities to earn, as are the risk premium and comparable ROE approaches. The Staff likewise used the DCF method, the CAPM, and a risk premium approach to develop its cost of equity range and recommendation. The Staff also reviewed returns on equity recently authorized by other state commissions.

Consumers requested a rate of return on common equity of 11.25% based on its proxy analyses. Wayne M. Leja, Consumers' Principal Financial Analyst, testified that he had selected his group of 21 proxy companies in accordance with the following criteria: 1) 50% or more of the proxy's operating income derived from electric operations; 2) net plant was over $5 billion for the selected companies; 3) the proxy companies were currently paying dividends; and 4) the selected companies had bonds rated at a minimum investment grade of Baa3 by Moody's Investor Services (Moody's) and BBB- by Standard & Poor's (S&P). Mr. Leja opined that taken as a whole, the companies in the proxy group were less risky than Consumers and that it was therefore necessary to make adjustments to reflect Consumers' higher risk. According to Mr. Leja, factors which support a conclusion that Consumers has more risk than the proxy group include the fact that Consumers has bond ratings that are lower than the proxy group as a whole and Consumers' coverage ratios are weaker than the average ratios for the proxy group.

Mr. Leja testified that the average result for the CAPM was 11.74% and the average risk premium ROE for the proxy group was 11.37%. The average result for the Value Line ROE on book value was 11.61% and the authorized ROE average result was 10.63%. Based on his review of the above results, Mr. Leja recommended an ROE range for Consumers' electric business of 11.00% to 11.50%, and that within this range, the Commission should adopt 11.25%. Mr. Leja testified that given current market-to-book values, the DCF method will understate perceived investor risks and that the results of the DCF analysis, if considered at all, must be adjusted upward or given less weight.

Mr. Leja noted that although the higher equity capitalization proposed in this case suggested less risk, this did not mean that Consumers' ROE should be set below its currently authorized level of 11.15%. According to Mr. Leja, the market is currently requiring higher returns on investments in utilities, despite the fact that utility equity ratios have been increasing. Mr. Leja testified that the requirement for higher investor returns involves factors including increasing interest rates and increased betas. Mr. Leja testified that long-term interest rates for 2008 were projected to be 5.25%, higher than the 4.9% average for 2006, which was the test year in Consumers' previous electric rate case. Mr. Leja further observed that the Value Line beta for the proxy companies had increased by almost 10% since the third quarter of 2005. Mr. Leja opined that this was significant because beta is a measure of risk of an investment.

The Staff initially recommended a cost of equity range of 10.30%-10.90% and used the midpoint of the range, 10.60%, in its overall cost of capital recommendation. The Staff used a group of 16 proxy companies in developing its analyses. The Staff selected a group of proxy companies using the following criteria: 1) 40% or more of the proxy's operating income derived from electric operations; 2) net plant was between $2 billion and $15 billion for the selected companies; 3) the proxy companies were currently paying dividends; and 4) the selected companies had bonds rated at a minimum investment grade of Baa3 by Moody's and BBB- by S&P.

The Staff used the DCF method to estimate a cost of equity for each of the companies in the proxy group. The Staff calculated an average dividend yield of 3.58% and an average five-year growth rate of 6.61% for the proxy group. The Staff's DCF cost of equity estimate using the constant model was 10.30%, close to Consumers' average DCF cost of equity estimate of 10.21%

for 61 Value Line rated electric utilities, and above the 10.03% cost of equity estimate for its electric utility proxy group.

The Staff also used the CAPM to estimate a cost of equity for Consumers in this case. The CAPM model suggests that an investor's required return is based on the investor's exposure to market risk or risk that is systemic in the market, i.e. nondiversifiable risk. The Staff estimated the risk premium by reviewing excerpts from the latest *Ibbotson Associates, Stocks, Bonds, Bills and Inflation: The 2006 Yearbook* and used market return data from 1926-2006 and 1958-2006. The Staff's risk premium was 7.13% for the entire 80-year period and 5.56% for the 48-year period. The Staff used 30-year Treasury bond yield estimates from Value Line, Global Insights, and Bloomberg for the risk free rate and derived a 5.10% rate from those sources. The Staff's beta coefficient was derived from Value Line's beta estimates and was 0.89. The Staff's CAPM cost of equity estimate was 11.44% for the 80-year period and 10.05% for the 48-year period, averaging to 10.75%.

The Staff conducted a risk premium analysis that considered Moody's Electric Utility Realized Market Return Average from 1932 through 2001, compared with utility composite bond yields from the same time period and incorporated that historical data with current utility statistics. The Staff's average 69-year market return above that of composite utility bond yields was 3.99%, which was used as the historical risk premium. The Staff added current utility bond spread premiums for A/A2 thru BBB-/Baa3 of 1.49% to 2.13% to its recommended risk free rate of 5.10%. Adding current bond rates to the historical risk premium, the Staff calculated a risk premium cost of equity estimate of 10.58% to 11.22%, which averaged to 10.90%.

The Staff argued that Consumers' business risk has diminished considerably because the company sold Palisades and exited the nuclear energy business entirely, thereby substantially reducing its risk profile. Consumers also divested its interest in the MCV, and CMS sold a number of higher risk national and international assets and realized over $1.87 billion in proceeds from the asset sales that it planned to invest into Consumers. The Staff asserted that these acts further reduced the company's actual and perceived risk. The Staff noted that the major credit rating agencies S&P, Moody's, and Fitch raised Consumers' and CMS's credit ratings a minimum of two notches, citing improved liquidity from the asset sales, reduced business risk resulting from Consumers' exit from the nuclear energy business, and an improved management strategy. In light of the significantly reduced risk and better management, the Staff contended that a 10.60% ROE was reasonable.

In response, Consumers observed that the Staff had made some errors in the proxy group's average growth rate estimates, which in turn affected the Staff's average DCF cost of equity. After making these corrections, the Staff calculated its average proxy group growth rate at 6.73% instead of 6.61%, which increased the Staff's original DCF cost of equity estimate from 10.30% to 10.42%.

Consumers argued that the Staff gave too much weight to the DCF method in determining a reasonable cost of equity for Consumers and that the Staff used historical spread data through the year 2002 when it should have included the years 2003 through 2006. According to Consumers, failure to include these later years' results is an understatement of the risk premium because the years 2003 through 2006 produced utility stock market returns substantially higher than utility bond yields. To support its argument, Consumers produced data reporting total market returns from the S&P 500 Electric Utilities Index, the S&P 500 Utilities Index, and the Dow Jones Utilities Average Index for the years 2003 through 2006.

In response, the Staff noted that it used Moody's figures for electric utility market returns and utility bond yields. Moody's stopped providing the return data in 2003, thus the Staff used the most recently available information for both market returns and utility bond yields. The Staff pointed out that in Consumers' analysis, it provided an estimate of the 2003 through 2006 market returns for the various utility indexes it reviewed, but did not provide corresponding utility bond returns for the same time period. According to the Staff, Consumers stated that utility bonds had year-end yields of less than 6% during the same time period, but offered no analysis or basis for that assumption. The Staff also noted that the DCF method is "one of the bedrock models most cost of capital analysts use in rate cases when estimating a reasonable return on equity for a utility." Staff's initial brief, p. 30. The Staff observed that it has relied on the DCF method in essentially every utility rate case and the Commission has given proportionate weight to the DCF method in determining appropriate ROEs.

The Attorney General and ABATE jointly sponsored the testimony of Charles W. King, an economic consultant with Snavely, King & Associates. Mr. King selected a group of 27 proxy companies that had a bond rating of B+ or better, that were not engaged in mergers, and that receive at least 60% of their revenues from regulated services. Mr. King developed his recommended ROE on the basis of three different DCF applications (the classic DCF calculation, the Federal Energy Regulatory Commission (FERC) 2-step growth model, and the sustainable growth model), a CAPM analysis, and a comparison of ROEs recently authorized by state commissions across the country. 11 Tr 1701.

Mr. King testified that the results of the classic DCF calculation indicated an average return of 10.56% for the proxy companies with a median of 9.82%. The FERC 2-step growth model produced a cost of equity for the proxy group of 10.11% and the sustainable growth model produced an average for the proxies of 10.00%. The results of the CAPM produced a return of 10.15%. *See*, Exhibit ABAG-8. Mr. King testified that because the CAPM calculations rest on a "highly dubious underlying assumption and on the considerable judgment required to select critical inputs . . . the best that can be said of the CAPM procedure is that it supports the results of my DCF applications." 11 Tr 1715.

Mr. King also compared authorized ROEs granted by state commissions over the past 17 years. *See*, Exhibit ABAG-7. According to Mr. King, in the third quarter of 2006, six commissions granted equity return awards to electric utilities averaging 9.98%. 11 Tr 1715. However, Mr. King noted that there is substantial evidence to suggest that commission authorized ROEs have been too high. 11 Tr 1716; Exhibit ABAG-4. According to Mr. King, the evidence suggests that there is approximately 78% price inflation over the book value of the companies.

Mr. King concluded that after applying the five different methods to derive the return on equity for the electric utility proxy group, he assigned a weight consistent with his earlier analysis based on the relative value of each procedure in indicating a rate of return. Mr. King testified that this produced a composite weighted return on equity of 10.11%. *See*, Exhibit ABAG-1.

The ALJ agreed with the Staff, the Attorney General, ABATE, and Dow/Hemlock[8] that the record did not support a rate of return on common equity of 11.25% as proposed by Consumers. The ALJ observed that despite its improved financial condition and significantly reduced risk resulting from the sale of Palisades, Consumers was nevertheless requesting an ROE that was 10 basis points higher than the ROE authorized in Case No. U-14347. The ALJ agreed with the Attorney General that to arrive at this result Consumers had to ignore the "inconveniently low DCF findings" presented by its own witness. The ALJ further found that Consumers' rationale for

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[8] In its initial brief, Dow/Hemlock adopted the Attorney General and ABATE's position on this issue.

excluding the results of the DCF analysis applied equally to all of the other approaches for determining ROE.

Nevertheless, the ALJ found that the ROE of 10.11% recommended by the Attorney General, ABATE, and Dow/Hemlock was too low, substantially lower than that presented by any of the other parties and lower than the average of ROEs recently authorized by regulatory commissions throughout the country. The ALJ also found that the weight Mr. King assigned to the various test results, which assigned 75% of the total weight to the DCF analyses, appeared unusually arbitrary. The ALJ observed that excessive reliance on any one method ran counter to the observation that no single model can be expected to perfectly simulate the operations of the market.

The ALJ concluded that the evidence best supported using the Staff's revised ROE range of 10.42% to 10.90%. The ALJ found that the Staff gave reasonable consideration and weight to all of the various methods available for estimating Consumers' cost of common equity. The ALJ also found that the Staff's ROE analysis included realistic and unbiased inputs and assumptions regarding current and future market conditions.

The ALJ found that the low point of the Staff's revised range, 10.42%, represented the most appropriate cost of common equity for Consumers. The ALJ based this finding on recent events that have significantly reduced the utility's overall risk and its cost of common equity. The ALJ observed that Consumers' sale of Palisades allowed it to fully exit the risky nuclear generation industry. The ALJ also noted that Consumers was no longer involved in the MCV's operation, which in the past has had an adverse effect on Consumers' net income and equity balance. In addition, equity infusions of at least $650 million and a steady increase in Consumers' retained earnings have improved the equity portion of the company's permanent capital structure. Finally, the ALJ observed that Consumers' bond ratings have been substantially upgraded and noted that the record reflects that between the time that the parties filed their testimony and the close of the record, Value Line's forecast of interest rates for 2008 had dropped noticeably. As a result, the ALJ posited that, "It is fair to assume that this drop would, at least to some degree, reduce the estimated cost figures derived from many of the analyses conducted."

In its exceptions, Consumers argues that the ALJ's recommendation of an ROE of 10.42% was error. Specifically, Consumers asserts that the ALJ erred by: 1) giving excessive weight to one analysis, contrary to his conclusion that to do so would be unreasonable; 2) failing to give any consideration and weight to two-thirds of the Staff's analyses despite his finding that reasonable consideration and weight should be given to all analyses; 3) failing to recognize the weaknesses in the DCF analysis that he relied on; 4) using an unlawful standard when he based his recommendation on improvements in Consumers' financial condition rather than on how Consumers' financial condition compared to that of the proxy group; 5) violating the requirement that the return on equity be set so that it is commensurate with returns earned by investments with comparable risk; 6) unreasonably considering factors that would tend to lower the required return without looking at offsetting factors that supported a higher return; 7) failing to correct certain miscalculations in the Staff analyses that he relied on as the basis for his recommendation and in ignoring the results of analyses presented by Consumers; and 8) recommending that the return on equity be set at the very bottom of the range recommended by the Staff. Consumers argued that "at a minimum the evidence requires the return be set not lower than 10.66%." Consumers' exceptions, p. 3.

The Attorney General, ABATE, and Dow/Hemlock argued that the ROE recommended by the ALJ was too high and that the 10.11% ROE recommended by Mr. King should be adopted. According to the Attorney General, the ALJ erred in finding that Mr. King's weighting of the different approaches used to estimate a reasonable ROE was "unusually arbitrary." According to the Attorney General, Mr. King explained the strengths and weaknesses of each ROE method and appropriately applied different weights to each of the results based on their respective credibility. Dow/Hemlock argued that Mr. King's analysis was more reliable than the analyses provided by the other witnesses because Mr. King used a wider variety of sources and analytical methods in arriving at his recommended ROE.

The Commission finds that the Staff's range of return on equity is the most reasonable. The data used to determine the return on equity should provide a valid and unbiased indicator of the market's ongoing perception of the investment risks associated with Consumers' electric business. The Commission finds that the Staff's analysis fulfilled that purpose and produced a reasonable range from which the Commission can choose an appropriate rate of return.

Having adopted the Staff's range of return on equity the Commission, must now authorize a specific point within that range. The Commission has reviewed the arguments made by Consumers in support of selecting a point at the higher end of the range and the arguments made by the other parties supporting points at the mid to lower end of the range. The Commission has determined that, for the reasons set forth below, the authorized ROE should be 10.70%.

The Commission concludes that setting the ROE at the low end of the Staff's range underestimates to some degree the company's overall risk profile. The 45 basis point reduction from the company's existing ROE of 11.15% reflects the Commission's determination that improvements to the company's capital structure, coupled with the divestiture of its nuclear assets, have lessened the risks faced by investors. Nevertheless, the Commission is not prepared at this time to adopt the lower end of the Staff's range of rates as recommended by the ALJ. Rather, the Commission finds that in balancing the interests of the ratepayers in just and reasonable rates against the need of Consumers to continue to attract capital from the financial markets justifies setting its ROE at 10.70%.

The Commission further observes that the record reflects that the median of ROEs recently authorized for 57 electric companies was 10.50%. *See,* Exhibit A-32. In authorizing a cost of equity at a level slightly higher than this median, the Commission has recognized Consumers' efforts to begin to improve customer service, safety, system reliability, and financial management. Weighing all of these factors, the Commission believes that a return on equity of 10.70%, a return of 4 basis points above the midpoint of the Staff's range, and 20 basis points above the median shown in Exhibit A-32, is appropriate under the circumstances of this case.

2. Long-term debt

Long-term debt is comprised of fixed rate issuances and variable rate issuances. Mr. Rao calculated a long-term debt rate based on the estimated cost for debt projected to be outstanding during the 2008 test year. The long-term debt cost, revised to include Zeeland related debt, is shown on Exhibit A-94. According to Mr. Rao, the long-term debt cost of 5.62% was determined on a net proceeds basis in accordance with past Commission practice.

The Staff recommended a long-term debt balance of $3,635,154,000, which included the proposed revisions for the Zeeland plant purchase, at a cost rate of 5.39%. The Staff's long- term debt cost rate did not include allowances for amortized call premiums or certain revolver, letter of credit, and Pollution Control Revenue Bond (PCRB) fees that Consumers requested.

In rebuttal, Consumers argued that the Staff's exclusions were improper and that if the Staff's original calculation were adjusted to add back the exclusions, the Staff's long-term debt cost rate would increase to 5.67%. The Staff agreed with Consumers' arguments regarding the adjustment for amortized call premiums and with the fees associated with the first letter of credit that

Consumers was required to provide to Entergy by the Palisades PPA. The Staff did not recommend that the fees associated with the second letter of credit should be included in the long term debt fees. The Staff also disagreed that the revolver fees, upfront amortized revolver fees and the PCRB fees were appropriate cost items to be included in Consumers' long-term debt cost rate.

The ALJ agreed with Consumers in part and the Staff in part regarding the Staff's recommended disallowances, but noted that the Staff's exhibit showing the adjustments to its original long-term debt cost estimate was not in the record. Therefore, the ALJ recommended that it was most reasonable to use a long-term debt cost rate of 5.62% as initially proposed by Consumers.

The Commission agrees with the ALJ and adopts a long-term debt cost rate of 5.62%. The Commission also finds that, consistent with Section VII.B.1, fees associated with the second letter of credit for the Palisades purchase shall be excluded from the long-term debt cost calculation in future rate cases. This decision does not preclude the Commission, in future proceedings, from determining the appropriateness of other cost items included in the calculation of long-term debt cost.

3. Short-term Debt and Preferred Stock

Consumers developed a short-term debt cost rate of 5.65% by adding Consumers' revolver credit spread of 75 basis points to a 2008 projected London Interbank Offered Rate (LIBOR) of 4.90%. Subsequently, the projected LIBOR rate increased to 5.33% and the revolver credit spread decreased to 35 basis points. The Staff agreed with these adjustments and the parties agreed to a short-term debt cost rate of 5.68%. Both Consumers and the Staff used a cost rate of 4.46% for preferred stock. Noting the agreement of the parties, the ALJ recommended that the Commission adopt the agreed to cost rates. There were no exceptions to this recommendation. The

Commission therefore adopts a short-term debt cost rate of 5.68% and a cost rate of 4.46% for preferred stock.

4. Other Cost Rates

The cost rates for other capital structure components (deferred income tax credit, deferred investment tax credit, and deferred federal income tax (FIT)), are zero in the capital structures presented by the parties and in the capital structure approved by the Commission.

5. Overall Rate of Return

Consumers' overall rate of return of 6.93% is calculated as shown on the following table:

Description	Amount	Ratio	Cost Rate	Weighted Cost
Short-Term Debt	$71,000,000	.81%	5.68%	0.05%
Long-Term Debt	$3,646,674,000	41.55%	5.62%	2.34%
Preferred Stock	$44,000,000	0.50%	4.46%	0.02%
Common Equity	$3,664,353,000	41.75%	10.70%	4.47%
Def Investment Tax Credit	0	.00%	0.00%	0.00%
Deferred FIT	$1,286,000,000	14.65%	0.00%	0.00%
JDITC				
Long-Term Debt	$31,732,000	0.36%	5.62%	0.02%
Preferred Stock	$383,000	0.00%	4.46%	0.000%
Common Equity	$31,885,000	0.36%	10.70%	0.04%
Total JDITC	$64,000,000			0.06%
TOTAL	$8,776,027,000	100.00%		6.93%

V. Adjusted Net Operating Income

To determine whether there is a revenue deficiency or excess, it is necessary to establish Consumers' adjusted net operating income (NOI) for the test year based on its current rates. Adjusted NOI constitutes the difference between a company's operating revenue and its operating expenses including depreciation, taxes, and allowance for funds used during construction (AFUDC). Consumers initially calculated jurisdictional revenue of $3,047,948,000 and costs of fuel used and total purchased and net interchanged (P&I) power expense of $1,500,373,000. Subsequently, Consumers accepted the Staff's jurisdictional revenue calculation of $3,035,678,000 and the Staff's estimate of fuel used and net P&I power expense of $1,488,745,000.

There were a number of contentious issues among the parties concerning changes to adjusted NOI. Several of these issues were apparently addressed by the PFD to the reasonable satisfaction of all parties, as demonstrated by the fact that there were no exceptions to the PFD filed regarding these particular issues. These issues will not be addressed further in this order.

A. Discount Fees on Accounts Receivables

Because the Commission adopts the working capital requirement proposed by the Staff, the Commission agrees that $5,764,000 ($5,729,000 jurisdictional) of discount fees on accounts receivables should be added to Consumers' net adjusted operating income calculation.

B. Employee Incentive Compensation Plan

In developing expenses for the 2008 test year, Consumers proposed an employee incentive compensation plan (EICP) for non-officers. John M. Butler, Senior Vice President of Human Resources and Administrative Services for Consumers and CMS, testified that Consumers has designed overall compensation levels to be at competitive levels and that the overall level of compensation paid employees is set based on market averages. According to Mr. Butler, paying employees market-based compensation levels is necessary to attract and retain qualified, competent employees, and customers are benefited when the utility employs a more qualified workforce. Mr. Butler stated that in its discretion, Consumers has chosen to shift a portion of overall compensation from base compensation to incentive compensation and that including incentive pay as part of a competitive pay package is a standard industry practice and a common means to influence short to mid-term business results. According to Mr. Butler, the revised EICP program that is currently in place is customer focused, unlike the plan that the company sought to include in rates in its last electric rate case. 10 Tr 1338-1360.

The Staff observed that in recent rate cases, the Commission has excluded proposed EICP payments in determining Consumers' cost of service. In Case No. U-14347, the Commission rejected the EICP on grounds that Consumers failed to show that its incentive payments would provide benefits to ratepayers at least commensurate with their costs. According to the Staff, Consumers now proposes a revised plan that it refers to as a customer-focused EICP. While the Staff indicated that the revised program is an improvement, Consumers nevertheless failed to quantify the benefits of the program to ratepayers and demonstrate that the benefits of the EICP to customers will outweigh the costs of the program. The Staff therefore recommended that 50% of the program costs, $3,185,000, should be approved for recovery in rates. The Staff also recommended that the inclusion of any EICP costs should be conditioned on Consumers' agreement to refund the EICP funds to ratepayers if the program is cancelled.

The Attorney General argued that none of the EICP costs should be included in rates because Consumers did not even attempt to show that the benefits of the program for ratepayers would be commensurate with the program costs.

The ALJ concluded that the Staff's proposal was the most reasonable. The ALJ recognized that although it might be difficult for a utility to conclusively show that its incentive program provides ratepayers with benefits that are commensurate with the program's costs, this does not justify the utility's decision to offer no benefit cost analysis at all in its filing. Nevertheless, the

ALJ found that the factors employed by Consumers in developing this incentive mechanism should provide some benefit to utility customers in the form of better service. The ALJ therefore recommended that the Commission adopt the Staff's proposal to include in the computation of Consumers' adjusted net operating income $3,185,000 of the utility's EICP costs. He further recommended that the recovery of these costs be conditioned upon Consumers' agreement to refund all related payments should it decide to discontinue the EICP.

Consumers took exception to the ALJ's recommendations that only 50% of the program's costs should be recoverable and that if the program were discontinued, Consumers should be required to refund the EICP costs to ratepayers. Consumers argued that there was no evidence to contradict its assertion that its overall level of compensation (base compensation plus EICP) was reasonable. Moreover, Consumers asserts that its decision to pay some portion of employee compensation in the form of incentive payments involves management discretion that is outside the purview of the Commission. Consumers argues that the ALJ's reference to the exclusion of incentive program costs in Case No. U-14347 is inapposite because the program proposed in this case is focused on customer service and does not use earnings per share, corporate free cash flow, or other corporate financial measures to determine payout. Instead, payouts are made to all employees under the plan if at least seven of nine customer-service related goals are met.

The Commission finds that the use of financial incentives that are clearly and directly tied to improvements in customer service, safety, and system reliability is a concept that it fully supports. Nevertheless, the EICP proposed by Consumers here, although a significant improvement over past proposals, is still problematic. While it is true that this program is based on performance measures that directly affect ratepayers, it nevertheless falls short of Commission expectations. Mr. Butler's testimony on Consumers' overall compensation levels was extensive, but his description of the performance measures used to determine whether EICP payments would be made, was lacking. Mr. Butler provided a brief description of nine performance categories, seven of which relate to the company's electric division: 1) downed wire response relieved in <4 hours; 2) employee safety severity reduction; 3) repetitive electric outages, customers with ≥ 5 outages; 4) baseload generating plant availability effective forced outage rate; 5) electric outage restoration restored in ≤ 36 hours; 6) meter reading read in approved period; and 7) call center answer time.

Of the performance measures with metrics assigned, most seem to require employees to simply do what the Commission's rules already require. For example, Consumers' performance standard for downed wire response relief in less than 4 hours requires nothing more than what is required by 1999 AC, R 460.723.[9] Likewise, 1999 AC, R 460.732 describes a service restoration factor, for all customers and conditions, of restoration within 36 hours, 90% of the time. In the Commission's view, a customer focused, employee incentive plan should require that higher standards than the regulatory minimum must be met before a ratepayer funded payout is made.

A more critical problem with the EICP is how well, if at all, the payments correlate with the employee or class of employees actually charged with doing the job, the performance of which is measured in the EICP. As Gary Kitts, the Commission's Bureau Administrator and Acting Director of the Regulated Energy Division pointed out, payouts under the plan will be made to all eligible employees[10] if at least seven of the nine performance measures are met. However:

> It does not appear that the plan provides for or requires individual employee goals or objectives to be met in order for each individual employee to earn the incentive. This plan will not provide significant incentives for many of the employees because

[9] "It is an unacceptable level of performance for an electric utility to fail to respond to a request for relief of a non-utility employee guarded downed wire at a location in a metropolitan statistical area within 240 minutes after notification at least 90% of the time under all conditions."

[10] According to Mr. Butler, "All regular, non-union, non-officer employees are eligible for the EICP payout." 10 Tr 1349.

> they are not directly involved in operations, and thus their conduct at work will not affect whether they will receive incentive payments.

11 Tr 1911.

The Commission finds that Consumers has made significant progress in adjusting its EICP in a manner that ties payments under the plan to service quality measures. Nevertheless, the Commission still has concerns regarding the appropriateness of the measures as they apply to each individual employee and the level of performance that must be met to receive the incentive payment. The Commission does not believe these are insurmountable issues and strongly encourages Consumers to continue refining its EICP for submission in a future rate proceeding. In this case, the Commission finds that the cost of the EICP, as currently designed, should be excluded from O&M costs.

C. Dues and Lobbying Expense

Consumers removed $416,000 ($413,000 jurisdictional) in dues and lobbying expense from base rates. This exclusion was in accordance with Consumers' proposal to include dues to the North American Electric Reliability Council (NERC) in its PSCR process rather than in base rates. The Staff recommended removal of two additional items: $175,000 in dues paid to the Edison Electric Institute (EEI), an amount that represents Consumers' share of EEI lobbying and $14,000 in partial dues that were paid to 5 different organizations. The Staff claimed that the $14,000 represented the amount used for lobbying that aimed at increasing utility shareholder value. The Attorney General proposed additional reductions of $163,198 paid to Grass Roots Lobbying and $24,570 in dues paid to various trade organizations engaged in political activism and lobbying. *See*, Exhibit AG-33. Consumers accepted the adjustments proposed by the Staff but argued that the Attorney General had failed to make a reasonable argument for his proposed exclusions. The ALJ agreed with the Attorney General that the additional exclusions were merited because the record supports a finding that the funds were likely expended on efforts to shape legislative or administrative policy at the state or federal level.[11] There were no exceptions to the ALJ's recommendation.

In its April 22, 2008 order in Case No. U-15001, pp. 4-5, the Commission ordered that NERC dues shall continue to be collected through base rates rather than through the PSCR process. Accordingly, the Commission finds that $416,000 ($413,000 jurisdictional) for NERC dues should be added to the projected test year other O&M expense. Exhibit A-7.

D. Billing System Cost Subsidy

Mr. Forner provided testimony on behalf of himself as a Consumers' electric customer. Mr. Forner's testimony focused on the amount of the billing subsidy to Consumers' Appliance Service Plan (ASP) program by electric customers; specifically, the amount of the subsidy calculated by Consumers and the Staff. Mr. Forner argued that the Commission had failed to include the cost of postage in calculating the subsidy to the ASP program and failed to include interest on the refund from the time the Commission determined that there was a subsidy until the refund was made. Further, Mr. Forner argued that the refund to customers should be made in a one-time payment. Mr. Forner claimed that the total amount Consumers should refund its customers was $758,864. 13 Tr 2373.

Mr. Forner further testified that Consumers' electric customers should receive compensation from the ASP for including the monthly billing of the ASP on the company's electric bills, monthly processing of ASP payments, call center support, and other services provided. Mr. Forner

[11]The ALJ calculated an additional disallowance of $184,618 consisting of $163,198 in Grass Roots Lobbying expense, $9,450 in dues paid to MEGA, $2,520 in MMA dues, Detroit Renaissance dues totaling $3,150, and $6,300 in Keystone Center dues (representing the remaining portion of the dues paid to Keystone Center in 2006 that were not previously removed by the Staff.)

claimed that Consumers should receive $.517 per ASP bill to cover the subsidy for including the ASP on the company's electric bills, $125 per month plus $12 per item for processing ASP payments, and $2,500 plus $18 per agent for call center support. Mr. Forner testified that:

> [T]he entire ASP "program margin" goes to the gas utility, including that program margin received from electric utility customers purchasing an ASP. Any program margin generated by the electric utility customers should go to the electric utility pursuant to MCL 460.10a(10). The percentage of electric utility customers participating in the ASP versus the overall total of customers is roughly forty percent (40%), therefore roughly 40% of the "program margin" for the time period covered should go to the electric utilities; which means for 2006 that would equate to $3,443,273 electric rate reduction.

13 Tr 2376.

In response, the Staff argued that the $470,000 subsidy was normalized to $235,000 annually to be recovered in rates. The Staff noted that if the rates set in this proceeding stay in effect for more than two years, then ratepayers will be overcompensated for the billing inserts. The Staff further noted that issues concerning the ASP program have always been considered in gas rate cases because Consumers' gas assets were used to set up the ASP program. The Staff argued that other issues regarding subsidies or alleged violations of the Code of Conduct raised by Mr. Forner are outside the scope of this proceeding and should be dismissed.

The ALJ found that Mr. Forner's arguments should be rejected. The amount of $0.104 per billing insert was determined by the Commission in its February 9, 2006 order in Case No. U-14329. The order further required that the billing subsidy be accounted for in Consumers' next electric rate case and recovered in rates established in that proceeding. The ALJ observed that the Commission's order did not indicate that interest should be paid on the reimbursement and that in fact the recovery of interest would violate general ratemaking principles. The ALJ also found that Mr. Forner's claims regarding inadequate reimbursement for the cost of postage were rejected by the Commission and this decision was affirmed by the Court of Appeals in *Forner v*

Public Service Comm, unpublished opinion per curiam of the Court of Appeals, issued February 19, 2008 (Docket No. 270941). Finally, the ALJ found that claims that Consumers is violating, or has in the past violated, the Code of Conduct in other ways are beyond the scope of this proceeding. The ALJ therefore recommended that the Commission approve the proposal to account for the subsidy by incorporating $235,000 annually into the company's rates.

Mr. Forner takes exception and repeats his initial arguments, namely that interest should be included in the reimbursement, that full postage costs have not been included in calculating the subsidy, and that it would be a waste of administrative resources to fail to address additional Code of Conduct violations in this proceeding.

The Commission agrees with the ALJ that the issues regarding the subsidy for ASP program billing inserts were fully addressed in the February 9, 2006 order in Case No. U-14329, and the Commission's decision was affirmed in its entirety by the Court of Appeals. Thus, Mr. Forner's claims regarding interest payments and postage costs for these particular violations are settled and shall not be revisited. Likewise, the Commission agrees that any additional claims regarding alleged Code of Conduct violations are beyond the scope of a rate proceeding.

E. Tree Trimming and Forestry Expense Tracker

The Staff proposed forestry related costs totaling $41,535,669 for the 2008 test year, a figure that represents the actual 2006 expense level adjusted for inflation. The Staff also supported the continuation of the forestry expense tracker and refund mechanism approved in Case No. U-14347. Consumers did not dispute the proposed expense level, but took issue with the continuation of the tracker. According to Consumers, the elimination of the tracker will allow the company to better respond to unforeseen issues between rate cases. Consumers asserted that although the forestry tracker was reasonable in December 2005, when the final order was issued in

Case No. U-14347, the company has subsequently demonstrated its ability to manage forestry and other issues that affect reliability and customer service. Consumers indicated that as an alternative to the forestry tracker, the Commission could require that the company provide reports to the Staff indicating spending on certain O&M expense items such as tree-trimming and forestry.

The Attorney General also argued that the forestry tracker should be eliminated on grounds that the Commission lacks specific statutory authority to approve the type of retroactive ratemaking embodied by this tracker.

The Staff, Dow/Hemlock, and ABATE responded that it would be irresponsible to eliminate the tracking mechanism at this point, when Consumers has not yet satisfactorily demonstrated that it will spend adequate amounts for tree-trimming and forestry. The Staff noted that much of the forestry expense is for ongoing tree trimming and brush management under contract to outside firms. According to the Staff, these expenses can be easily cut when the company is cash strapped or when necessary to meet company profit targets. The Staff argued that for several years Consumers did not show a willingness to spend adequately for its tree trimming and forestry management and contended that it is imperative to continue the tracking and refund mechanism for sufficient time to ensure that Consumers fully supports the program.

The ALJ found that the Attorney General's argument was without merit and has been repeatedly rejected by the Commission. The ALJ agreed with the Staff, Dow/Hemlock, and ABATE that, despite the substantial increase in forestry expenditures in 2006, Consumers' system reliability has not improved. Thus, a long-term increase in forestry related efforts is required and, because funding can easily be shifted from forestry to other purposes, the tracker is appropriate. Consumers objects to the ALJ's recommendation and again argues that a reporting requirement for tree-trimming and forestry expenditures would be appropriate; but the tracking and reconciliation mechanism, which forces the company to make investments in one aspect of its business, could lead to the unintended consequence that Consumers would be unable to address other, more urgent, needs between rate cases.

The Commission agrees with the ALJ's reasoning and conclusions on this issue and finds that the forestry tracker should continue until Consumers adequately demonstrates that it has caught up with much neglected tree trimming. The Commission is generally cautious about requiring measures that include tracking or refund mechanisms. However, because Consumers' failure to adequately fund its forestry program for several years has compromised service reliability, quality, and safety, the Commission determines that it is prudent to continue the forestry tracker until the Commission's concerns are allayed.

F. Pension and Other Post Employment Benefits Tracker

Consumers proposed that pension and OPEB costs should be included in base rates and requested that the tracker authorized by the Commission in the December 22, 2005 order in Case No. U-14347 should be eliminated. According to Consumers, pension costs and OPEB expenses are no longer as volatile as they were in the past so the trackers are no longer necessary. The Staff proposed that pension costs should be increased by $350,000 over 2006 levels and OPEB expense should likewise be increased by $1,907,000. The Staff agreed with Consumers that the trackers were no longer necessary. Noting the agreement among the parties, the ALJ recommended that the Commission adopt the pension and OPEB expense levels recommended by the Staff and terminate the trackers effective December 31, 2007.

Consumers takes partial exception to the ALJ's recommendation, arguing that the trackers should be eliminated prospectively, not retrospectively, as the ALJ recommended. The Commission observes that the PEM and OPEB trackers were also eliminated for Consumers' gas division in the settlement in Case No U-15190. In that case, the PEM and OPEB trackers were eliminated effective the date of the order approving the settlement agreement. The Commission therefore rejects the ALJ's recommendation to end the trackers retrospectively and approves the elimination of these mechanisms effective the date of this order.

G. Incremental Environmental Compliance Costs

As authorized in the order issued on June 26, 2007, the Staff engaged an outside expert to review and report on Consumers' environmental compliance investments. The report was entered as Exhibit S-10. The report and witnesses indicated that the company's investments in environmental compliance were reasonable and prudent. The conclusions of the report were supported by the Staff and Consumers. The ALJ recommended that the Commission adopt the findings in the report. There were no exceptions to this recommendation. The Commission therefore adopts the findings of the report.

H. Pro-forma Tax Adjustment

The purpose of the pro-forma tax adjustment is to calculate the change in income taxes resulting from the change in interest expense allowed to Consumers in this case. On the basis of the adjustments approved in this order, Consumers' adjusted NOI decreases by $953,000 from the level recommended in the PFD. The jurisdictional pro-forma income tax adjustment is computed as follows:

Description	Amount
Rate Base	$5,013,880,000
Cost of Debt	x 2.41%
Allowable Interest	$ 120,835,000
Interest Deduction Included in Recorded Income Tax Accruals	$ 159,336,000
Change in Interest Expense	($ 38,501,000)
Federal Income Tax Rate	x 35%
Change in Federal Income Taxes	$ 13,476,000

I. Adjusted Net Operating Income Summary

Based on the modifications to the PFD discussed above, Consumers' adjusted net operating income for the 2008 test year is calculated as follows:

Description	Adjustment	Jurisdictional Amount	Net of Tax @63.7655%	Amount
Recommended NOI (PFD)				$379,775,689
Pro-Forma Tax/Int Sync			($ 953,000)	
EICP	$ 3,185,000	$ 3,166,000	$2,019,000	
AR Financing Cost	($ 5,764,000)	($ 5,729,000)	($ 3,653,000)	
NERC Dues	($ 416,000)	($ 413,000)	($ 263,000)	
Net Operating Income				$376,926,000

VI. Base Revenue Deficiency/Excess

In accordance with the foregoing findings, Consumers' base revenue excess for the test year is computed as follows:

Rate Base	$5,013,880,000
Rate of Return	6.93%
Income Required	$ 347,462,000
Adjusted Net Operating Income	$ 376,926,000
Income Deficiency (Excess)	($ 29,464,000)
Revenue Multiplier	1.5683
Revenue Deficiency (Excess)	($ 46,208,400)

VII. Other Revenue Issues

A. Zeeland Related Revenue Issues

In its amended application, Consumers requested that the Commission authorize rate recovery of $84.3 million for costs associated with the purchase and operation of the Zeeland Generating Station. On December 18, 2007 the Commission issued an order in this proceeding finding that the purchase by Consumers of the Zeeland Generating Station, on the terms provided by the purchase agreement, is reasonable and prudent, and that the reasonable and prudent costs associated with purchasing, owning, operating, and maintaining the Zeeland Generating Station are recoverable in Consumers' rates. (Order, pp. 30-31). The Commission also authorized Consumers to increase its rates by $69.5 million annually for costs associated with the Zeeland Generating Station to be paid by a surcharge effective on the date of the closing of the Zeeland transaction. The difference of $14.8 million between the amount Consumers requested and the amount the Commission authorized Consumers to recover was the result of 4 adjustments: 1) unidentified transaction costs of $1.8 million were excluded from the revenue requirement; 2) the pre-tax rate of return was reduced to 9.00%, thereby reducing the recovery by $2.9 million; 3) a reduction in property tax expense of $6.2 million; 4) a reduction in O&M expense of $3.9 million.

In its initial brief, Consumers indicated that for the purpose of calculating the revenue deficiency for the 2008 test year, the final rate relief pretax rate of return should be used. Consumers also indicated that it was not disputing the $6.2 million adjustment in property tax expense.

Regarding the other two adjustments, Consumers argued that the "unidentified transaction costs" were in fact transition costs that the company expected to incur. Consumers requested that the Commission include these costs in determining the revenue deficiency. If the Commission does not allow recovery in rates, Consumers argued that these costs should be excluded as part of the Zeeland Generating Station rate base because transaction costs are appropriately included as part of rate base. Consumers also argued that the fourth adjustment was based on the Staff's erroneous assumption that the O&M costs for the Zeeland plant would continue at the 2006 level. Consumers argued that the O&M costs for a gas-fired plant are highly dependent on the hours of operation and that the company expects to operate the plant at twice the capacity factor achieved in 2006.

The Staff argued that the unidentified transaction costs should be excluded but agreed with Consumers on the treatment of those costs, namely that the reduction should be made by an adjustment to rate base and not by an adjustment to operating expense. The Staff likewise agreed that the calculation of the Zeeland Generating Station's revenue requirement should be updated to reflect the pre-tax rate of return authorized by this order. The Staff disagreed with Consumers' claim that test year O&M expense associated with the Zeeland Generating Station was expected to be $3.9 million above the Staff's inflation adjusted figure. According to the Staff, the Commission has routinely adopted "an O&M indexing mechanism for all O&M costs" and there is no reason to treat costs associated with the Zeeland Generating Station in any different manner. Staff's reply brief, p. 8.

The ALJ found insufficient support for allowing cost recovery for the $1.8 million of transaction costs that Consumers' own witness was unable to identify but agreed with the Staff and Consumers that the disallowance of these costs should have been made through a reduction in rate base as opposed to an adjustment to projected operating expense. The ALJ also found insufficient evidence for allowing Consumers to annually recover O&M expense for the Zeeland Generating Station that is $3.9 million higher than the 2006 level adjusted for inflation.

The ALJ also agreed with the assertions by Consumers and the Staff that the utility's overall revenue requirement must reflect the significant change to its cost of capital due to the Zeeland Generating Station's purchase and that the final calculation of the Zeeland plant's revenue requirement should reflect the updated pre-tax rate of return adopted by the Commission in its final order. This would necessitate application of the final pre-tax rate of return based on a capital structure that reflects Consumers' purchase of the Zeeland facility.

The ALJ found that Consumers and the Staff reached the correct conclusion regarding the $6.2 million property tax adjustment and agreed with Consumers that the surcharge established in the December 18, 2007 order should be discontinued and the revenue requirement arising from the utility's purchase and operation of the Zeeland Generating Station should be rolled into base rates.

Based on his findings on these issues, the ALJ recommended that the Commission discontinue the previously established surcharge and incorporate into Consumers' base rates a Zeeland-related revenue requirement of $72,751,000.

Consumers takes exception to the ALJ's finding regarding $3.9 million in above-inflation O&M expenses for operation of the Zeeland Generating Station. Consumers argues that it presented detailed testimony that the Zeeland plant will be operated more often in 2008 than it was in 2006 and reasserted that O&M costs for gas-fired generating plants are highly dependent on hours of operation. Consumers argued that in 2006, under its previous owners, the Zeeland Generating Station was operated at only half its capacity factor, possibly because of high gas prices or the owner's financial difficulties.

The Staff replied that the ALJ's recommendation was correct and that Consumers' evidence for its proposed increase in O&M costs was speculative and not supported by any historical data.

The most contentious issue regarding the revenue requirement for the Zeeland Generating Station is Consumers' proposal to increase Zeeland-related revenue requirements by $3.9 million above the inflation adjusted amount. The Commission agrees with the Staff that without some historical evidence reflecting operational changes that result in increased costs of almost 60% over inflation adjusted costs, such a significant increase cannot be justified. The Commission therefore adopts the recommendations in the PFD regarding the issues associated with the purchase and operation of the Zeeland Generating Station. The rates in this order reflect the discontinuance of the previously established surcharge for the Zeeland Generating Station and the incorporation into Consumers' base rates of a Zeeland-related revenue requirement of $73,677,000.[12]

B. Palisades Issues

In the March 27, 2007 order in Case No. U-14992, the Commission granted a number of regulatory approvals to facilitate Consumers' sale of its Palisades nuclear plant to Entergy in April 2007. The order did not address the disposition of the transaction costs that Consumers incurred to undertake the sale and related transactions, but the Commission ruled instead that the reasonableness of those costs and their allocation should be deferred until this rate case. Order in Case No. U-14992, p. 78. The Commission did order Consumers to refund to ratepayers approximately $255 million – $66 million in gain on the sale plus $189 million of excess decommissioning funds made available by the sale – over an 18-month period. *Id.*, at 82-85; June 26, 2007, order in Case No. U-14992, pp. 7-9 (rehearing).

1. Allowable Transactions Costs and Allocation

Consumers has requested that any Palisades costs it previously recovered through base rates be removed prospectively. It further requested that the Commission authorize a second refund of

[12]The $72,751,000 revenue requirement recommended in the PFD was adjusted to reflect the pre-tax rate of return of 9.55% approved in this order.

an additional $127 million of excess decommissioning proceeds that it realized from the Palisades sale, but that the refund be subject to set-off to recover the transaction costs deferred in Case No. U-14992. Consumers computed the set-off amount of $28,214,112 in total transaction costs, which included consulting fees for advisory services, legal fees, land surveys, and title fees.

In the absence of any objection, the ALJ accepted the request to remove Palisades' costs of $169.1 million from base rates (and cancel the PSCR crediting mechanism instituted for that purpose in Case No. U-14992). The ALJ's recommendation is reflected in the rates approved in this case.

In accordance with the Staff's position, the ALJ recommended that a refund of the remaining decommissioning funds, net of any set-off, should occur as part of a final reconciliation of Palisades-related items, which Consumers should file within 30 days of issuance of this order. The ALJ recommended that the reconciliation address final amounts of transaction costs, identify all decommissioning and other funds relating to Palisades, compute interest on amounts subject to refund, and set forth a computation of a negative surcharge to spread the refund over nine months. In the absence of objection, the Commission adopts the reconciliation procedure for issuing the remaining Palisades refunds and orders Consumers to file the Palisades reconciliation within 30 days.

The ALJ recommended that the Commission disallow $1,716,793 of the transaction costs in accordance with two items that drew Staff objections. He first found disallowable $1,000,793 that Consumers spent to obtain a banker's independent fairness opinion on the Palisades sale. Second, the ALJ recommended disallowing $716,000 that Consumers paid for a letter of credit to secure the transfer to Entergy of its pre-April 7, 1983 decommissioning obligations owed to the DOE. The ALJ further recommended that the remaining $26,497,319 of transaction costs be shared equally between ratepayers and shareholders to correspond to their sharing of benefits from the sale. Consumers filed exceptions to both recommended disallowances and to the sharing of the remainder of the transaction costs.

With respect to the disallowances, Consumers argues that the costs were reasonable and were directly related to the sale of the Palisades plant. In view of the complexity and dollar amounts at stake, Consumers argues that spending $1 million to secure an independent opinion was necessary and prudent. It says that the services provided by the consultant it retained did not make an independent opinion unnecessary, but that the consultant played a different role by guiding Consumers through the process of selling a nuclear plant.

Consumers explains that the letter of credit assures that it would make Entergy whole for any offset against a future award of damages that Entergy may obtain from DOE arising from the U.S. government's failure to accept SNF. The potential offset pertains to Consumers' pre-April 7, 1983 SNF liability owed to DOE. Consumers justifies the cost of the letter of credit as a necessary component of the Palisades transaction and contends that the letter enabled it to retain the pre-1983 DOE liability on its books as a low-cost source of debt capital.

The Staff and MEC/PIRGIM support the two disallowances on prudence grounds. These parties argue that Consumers' Board of Directors requested the $1 million fairness opinion (set forth in three pages plus a cover sheet), even though Consumers had the advisory services of the best auction manager available in the business of advising on nuclear plant sales. The Staff contends that the letter of credit represents yet another expense caused by DOE's failure to fulfill its responsibility to accept SNF, for which Consumers ought to pursue recompense from the U.S. government, not from ratepayers.

The Commission finds that the two disallowances proposed by the Staff are appropriate. The Staff raised valid questions regarding whether each of these items was necessary to the Palisades sale, and Consumers did not provide persuasive explanations in response to those questions. It is not clear on the record why Consumers felt it necessary to secure the opinion of yet another financial expert, what role that opinion played in facilitating a sale on terms advantageous to ratepayers, or why the opinion was not redundant in light of other experts that Consumers retained. (The opinion itself is not part of the record.)

Similarly, it is not clear what role the letter of credit played in enabling the Palisades transaction to be completed or how it affected the balance of benefits and obligations being exchanged between buyer and seller. Because it relates to DOE's longstanding, as-yet unresolved failure to discharge its SNF responsibilities, it is also unclear why ratepayers should bear additional costs in anticipation of a possible litigation outcome.

Consumers takes exception to sharing responsibility for the remaining transaction costs equally between ratepayers and investors. Consumers argues that the transaction costs were a necessary and integral part of the Palisades sale transaction and that, but for those costs, the sale, with all of its attendant benefits, could not have taken place. Consumers claims that ratepayers benefited greatly from the sale, both by recouping all of the transaction gains as refunds and by acquiring future Palisades output under a long-term PPA that produces cost savings. Consumers says that any benefit its investors may have received as a result of the utility's improved financial condition pales in comparison to the ratepayer benefits.

Consumers argues that it demonstrated that the transaction costs were reasonable and prudent and, except for the two disallowed items, no one took issue with it. According to Consumers, if the costs are in fact prudent, disallowing half of them would not only be contrary to normal ratemaking principles, but it would also violate the utility's right to recover its prudent investment. Consumers contends that a write-off would act as a disincentive against similar future transactions, regardless of whether ratepayers would be better off.

Consumers disputes the Staff's claim that movements in the stock price of CMS, its parent company, demonstrated benefits to investors that should require them to absorb a share of the transaction costs. Consumers contends that recovery of prudent costs does not depend upon whether the utility realizes financial benefits or whether its stock price goes up. Consumers claims that the market continues to view CMS as an unusually risky investment. Consumers asserts that there is no statistically significant correlation between the CMS stock price movements and the announcement of the Palisades sale.

MEC/PIRGIM opposes any recovery of transaction costs from ratepayers. MEC/PIRGIM argues that Consumers undertook the Palisades sale as a business decision to further its shareholder interests. MEC/PIRGIM claims that the transaction in fact harmed ratepayers by removing a low-cost baseload plant from the Commission's regulatory jurisdiction. MEC/PIRGIM contends that Entergy acquired the Palisades assets too cheaply and that Consumers obtained for itself an immediate cash infusion. According to MEC/PIRGIM, if the Commission were inclined to allow recovery of something less than 50% of the costs, it should amortize that amount over 15 years without allowing it to earn a return.

The Staff supports the ALJ's recommendation to share the transaction costs (net of proposed disallowances) equally. It claims that 50/50 sharing is fair, given the benefits that both ratepayers and shareholders realized. It asserts that allocating costs is within the Commission's broad statutory authority to set just and reasonable rates.

As an initial matter, MEC/PIRGIM's claim that the Palisades sale was a detriment to ratepayers is contrary to the March 27, 2007 order in Case No. U-14992. Had the Commission not been fully persuaded of the substantial ratepayer benefits, it would have withheld approval of the PPA and the other requests necessary to complete the sale. MEC/PIRGIM ignores the benefits of large refunds being issued to ratepayers, the reduction of risk from exiting the nuclear generation business, and the long-term contractual right to purchase the power on reasonable terms. In effect, MEC/PIRGIM is expressing its disagreement with the decision in Case No. U-14992, which it actively litigated. The Commission rejects its proposal to shift all of the transaction costs to Consumers.

Except for disallowed items totaling $1,716,793, the Commission finds that the Palisades transaction costs are reasonable and prudent. The record shows that Consumers incurred the costs as necessary to conduct an auction process for Palisades, negotiate a complex structured arrangement, and close the sale. As discussed at length in Case No. U-14992, the ratepayer benefits were substantial. Consumers should therefore be permitted to offset its allowable transaction costs of $26,497,319 against refund obligations in the upcoming Palisades reconciliation.[13]

The Staff's argument based on investors' benefits depends, to some degree, on short-term movements in the price of CMS stock, the significance of which Consumers disputes. Stock price movements may create a basis for drawing a relatively slim inference of investor benefits, but that is not conclusive. In any event, it is reasonable for the company to pursue benefits that further the obligations it owes to both investors and ratepayers, without sacrificing either of the others' interests – for example, the risk reduction from exiting the nuclear business is good for both

[13]Given its finding that Consumers should be allowed to recover the transaction costs, the Commission does not accept MEC/PIRGIM's proposal to amortize the transaction costs as another form of sharing.

ratepayers and the company. The circumstances of this case do not present any reason to find that an overlap of benefits between ratepayers and investors requires a sharing of the transaction costs. This is not to say that the Commission is foreclosing consideration of shareholder benefits in future cases, but cost-sharing issues in those cases will turn on their unique facts and circumstances.

2. Palisades Refund to Rate E-1

The ALJ accepted Dow/Hemlock's claim that Hemlock's service under Consumers' General Service Large Industrial Economic Development Rate E-1 (Rate E-1) should qualify for the negative surcharge used to implement any Palisades refund. In their exceptions, Consumers and the Staff oppose this recommendation.

Consumers points to tariff language in Rate E-1 that fixes the rate at 4.2¢ per kWh "inclusive of surcharges, PSCR factors, and other charges of any kind, except as expressly provided herein, for all kWh of new load used." Consumers Tariff M.P.S.C. No. 13 – Electric, Original Sheet No. D-44.00. Consumers contends that Hemlock Semiconductor, in order to lock in a low rate and thereby satisfy its need for price certainty, accepted a tariff that precluded any of the usual rate adjustments for the duration of Rate E-1. Consumers contends that a negative surcharge is a type of "surcharge" or "other charges of any kind" that cannot be applied to a Rate E-1 customer's bill. Consumers adds that the Commission in Case No. U-14992 explicitly approved a negative surcharge to implement the refund, which was not applied to Hemlock Semiconductor's bills for Rate E-1 service. Consumers argues that this approach is not discriminatory, because it is permissible to make rate distinctions appropriate to differently situated customers.

The Staff agrees with Consumers that Rate E-1 service is ineligible for Palisades refunds. The Staff emphasizes that the contrary position would be unfair, in that it would insulate Rate E-1 from billing adjustments that increase rates, but not from decreases.

Dow/Hemlock contends that withholding refunds from a Rate E-1 customer violates the March 27, 2007 order in Case No. U-14992, which required Consumers to issue Palisades refunds to all customers based on their energy usage. Dow/Hemlock says that Consumers included Rate E-1 sales in its computation of the equal mills per kilowatt-hour credit in Case No. U-14992, but that it then filed tariff sheets that excluded Rate E-1 customers from the credit. Dow/Hemlock further suggests that Consumers is appropriating Hemlock Semiconductor's share of the refund for itself.

Dow/Hemlock interprets Rate E-1, not as fixing a definitive rate, but rather as setting a capped rate that can be lowered further. For this, Dow/Hemlock relies on the tariff provision that the rate is "inclusive of surcharges, PSCR factors, and other charges of any kind," which it says does not bar adjustments that reduce rates. Dow/Hemlock contends that Consumers' attempt to characterize the Palisades refund as a negative surcharge strains the normal usage of the word, as a credit or refund is not a surcharge of any sort in its commonly understood sense. Dow/Hemlock further suggests that the Commission did not intend to foreclose refunds to Rate E-1 customers when it approved a negative surcharge in Case No. U-14992.

According to Dow/Hemlock, the purpose of Rate E-1 is to use discounted rates to stimulate economic development, only very large customers with new load qualify for Rate E-1, and Hemlock Semiconductor (which is partly owned by Dow) is the only customer being served under it. Dow/Hemlock argues that even though Rate E-1 is discounted compared to other rates, it does not produce a revenue shortfall or use subsidies provided by other rates. According to

Dow/Hemlock, the proper measure of cost justification is incremental cost, given Rate E-1's purpose to attract new load. It claims that Rate E-1 does recover its incremental costs and makes a contribution toward the embedded costs that Consumers incurs to serve its other customers. Dow/Hemlock contends that withholding the refunds from Rate E-1 sales is discriminatory.

The Commission does not agree with Dow/Hemlock that its orders in Case No. U-14992 dictate whether or not a Rate E-1 customer should participate in the Palisades refund. None of the parties raised the precise issue regarding a Rate E-1 customer's refund status in that case, and the Commission thus did not have reason to consider the issue. The negative surcharge resulting from the orders in Case No. U-14992 is not at issue in this case,[14] but Dow/Hemlock is addressing the upcoming refund to return the remaining decommissioning funds.

The Commission construes the Rate E-1 tariff as foreclosing its sales from being credited for the upcoming Palisades refund. The tariff establishes that the customer obtains a fixed, certain rate of 4.2¢ per kWh, subject only to those changes "as expressly provided herein" for the Rate E-1 term. A negative surcharge is arguably different from the "surcharges" expressly subsumed by Rate E-1, in the sense that it is not an extra amount owed. However, the intent of the wording is to set a certain rate. This is also apparent from the circumstances surrounding the tariff, which was designed to attract a particular type of economic development at a favorable rate, with price certainty. It would not be reasonable or equitable to apply price certainty in asymmetrical terms, as each credit or reduction would require further subsidization by other ratepayers beyond that accommodated in the prescribed rate. Similarly, Dow/Hemlock cannot claim undue discrimina-

[14]Dow's replies to exceptions do not cite evidence to support its claim that Consumers is retaining part of the negative surcharge allocable to Rate E-1 sales in Case No. U-14992. Technically, the claim is beyond the scope of this order, but, if true, it would be disturbing. The Commission directed that all net proceeds be returned to customers via the negative surcharge. The Staff is directed to investigate the claim and report on it in the upcoming Palisades refund reconciliation being commenced by this order.

tion by reason of Rate E-1, given the benefits being conferred upon it, including price certainty. Finally, part of the rationale of the Palisades refund is to return funds to the general base of customers who historically paid for Palisades costs (although the Commission did not attempt to achieve the absolute precision of a historical refund, which would have entailed more costs and administrative complexity than the precision merited). By definition, the Rate E-1 class is new load that paid little, if anything, for Palisades in the past.

C. Energy Efficiency Program

As part of the amended application in this case, Consumers proposed a framework for an EE program for all customer classes. According to Terrence J. Mierzwa, Manager of Marketing and Customer Research for Consumers, the program framework was comprised of three elements designed to address: 1) the recovery of costs associated with program promotion and administration; 2) the potential lost sales and revenue reduction associated with energy efficiency; and 3) an incentive mechanism to achieve performance targets. 10 Tr 1369.

Consumers' annual budget of $24 million for the EE programs was based on spending targets identified in the 21st Century Energy Plan. Mr. Mierzwa testified that Consumers would dedicate $2.4 million for low-income customer efficiency measures, $1.2 million for administration, and $1.2 million for evaluation. The remaining $19.2 million would be spent on residential, commercial, and industrial energy efficiency programs. Mr. Mierzwa further noted that Consumers engaged a qualified consulting firm to assess existing programs across the country in order to develop a set of "best practice" programs that have delivered proven results in other jurisdictions and that can be effectively adopted in Consumers' service territory. 10 Tr 1372.

Regarding program cost recovery, Mr. Mierzwa proposed that costs associated with low-income programs, administration, and evaluation should be expensed and recovered in rates as a fixed monthly charge on all customers except those taking service under Rate E-1. The remainder of the program costs would be capitalized and amortized over the weighted average life of the efficiency measures. According to Mr. Mierzwa, the company proposes that these costs be recovered from customers with a return on the unamortized balance at Consumers' pre-tax authorized overall rate. 10 Tr 1369-1371.

Consumers' proposed EE program also included an incentive mechanism that would increase its rate of return based on a sliding cents/kilowatt-hour (¢/kWh) basis. *See*, Exhibit A-90. Consumers indicated that, based on an anticipated cost level of 3¢/kWh, its incentive would be approximately $33 million based on current rate base. 11 Tr 1918.

The Staff proposed an alternative incentive mechanism that would allow the company to qualify for the incentive if: 1) Consumers' EE program achieved demand savings at a cost below a set maximum $/kW as well as ¢/kWh; and 2) there is a net reduction in total customer bills. If both conditions are met, then the company qualifies for an incentive equal to 20% of the net savings actually experienced up to a maximum of one-half of the actual program costs, or $12 million. 10 Tr 1384-1385. The Staff argued that the ¢/kWh number measures the relative effectiveness of the program in reducing overall energy consumption and is a reasonable means of evaluating the effect of the program on participants, while the $/kW number measures the relative effectiveness of the program in reducing the level of demand that the supply system must meet and provides a reasonable means of evaluating the effect of the program on non-participants as well as participants. In response, Consumers accepted the proposal but requested a modification so that low-income programs would be excluded from the calculation of net reduction in total customer bills. Consumers also clarified that savings across the entire life cycle should be included when calculating the net reduction in total customer bills. 10 Tr 1385-1386.

The Staff reviewed Consumers' proposed energy efficiency program and recommended its adoption with the above discussed modifications to the incentive program. The Staff also recommended that low-income programs be included in the evaluation of whether the incentive should be paid. The Staff argued that if low-income programs are excluded, the incentive mechanism will provide the unintended outcome that low-income programs may be shortchanged to the benefit of other programs. According to the Staff, this perverse incentive would not be good public policy. MEC/PIRGIM generally approved of the program but noted that the proposed funding level should be higher and argued that the incentive was extreme given the small size of the program. MEC/PIRGIM also recommended that Consumers integrate the projected energy efficiency and conservation effects in its five-year PSCR forecasts included in its PSCR plan applications.

The Attorney General, CNE, Energy Michigan, ABATE, and Dow/Hemlock opposed the EE program. ABATE, the Attorney General, and Dow/Hemlock argued that Consumers does not require an incentive mechanism and that the incentive proposed by the company would substantially inflate the cost of providing energy efficiency services to retail end users and create additional rate volatility and uncertainty. According to ABATE, Consumers is expected to assume certain business risks that may decrease sales, including weather fluctuations and customer-initiated energy efficiency measures. ABATE contends that the traditional ratemaking process is adequately designed to address these risks. ABATE further argued that if the Commission approves the EE program, then large industrial customers should be permitted to opt out. ABATE contends that industrial customers already have an incentive to engage in energy efficient products and processes without the need for a regulated program.

CNE and Energy Michigan also argue that Consumers' EE program should be rejected on grounds that Consumers has not provided sufficient evidence showing how the funding will be spent, how the program will operate, how the proposed incentives will be earned, and other related matters. Dow/Hemlock similarly argues that if the Commission approves the program, the evaluation process must be transparent, provide interested parties with an opportunity to review and comment on the proposed savings, and require Commission approval before any incentive is awarded.

The Attorney General argued that the EE program should be rejected on the grounds that it violates MCL 460.6c because the costs of the proposed program are not included in general utility rates and because Consumers failed to provide sufficient evidence in the record for the Commission to determine the cost/benefit of the program. Furthermore, the Attorney General argued that it is improper to require every ratepayer to bear the cost of a program in which only a few ratepayers participate. The Attorney General asserted that the EE program, if approved, would place further financial pressures on ratepayers already suffering through a bad economy and high energy costs. The Attorney General recommended that the Commission consider a voluntary EE program, similar in concept to Consumers' green generation program.

The ALJ recommended that the proposed EE program, as modified by the Staff's proposal should be adopted. However, because the record closed before Consumers identified the specific EE programs to be implemented and their corresponding funding levels, the ALJ recommended that the Commission refrain from adjusting Consumers' base rates until the details of the programs have been finalized.

In response to the Attorney General and ABATE, the ALJ observed that the Court of Appeals in *Detroit Edison Company v PSC*, 221 Mich App 370, 385-386; 562 NW2d 224 (1997), explicitly held that the Commission had the authority to approve recovery of all reasonable and prudent costs, including incentives, associated with energy efficiency programs. The ALJ found irrelevant the fact that not all of Consumers' customers will be willing or able to simultaneously participate in one or more of the EE programs. The ALJ noted that the programs will be developed so that all customers are eligible to participate and that benefits derived as a result of deferred plant construction or avoided capacity and power purchases will flow to all ratepayers in the form of lower rates.

The ALJ disagreed with Consumers' recommendation that the low-income EE programs should not be considered when determining whether an incentive payment is warranted. According to the ALJ, one of the central purposes of the incentive mechanism is to ensure that the utility operates programs that provide a net benefit to its customers and energy efficiency benefits are as important to low-income customers as they are to other ratepayers. The ALJ found that if low-income programs are excluded from the EE program's otherwise applicable evaluation standards, the incentive mechanism "could serve to create a bias in favor of short-changing low-income programs to the benefit of programs directed toward other customer classes." PFD, pp. 84-85.

As an initial matter, the Commission wholly approves of utility initiated energy efficiency programs that are efficient, cost effective, and available for all classes of customers. As the Commission observed in the October 18, 2005 order in Case No. U-14667, "[T]he Commission finds that a rational energy policy for Michigan must include efforts towards identifying and implementing practical, cost-effective, and achievable reductions in energy demand through energy efficiency programs." In that order, the Commission described Michigan's considerable experience in addressing the challenges of energy scarcity and high energy costs, highlighting programs offered by Consumers beginning more than three decades ago.

As noted by Geoffrey Crandall of MSB Energy Associates, Consumers has a long history of providing robust and cost effective energy conservation and efficiency services to its customers. In the 1970's and 1980's, Consumers offered its customers a variety of programs including the Customer Information Program, Michigan Residential Conservation Services Program, Zero Interest loan program for ceiling insulation and vent dampers, and the Below Market Loan programs for residential efficiency improvements. According to Mr. Crandall, Consumers has demonstrated quite conclusively that it has the capability to design, develop, implement, and manage energy efficiency programs in a cost effective manner and should be commended for this initiative. 13 Tr 2325-2326.

The Commission finds however, that in light of the number of energy efficiency bills presently being debated in the Legislature, it would be prudent to defer approval of Consumers' proposed EE program until the Legislature has completed its work. Some of the bills under consideration have specific savings requirements for energy efficiency and incorporate processes for review similar to those suggested by intervenors in this case. In addition, some of the bills provide for incentive mechanisms that may differ from the mechanism discussed in this case.

D. Electric Choice Incentive Mechanism

Consumers proposed an Electric Choice Incentive Mechanism (ECIM) designed to smooth the effect of fluctuations in its retail open access (ROA) sales. According to Consumers, if ROA sales increase or decrease more than 5% from the amount set in rates, a charge or credit would apply to rates of the class where the ROA sales change occurred. Consumers argues that because it is difficult to predict ROA sales, the ECIM would assist the company in its management. Consumers further notes that the proposed ECIM is similar to a mechanism approved for The Detroit Edison Company (Detroit Edison) in Case No. U-14838.

The Staff supported the ECIM and argued that it would provide an incentive for Consumers to further reduce costs in the event of ROA sales changes.

The Attorney General argued that the Commission lacks specific statutory authority to approve the ECIM, which the Attorney General claims violates the rule against retroactive ratemaking. In addition, the Attorney General, Dow/Hemlock, and ABATE claim that because ROA load is expected to be flat for the next few years, the ECIM is unnecessary. Dow/Hemlock argues that Consumers' ROA program is half the size of Detroit Edison's, thus, Consumers doesn't have the exposure to ROA fluctuations that Detroit Edison does, which limits the justification for authorizing the ECIM for Consumers.

The ALJ recommended that the Commission approve the ECIM observing that although ROA load fluctuation is expected to be flat for the next few years, in the past, annual variations in ROA load have ranged from -64% to +227%.

The Commission agrees with the ALJ, the Staff, and Consumers that the ECIM is reasonable and should be approved.

E. Low-Income and Energy Efficiency Fund

Consumers proposed to again provide funding for the Low-Income Energy and Efficiency Fund (LIEEF) administered by the Commission. The Staff concurred with Consumers' proposal.

As they have repeatedly claimed in the past, the Attorney General and ABATE once more contend that the Commission does not have the authority to fund the LIEEF through general utility rates. The Commission declines to yet again address the arguments of these parties and instead refers them to *In re Application of Detroit Edison Company*, 276 Mich App 216, 230-231; 740 NW2d 685 (2007) and *Attorney General v Public Service Comm,* ___ Mich App ___; ___ NW2d ___ (Approved for publication, May 27, 2008).

F. Nuclear Legacy Costs

In its initial application and amended application filed on July 3, 2007, Consumers requested the Commission authorize a Nuclear Legacy Investment Surcharge of $13 million. Application Section VI. E; originally filed Exhibit A-10. The three components of the request were a return on: 1) Big Rock Point decommissioning and site restoration costs; 2) spent fuel storage facility investment; and 3) the $30 million payment to Entergy to assume responsibility for the Big Rock ISFSI. On November 20, 2007, Consumers withdrew its request for authority to recover the Nuclear Legacy Investment Surcharge noting, "The withdrawal of this proposal eliminates the need in this proceeding to review the long history of certain nuclear decommissioning and spent nuclear fuel issues. Withdrawal of the request . . . reduces the Company's overall rate request by $13 million." 8 Tr 846.

Despite Consumers' request to withdraw these issues from consideration in this rate case, MEC/PIRGIM raised a number of issues related to Consumers' nuclear legacy costs. MEC/PIRGIM argues: 1) the Commission should order Consumers to immediately deposit into a special purpose trust approximately $141 million in Big Rock nuclear-related surcharges and interest recovered from ratepayers during the rate freeze in effect from 2001 through 2003; 2) the Commission should rule that Consumers must collect all costs arising from the DOE's failure to take possession of SNF from both Big Rock Point and Palisades in its damage suit against the DOE rather than recovering these costs from ratepayers; 3) Consumers should be directed to place all SNF disposal fees collected from its customers for pre-April 7, 1983 nuclear generation in an external, interest-bearing trust regulated by the Commission; 4) the Commission should require an audit and reconciliation of the Palisades and Big Rock Point ISFSI sale and transfer transactions, including a review of all final sale proceeds, transaction costs, and DOE-related ISFSI costs included in Palisades' net book value; and 5) the Commission should exclude from rate recovery $6,928,000 in annual costs that it claims relate exclusively to enhanced security for nuclear facilities that Consumers no longer owns.

In response, Consumers argued that: 1) MEC/PIRGIM's claim that $141 million in nuclear related surcharges from 2000 through 2003 were actually collected was unsupported. Consumers points to the tariff in effect at that time, which indicates that the surcharge was not collected; 2) MEC/PIRGIM's argument that all nuclear related costs should be recovered from the DOE and not from ratepayers is not in issue here because the company is not seeking recovery of these costs; 3) the placement of pre-1983 SNF disposal fees in an external trust is an issue that the Commission has addressed repeatedly and has consistently found that the current ratemaking treatment of these fees benefits customers; and 4) Consumers intends in the future to file a case that will allow nuclear legacy costs to be examined and recovered.

The Staff replied that it did not agree with MEC/PIRGIM that nuclear legacy issues should be resolved in this case. The Staff contended that addressing the issues regarding the funding of the Big Rock Decommissioning Fund and the reconciliation of the actual final costs of decommissioning Big Rock and the transfer of the Big Rock ISFSI to Entergy in one proceeding would promote administrative efficiency. The Staff did agree with MEC/PIRGIM's recommendation that the Commission establish a date in 2008 by which the Company should file a final Big Rock decommissioning case. The Staff concurred with Consumers that the current ratemaking treatment of pre-April 1983 SNF disposal costs benefits ratepayers and that the Commission has repeatedly rejected MEC/PIRGIM's arguments on this issue.

The Attorney General supported MEC/PIRGIM on its claim regarding the $141 million in nuclear-related surcharges and interest recovered from ratepayers during the rate freeze.

According to the Attorney General, Consumers clearly collected these surcharges but never properly reflected them in its books. The Attorney General and ABATE also supported MEC/PIRGIM's claim that all SNF-related disposal fees should be recovered from the DOE and not from ratepayers. Dow/Hemlock urged the Commission to decide the nuclear legacy issues "as a matter of fairness."

The ALJ largely agreed with the Staff's recommendations on these issues. The ALJ agreed that the $141 million of Big Rock decommissioning payments should be addressed in a Big Rock reconciliation proceeding. The ALJ also found that MEC/PIRGIM's demand that the Commission rule that all SNF disposal costs should be recovered through Consumers' breach of contract suit against DOE and not from ratepayers should be rejected on grounds it was overbroad. The ALJ agreed with the Staff that some of the SNF costs would have been incurred even if the DOE had not breached its contract and that these costs should be considered after the DOE litigation is resolved. The ALJ also found that MEC/PIRGIM's arguments concerning the treatment of pre-1983 SNF disposal costs has been repeatedly rejected by the Commission. The ALJ observed that the Commission's regulatory control over Consumers along with the letter of credit obtained in connection with the sale of Palisades and Big Rock contradicts MEC/PIRGIM's claim that the integrity or availability of these funds may be compromised.

The ALJ did agree with MEC/PIRGIM's fourth and fifth requests. The ALJ agreed that the Commission should require an audit of the Big Rock ISFSI sale and transfer transactions, including a review of all final sale proceeds, transaction costs, and DOE-related ISFSI costs. The ALJ further recommended that because Consumers has repeatedly delayed the filing of its Big Rock reconciliation application, the Commission should set a deadline of 60 days following the implementation of the tariffs approved in this case for submission of the company's Big Rock

ISFSI reconciliation case. The ALJ also found merit in MEC/PIRGIM's claims regarding enhanced nuclear security costs but noted that there was insufficient evidence in the record to remove these costs from rates at this time. Instead, the ALJ recommended that an audit of Consumers' enhanced nuclear security costs be incorporated into the Big Rock reconciliation proceeding.

Consumers takes exception to the ALJ's recommendations and argues that the Commission has already established a procedure for the recovery of Palisades and Big Rock transaction costs in Case No. U-14992 and likewise established a reconciliation proceeding for enhanced nuclear security costs in Case No. U-14126. Consumers contends that MEC/PIRGIM's claims amount to a collateral attack on prior Commission orders.

The Commission agrees in part with Consumers that both the order in Case No. U-14992 and the settlement in Case No. U-14126 require reconciliations at some point. However, while Consumers will file its reconciliation for the Palisades transaction as required by this order, Case No. U-14992 did not address the filing of a reconciliation of the Big Rock ISFSI decommissioning costs and other nuclear and transaction-related expenses. The Commission therefore finds that Consumers shall file an application for the reconciliation of all Big Rock related transactions, including a review of all final sales proceeds, transaction costs, and DOE related decommissioning costs by October 1, 2008.

While the Commission agrees with the ALJ and MEC/PIRGIM that there are some concerns related to the continued collection of the enhanced security cost surcharge authorized in the August 10, 2004 order in Case No. U-14126, which Consumers will continue to collect until August 2009, the Commission finds that these concerns will be addressed in the reconciliation agreed to by the parties to the settlement agreement in Case No U-14126. The Commission therefore finds that Consumers shall file its reconciliation of costs associated with enhanced security by March 1, 2010.

VIII. Overall Revenue

Based on the foregoing findings, Consumers' revenue deficiency for the 2008 test year is computed as follows:

Zeeland related revenue requirement	$ 73,677,000
Revenue increase previously approved	$ 69,500,000
Revenue deficiency for Zeeland	$ 4,177,000
Base revenue excess	($ 46,208,400)
Revenue excess including Zeeland Generating Station	($ 42,031,400)
Discontinuance of Zeeland surcharge and incorporation into base rates	$ 69,500,000
Revenue Deficiency	$ 27,468,600

IX. Cost of Service and Tariff Issues

A. Cost Allocation

1. Production Cost Allocation Method

In Consumers' most recent rate case, the December 22, 2005 order in Case No. U-14347, the Commission adopted a new production cost allocation method known as MH4CP 25/50/25. This method uses a multi-hour approach, which looks at a seven-hour time period, from 1:00 p.m. to 8:00 p.m., on the peak day of each summer month, June through September. This encompasses the high demand part of the day. The Commission directed Consumers to file a class cost of service study (COSS) in its next electric rate case (the present proceeding) utilizing this method.

Both Consumers and the Staff applied the MH4CP 25/50/25 method in preparing their COSSs in this case. Finding that expected energy usage, rather than demand, "is the crucial factor leading to the construction of relatively costly, base-load generating plants," the ALJ recommended that the Commission adopt the use of the MH4CP 25/50/25 method.

ABATE takes exception to this finding. ABATE argues that this method sends the wrong price signal to customers by de-emphasizing peak demand. ABATE contends that the use of the MH4CP 25/50/25 method is inconsistent with other aspects of this rate case, including Consumers' requests for approval of an EE program, and the use of seasonal rates. ABATE argues that the new method masks the consequences of peaking behavior and fails to provide a symmetrical allocation of capital and operating costs. ABATE urges the Commission to return to the historical 12CP 75/25 method because it produces lower cost allocations for industrial customers, and to consider using a 4CP 75/25 method in the next electric rate case.

In reply, the Staff criticizes ABATE's argument that the approval of an EE program is somehow incongruous with the use of this cost allocation method. The Staff argues that it is absurd to conclude that emphasizing energy consumption in the cost allocation method is contrary to the concept of trying to reduce energy consumption through efficiency. The Staff points out that the purpose of the energy efficiency program is not to discourage peak demand, but to encourage efficient consumption at all times. Reductions in peak demand do not necessarily lead to reductions in overall energy consumption. The Staff contends that the correct price signal for encouraging energy efficiency is a higher price for energy, and that the proposed method achieves this result by allocating a larger fraction of the utility's power production capacity costs to the energy function and less to peak demand.

In reply, Consumers also supports the Staff's proposed cost allocation method.

The Commission adopts the findings and recommendations of the ALJ and approves the Staff's proposed method. This method, in comparison to the old method advocated by ABATE, shifts 50% of generation plant costs away from system peak demands, and reclassifies them as related to on-peak energy or average demand. This recognizes that more of the demand to which Consumers is responding is constant demand rather than peak demand. In previously authorizing the use of this method, the Commission stated that, "While the total amount of generation capacity needed by Consumers is based on peak demand, the greatest amount of investment is incurred to serve base load and intermediate load. . . .[I]t is appropriate to increase the weight given to average demand in the allocation of the production plant costs relative to peak demand, and to expand the number of hours used for this calculation." December 22, 2005 order in Case No. U-14347, pp. 74-75. The Commission finds that this still holds true and reaffirms the MH4CP 25/50/25 COSS method used by both Consumers and the Staff in this proceeding.

2. Transmission Cost Allocation Model

Because transmission costs are primarily demand related, the Commission had previously directed Consumers to continue to allocate these costs using the 12CP 75/25 method. December 22, 2005 order in Case No. U-14347, p. 73, n. 23. No party objected to this method, and the ALJ recommended that this method continue to be used for allocating transmission costs in this proceeding. No party filed exceptions to this finding, and the Commission adopts the recommendation of the ALJ.

3. Miscellaneous Cost Allocation Issues

The Staff advocated using the 12CP 100% demand method with zero weight for energy to allocate Consumers' production costs between the utility's jurisdictional and non-jurisdictional customers. The ALJ adopted this proposal. The ALJ further recommended that Consumers'

COSS should be updated to reflect the Commission's rulings in this matter concerning final rate relief, and 40 proposed allocation factor modifications suggested by the Staff. No party filed exceptions to these findings, and the Commission adopts the recommendations of the ALJ concerning these miscellaneous cost issues.

B. Non-ROA Rate Design and Tariff Issues

Consumers proposed a comprehensive redesign of rates that is intended to simplify the rate structure and move as many rate classes as possible to paying rates based on the cost to serve each class. As a result, some classes' rates will increase and some will decrease, as is true of subcategories within classes.

The determination of whether and to what extent a rate class is currently paying its cost to serve is made through the COSS. Both Consumers and the Staff performed COSSs that contain determinations on each class. *See, e.g.,* Exhibits A-5, S-6-rev. The Staff computed the revenue "sufficiency" (payment above the cost to serve) or "deficiency" (payment below the cost to serve) for each class. Exhibit S-6-rev., page 1 of 5, line 18. Consumers, on the other hand, created a category called "index of return," which is a measurement of the extent to which a class is paying its cost to serve, derived by dividing the rate of return on rate base for that class by the rate of return on rate base for total jurisdictional electric sales. Exhibit A-5, line 17. Thus, for example, Consumers' Exhibit A-5 shows that, where total jurisdictional electric sales have an index of return of 100%, residential customers are paying rates that produce an index of return of about 66%, commercial and industrial (C&I) secondary customers about 148%, and C&I primary customers about 118% of the overall average rate of return for all customer classes. Similarly, the Staff found that residential customers show a revenue deficiency of about $92 million, and C&I

secondary and primary customers show a revenue sufficiency of about $84 million and $61 million, respectively. Similar calculations were performed for each rate class.

Consumers proposes to consolidate 24 existing rate schedules into seven, and to rename three others, thus moving from 27 rate schedules to 10. Consumers proposes several subcategories for the new rate schedules, including: Residential Life Support (RLS), Residential Small Farm (RSF), Residential Income Assistance (RIA), and Residential Senior Citizen (RSC) for residential customers; and General Aggregate On-Peak Demand (GAP), General Interruptible (GI), General Market Indexed (GMI), General Economic Development (GED), General Educational Institution (GEI), and General Furnace & Metal Melting (GFM) for business customers. *See,* Exhibits A-33, A-34. Consumers testified that, in allocating costs, the company deviated from cost of service principles only for the purposes of (1) maintaining the residential subsidy, (2) assigning to other customers the revenue shortfall expected to result from the proposed GED, and (3) allocating the power supply portion of the general self-generation (GSG) rate to other full service customers. 10 Tr 1479-1480. Several of the proposed changes were non-controversial, including the use of seasonal and time of day energy charges, elimination of the existing residential water-heating and space-heating rates, and adoption of the GMI, RLS, and new interruptible rates.[15]

1. Rate Re-alignment

Consumers' current full service rates reflect prior determinations to mitigate rate impacts on residential customers through inter-class subsidies borne by C&I customers. Inter-class subsidies

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[15]The Commission takes note of two miscellaneous issues related to rate design. First, Consumers noted in its exceptions that the ALJ incorrectly listed the on-premises bill collection charge as $50 (PFD, p. 105). The correct amount is $20. Second, the Commission notes that it agreed with the Staff in its April 22, 2008 order in Case No. U-15001, pp. 4-5, and found that North American Electric Reliability Council dues should continue to be collected through base rates. Thus, the Commission finds that, in accordance with the Staff's calculation, $413,000 should be added to the projected test year other O&M Expense. Staff's exceptions, p. 18; Exhibit A-7. *See,* pp. 33-34, *supra.*

result in rates that do not perfectly reflect the actual cost to serve that class. As it has previously stated, "The Commission is not convinced that all customers should eventually pay rates that are based solely on the cost to serve them. Other factors need to be weighed when setting rates." December 22, 2005 order in Case No. U-14399, p. 33. In addition, it is important to remember that perfection is not achievable. The perfectly cost-based rate does not exist because the calculation depends partially on load – a factor that is constantly changing. However, the Commission is persuaded that it is time to move towards better rate alignment, keeping in mind that certain classes may continue to receive a subsidy indefinitely.

The residential subsidy is not currently collected from ROA customers. It is paid by full service C&I customers through their distribution charge. *See,* December 22, 2005 order in Case No. U-14347, p. 71. According to Consumers, its existing rates provide residential customers with an annual subsidy of $114 million. The Staff calculates the total subsidy at $73 million, based on a different calculation of revenue requirements. Consumers proposes to eliminate the residential subsidy over a five-year period beginning with the next rate case, reducing the subsidy by 20% per year. During the five-year period, Consumers proposes to assess the progressively smaller residential subsidy equally to all full service and ROA primary, secondary, and self-generation business classes through a combination of fixed and variable access or delivery charges.
10 Tr 1460; Exhibit A-42.

The Staff supported the proposal to align rates according to costs and to recover the residential subsidy equally from full service and ROA customers during the period of gradual elimination. The Staff offered three, five, and ten-year scenarios under which the subsidy could be eliminated, beginning in a future rate case.

The Attorney General cautioned against setting all rates on cost of service principles.

Energy Michigan, CNE, and NEMA argued that ROA customers should not be required to share the burden of the residential subsidy, when they do not rely on Consumers' generation, it may be catastrophic to the choice program, and the subsidy will soon be gone in any case.

The ALJ found that Consumers' proposal should be adopted, and should take place over a minimum of five years. The ALJ rejected the arguments of the intervenors, finding that nothing in the record indicates that any portion of the existing subsidy is specifically tied to generation, and that the inequity between ROA and full service customers should come to an end. The ALJ found that the Staff did not advocate any particular plan.

In its exceptions, the Staff indicates that the ALJ misconstrued its position. The Staff points out that Consumers does not advocate beginning removal of the residential subsidy in this case, but rather in a future rate case, and the Staff agrees. The Staff further points out that currently pending legislation may address this issue.

The Attorney General, while not objecting to elimination of the residential subsidy, argues that a COSS does not provide a precise measure of a class' contribution. The Attorney General disputes Consumers' $114 million figure. The Attorney General argues that a COSS can only serve as a guide or reference, and the data in a COSS remain useful for only a short period of time. For these reasons, the Attorney General contends that if the Commission moves to align rates according to costs, it should adopt the notion of a "deadband" target, wherein plus or minus 10% of the index of return should be used when computing the amount of the residential subsidy. Using 90% for the index of return brings the size of the subsidy down to $83 million. The Attorney General describes this deadband notion as a fair and equitable method to account for the imprecise nature of a COSS.

In addition, the Attorney General finds no support for the proposed five-year period, as opposed to any other time period. The Attorney General contends that the revenue differential caused by the residential subsidy should be resolved over a number of rate cases, each one supported by an updated or new COSS. Following that procedure, the Attorney General argues, will allow the Commission to avoid: (1) pre-approving any rate increase associated with eliminating the subsidy; (2) front-end loading the elimination of the subsidy; and (3) relying on outdated information for each subsequent rate change.

CNE, Energy Michigan, and NEMA (the ROA intervenors) take exception to the ALJ's recommendation that ROA customers participate in paying the residential subsidy until it is phased out. The ROA intervenors note that the Commission rejected elimination of the subsidy in the December 22, 2005 orders in Case Nos. U-14347 and U-14399, and they contend that the ALJ made no attempt to distinguish those cases from this one. They argue that the only thing that has changed since 2005 is that competition has decreased. The ROA intervenors further argue that they already pay $5 million in annual securitization and stranded cost subsidies that lower retail generation costs for everyone. They assert that this is not the right time to impose any additional subsidy on ROA customers.

The ROA intervenors further argue that it is unfair to gradually adjust rates over five years in order to avoid rate shock to the residential class, while imposing 100% of proposed subsidy charges on ROA customers without any phase-in period. They argue that, in order to avoid rate shock, the subsidy attributed to ROA customers (because they do not contribute to the residential subsidy) should be phased out by doing nothing to ROA rates, and simply letting the process gradually lower C&I bundled rates. Finally, in the alternative, the ROA intervenors argue that, if the Commission directs the inclusion of ROA customers in the payment of the subsidy, the system access fee proposed by Consumers should include a generation component that should be separated out for ROA customers, who should pay only a distribution component.

Several parties filed replies on this issue. ABATE argues that the Staff seems to want to set no definite plan for eliminating the subsidy. ABATE argues in favor of a definite timetable in order to aid with planning and budgeting. ABATE also supports limiting any ROA contribution to the subsidy to the distribution portion, and gradually phasing-in that contribution.

CNE and Energy Michigan both reply, urging the Commission to decline to implement reduction of the subsidy in this case.

Consumers, in its replies, points out that the Staff, while not advocating a particular subsidy reduction schedule, did recognize the value of moving to cost based rates over some period of time. In reply to the Attorney General, Consumers points out that the Attorney General offers no alternative method to the cost of service approach, and the company argues that the deadband has no methodological justification. Consumers points out that future rate cases will inevitably include new COSSs. Consumers characterizes the position of CNE and Energy Michigan as self-serving and anti-competitive.

The Commission rejects the proposal to include ROA customers in the payment of the subsidy. These customers have, after several years of subsidization themselves, been brought to cost of service based distribution charges. Rates based on the cost to serve each customer class are the Commission's goal, and the Commission finds that the ROA distribution charges should remain cost based.

The Commission finds that it is time to make significant progress to align rates. Thus, the Commission directs that the subsidy paid by full service C&I customers shall be reduced by approximately $19.9 million beginning with the implementation of rates resulting from this order.

The effect on residential rates will be $0.00153 per kWh, or approximately 1.5 mills. This amount is in addition to the $27,468,600 revenue deficiency, that corresponds to a $0.00211 per kWh (2.11 mills) increase for residential customers, which is offset by the elimination of the surcharge established in the interim order. This results in a negligible impact on residential customers' rates. This rate realignment will send the message that Michigan is a good place to do business, where electric rates are just and equitable and economic development is valued. Moreover, the Commission is committed to making additional progress to align commercial and industrial rates with their cost to serve in Consumers' next rate case.

2. System Access Charge for Residential Customers

Both Consumers and the Staff supported incorporation of a fixed monthly system access charge of $6.00 into the utility's basic rate structure for residential customers, that would replace the current minimum charge based on energy usage for a minimum of 2 kWh per day. The ALJ found that, because many of the costs associated with providing electric service do not vary with consumption, the $6.00 per month system access charge should be adopted.

The Attorney General filed exceptions, arguing that Consumers provided little support for the access charge and that it increases residential rates. The Attorney General points out that Consumers currently has a minimum charge for customers that use less than 60 kWh per month, but none for customers above that usage amount. The Attorney General contends that the imposition of a fixed charge for customers above 60 kWh per month acts as a disincentive to conserve energy.

In reply, the Staff points out that the fixed charge does not increase rates, but rather is a change to the rate design that will result in collecting the same amount of costs. The Staff contends that it is appropriate to shift some costs from the energy charge to the customer charge because these costs do not vary with consumption, and points out that nearly every electric and gas utility currently has an approved fixed monthly charge. Finally, the Staff points out that the proposed charge is no more of a disincentive to conserve than the old way of collecting the same costs, and that the vast majority of the customer's bill is still based on usage, creating an incentive to conserve. Consumers also replied in support of the PFD.

The Commission is persuaded that the proposed $6.00 per month system access charge is appropriate. It does not increase the residential customer class' cost of service. Rather, it merely reflects the fact that a flat customer charge, rather than an energy related charge, is a more appropriate way of collecting the fixed costs associated with serving each residential customer at any usage level.

3. Residential Income Assistance and Senior Citizen Credits

Consumers proposes, and the Staff supports, a new residential income assistance (RIA) provision, under which customers currently receiving assistance under the Home Heating Credit (which is based on a showing of need) would be eligible for a monthly credit of $6.00; and a new senior citizen credit which would provide customers currently served under Consumers' senior citizen rate provisions a $3.00 monthly credit.[16] The current senior citizen rate provides discounts based on blocks of power usage. The proposed credit would be open only to seniors on the existing senior rate, and would be a uniform flat credit of $3.00, unrelated to usage. The intent of the new provisions is to shift the qualifying factor for receiving assistance away from age *per se* and towards need. Needy seniors would thus be encouraged to migrate to the RIA provision, which provides a larger credit. There would be no new credit open to seniors purely on the basis of age.

[16] Consumers initially proposed a $4.00 monthly credit, but later agreed to the Staff's suggestion of $3.00.

The ALJ recommended adoption of these two proposals, along with adoption of two additional suggestions made by the Attorney General that the utility explore the use of a death reporting service in order to remove ineligible customers on a regular basis, and amend the senior citizen provision to ensure that eligible age-qualified relatives living with the original eligible customer are allowed to retain the credit when the original customer dies.

AARP takes exception to the proposed senior citizen credit. AARP points out that the first tier of Consumers' existing senior citizen rates (service at 14 kWh/day or less) would be eliminated, and customers in this tier who do not qualify for the RIA would see a 40% increase in their rates under the new proposal. AARP points out that 96% of senior citizens do not qualify for the RIA credit. AARP argues that this will cause rate shock for these customers. AARP contends that Consumers should retain the first tier in its current form, because that will encourage energy efficiency and equitably allocate rates. In the alternative, AARP argues, the Commission should limit any increase to the rates paid by seniors using 14kWh/day or less to no more than 25%.

AARP further argues that the ALJ erred in fixing the senior credit at $3.00 rather than $4.00.

In reply, Consumers points out that the fact that 96% of seniors do not qualify for the RIA illustrates the need for aiming the qualification factor away from age and towards need. Also, Consumers points out, the proposed senior citizen discount will be available to all qualifying seniors currently taking service under the senior citizen tariff, with monthly consumption no longer being a factor.

The Staff also replies in support of the PFD, noting that the proposal reasonably balances the interests of existing full-paying residential ratepayers with those who receive residential discounts, without harming any senior citizens who are in need of assistance.

The Commission agrees with the ALJ and the Staff, and finds that these two provisions should be approved. Any discount offered to one group must be recovered by the utility from another group – in this case, the remaining residential ratepayers. As AARP concedes, the vast majority of senior citizens do not qualify for a discount on the basis of need. The proposed RIA and senior citizen credits will ensure that those who are in need will see a discount that offsets the system access charge; and seniors who currently qualify for senior citizen rates will continue to receive the $3.00 credit, which cuts in half the system access charge. These credits pose a reasonable burden for the remaining residential ratepayers who must fund them. The Commission directs Consumers to submit, with its tariffs, a proposal for advertising the existence of the new RIA rate to customers.

4. Substation Ownership Credit Provision

Consumers initially proposed to reduce its substation ownership credit. The ALJ rejected the proposal and recommended that the Commission adopt, for purposes of this case, a substation ownership credit equal to $0.77 per kW of maximum demand. No party took exception to this finding, and the Commission adopts the recommendation of the ALJ.

5. Pumping Credit Provisions

As part of moving customers towards cost based rates, Consumers proposes to eliminate its municipal pumping service rates and to shift those customers to various general service rate classes. To mitigate the rate increase associated with this restructuring of rates, the Staff proposed a pumping credit that effectively cuts the rate increase in half, and Consumers agreed. The MML objected to the restructuring, but the ALJ found that the MML significantly overstated the effect on rates, and recommended that the Commission adopt the new rate structure with the proposed pumping credit.

The MML takes exception to this recommendation, arguing the restructuring results in rate shock for municipalities. The MML argues that these 50-year old discounted rates should remain in effect because municipal pumping service has unique characteristics that preclude it from being grouped with commercial customers. For example, the MML argues, commercial customers can cut costs and operations when demand is low. However, because municipalities are legally obligated to be ready at all times to meet the service level required on the highest demand day, they cannot cut costs in response to demand. The MML points out that water pumping and treatment are subject to the legal and environmental constraints set by regulation. The MML contends that Consumers' proposal rewards entities with high load factors, and penalizes users whose usage fluctuates. However, the MML argues, a municipality may not use an interruptible rate, and may not arbitrarily vary load factors.

The MML argues that Consumers has failed to present sufficient evidence showing that the proposed rate change is appropriate. The MML posits that the wholesale consolidation of classes with different characteristics will not capture the effect of variations in all of the cost-causing attributes. The MML further argues that the proposed change will result in rate shock. For example, under the rates adopted in the PFD, the MML states that Grand Rapids Lake Michigan Filtration Plant will "experience an increase somewhat higher than 10.41% for this site and will still see increases in some months of nearly 30%." MML's exceptions, p. 13. The MML argues that the Commission should retain the 50-year old rate structure, or should institute a more gradual change in the rate design. Alternatively, the MML urges the Commission to direct Consumers to work with the municipalities to develop a new municipal class of rates.

In reply, the Staff points out that the credit that Consumers agreed to will apply to whatever rates are set and will cut the rate increase, whatever it is, in half. The Staff further clarifies for the MML that the credit will continue for the foreseeable future.

In reply, Consumers argues that its proposed rate change is not just a consolidation, but also results in rates that better reflect costs of service and that send better price signals. Consumers points out that the fact that the pumping rates are very old does not insulate them from reasonable revisions. Consumers argues that the current pumping rates do not reflect the cost to serve, in that, for example, the index of return for customers on the current rate PS-3 is between 40% and 70% depending on the voltage level.

The Commission is persuaded that the movement towards rates that better reflect the cost to serve is timely and appropriate. As the Commission has stated before, simply because a procedure or standard has been in place for a long time does not mean that it is not subject to improvement. The Commission is sensitive to the concerns of the municipalities with regard to their regulatory duties and operational constraints. However, the proposed rate structure does not appear to threaten their ability to carry out their duties, while assigning the costs of service in a more equitable way. The MML provided examples of potential rate increases (such as an average increase of 10.4% in Grand Rapids) that do not appear to constitute rate shock. The pumping credit will help to alleviate any rate shock that may occur. It is also possible that the municipalities will find more efficient methods for providing service that will mitigate any rate increase. The Commission approves the proposed changes to the rate structure governing municipal pumping, adjusted to include the Staff's proposed pumping credit.

6. Green Generation Tariff

The Staff proposed two changes to Consumers' Green Generation Renewable Resources Tariff that would offer customers the option of subscribing to renewable energy under a long-term fixed price, and offer energy suppliers the option of selling renewable energy into the program under a long-term fixed price. Consumers opposed the two changes, arguing that they may result in agreements that are inadequate to cover the cost of renewable generation, may conflict with new legislation, and may unintentionally shift unrecovered costs to other customers.

The ALJ found that the timing of this proposal is inappropriate, because significant changes in the law concerning renewable generation, including a renewable portfolio standard (RPS), appear to be on the near horizon. The ALJ recommended that, once the Legislature either acts or indicates that it will not act on an RPS, the Commission initiate a collaborative process to address potential changes to this tariff.

The Staff takes exception to this recommendation. The Staff points out that voluntary green price programs and RPS programs are entirely different, and coexist in many states. The Staff agrees that a collaborative would be useful and argues that there is no reason to delay that process. The Staff notes that proposals for a mandatory RPS have been introduced in the Legislature every year since 2003, but have failed to pass; and, meanwhile the Commission bears the responsibility for promoting the use of renewable energy resources. MCL 460.10r(6).

The Staff is correct that the outcome of the legislative process is unknown. Further, the Commission is interested in exploring improvements to the green generation tariff that will increase participation. However, the Commission agrees with the ALJ that this is not the time to commence this collaborative. The Commission intends to monitor legislative activity and will make a determination at some point in the future whether it should commence a collaborative.

7. Self-Generation Rate and Standby Power

One of the areas in which Consumers deviated from cost based rates was in its proposal to allocate the power supply portion of the costs otherwise assignable to members of the general self-generation (GSG) service class to other, full service customers. The proposed tariff recovers costs from GSG customers through: (1) a maximum demand rate and fixed monthly charge, and (2) a standby power charge consisting of a MISO-based energy charge, a capacity charge based on the cost of all capacity purchases needed to meet the customer's peak load, and a transmission cost recovery charge.

ABATE and Dow/Hemlock argued that the proposed GSG tariff should be clarified to specifically state that a GSG customer taking both firm and standby service will be able to receive power up to its contracted firm demand level prior to incurring standby service charges. The Staff, the parties, and the ALJ agreed with this proposal.

ABATE and Dow/Hemlock further argued that the GSG tariff should be amended to remove the capacity charge component from the rates imposed on GSG customers for standby service. Consumers opposed this change, arguing that it would result in a rate that fails to recover from GSG customers the fair value of the standby service they receive.

The ALJ agreed with Consumers, finding that if standby customers are shielded from paying toward overall capacity costs, other ratepayers will inevitably be assessed for the value of the capacity diverted to GSG customers.

ABATE and Dow/Hemlock take exception to the ALJ's recommendation, arguing that capacity charges incurred by bundled customers are being unfairly allocated to standby customers. Dow/Hemlock argues that there are no capacity costs associated with Consumers' provision of standby service, because the utility does not purchase capacity to provide standby service to GSG customers, and because the power supply cost is partially based on MISO's locational marginal price (LMP). Dow/Hemlock contends that it makes no sense to charge customers both a market price for energy and also a share of Consumers' embedded costs for capacity, because the real-time LMP energy price compensates the generator for its capacity. Dow/Hemlock maintains that provision of MISO LMP-based standby service does not deprive other ratepayers of the value of Consumers' capacity that could be sold to other load serving entities. Further, ABATE and Dow/Hemlock argue, the customer taking standby service faces price uncertainty, because the price of capacity will not be known ahead of time.

In reply, Consumers argues in support of the PFD.

The Commission agrees with the ALJ and finds that the proposed amendment of the tariff would result in other customers being charged for the value of the capacity diverted to GSG customers. GSG customers do sometimes take standby service. The Commission is not persuaded that GSG customers should be insulated from marginal capacity costs when they elect to take standby service.

Additional issues arose concerning the GSG tariff language. In response to the Staff's concerns, Consumers agreed to bifurcate the rate into two rates (GSG-1 and GSG-2) in order to serve primary and secondary voltage levels. The Staff offered 16 additional amendments, with a view towards encouraging distributed generation in Michigan. The ALJ found that, "due to the range and number of the Staff's other recommended changes . . . the ALJ concludes that these remaining proposals should be reserved for review in other, more narrowly-focused proceedings." PFD, pp. 118-119.

The Staff takes exception to the ALJ's recommendation. The Staff indicates that Consumers has agreed to eight of the 16 amendments, and urges the Commission to adopt the remaining eight modifications, which the Staff characterizes as minor edits to Rates GSG-1 and GSG-2. In reply, Consumers contends that these are not minor edits, but it does not address each recommendation individually. Consumers offers general criticisms of the proposed amendments, arguing that they are inconsistent with long-standing nature-of-service language, and urges the Commission to reject all of them. Consumers also argues that a proposal to increase the GSG-2 level from 100 kW to 2,000 kW is unjustified. This proposal does not appear to be part of the Staff's suggested amendments.

The proposed amendments not agreed to by Consumers are as follows:

(1) The Staff recommends that the GSG tariff specifically acknowledge that Rate GSG customers may take service under any of the utility's other tariffs, in which case the other tariff applies. Consumers does not specifically address this suggestion. The Commission approves this amendment.

(2) The Staff recommends that the GSG tariff specifically allow for various metering and data communications options. As the ALJ noted, this issue is currently being explored in the ongoing smart metering investigation (Case No. U-15183). This amendment is not approved at this time. The Commission will await the results of the investigation.

(3) The Staff recommends that the GSG tariff be amended to remove stipulations as to whether the customer will deliver single-phase or three-phase energy (which will be governed by interconnection standards). Consumers did not specifically address this point. The Commission approves this amendment.

(4) The Staff recommends that the GSG tariff be amended to remove stipulations as to monthly minimum charges, and to indicate that those charges, if any, should be as specified in the customer's otherwise applicable full service rate. The Commission approves this amendment.

(5) The Staff recommends that "availability" provisions in the GSG tariff should state that "standby charges for customers operating variable output, non-dispatchable generation will not be established based on the name-plate capacity of the customers' generators, but will be established in a manner approved by the MPSC that appropriately accounts for the generator(s) actual production and customer's actual consumption." Staff's replies to exceptions, pp. 13-14. Again, Consumers does not appear to have addressed this point. The Commission approves this amendment.

(6) The Staff recommends adoption of its administrative cost charge option for Rate GSG-2. The Commission approves this amendment.

(7) The Staff recommends adoption of its proposed power supply standby charges provisions for Rate GSG-2. The Commission approves this amendment.

(8) The Staff recommends adoption of its proposed delivery standby charges provisions for Rate GSG-2. The Commission approves this amendment.

The eight amendments agreed to by Consumers are also approved.

8. GAP Pilot Provision

Consumers proposes a 125 MW general aggregate peak (GAP) pilot program under which the utility offers to dedicate up to 115 MW of on-peak demand to its primary business class, and 10 MW to its secondary business class, so long as each customer meets certain conditions, including having at least 750 kW of average annual on-peak demand for primary service or 250 kW for secondary service, on each aggregated account. Consumers later agreed to Kroger's request to reduce the threshold for primary service on-peak to 250 kW for each account. With this modification, the ALJ recommended that the Commission authorize implementation of the GAP pilot provision. No party filed exceptions to this finding, and the Commission adopts the recommendation of the ALJ.

9. Discontinuance of the Transitional Primary Rate Tariff

The transitional primary rate (TPR) tariff was instituted in order to provide temporarily discounted rates to customers who were taking service under special contracts that were expiring on December 31, 2005. The TPR tariff is a rider that is applied as a credit adjustment to other rates. The TPR tariff was intended to shield those customers from rate shock upon their return to full service. *See,* December 22, 2005 order in Case No. U-14347, p. 78. The TPR tariff remains in effect until January 11, 2009, or until changed by a Commission rate order, whichever occurs first.

Consumers proposed eliminating the TPR tariff because, it argues, the need for the special rate is mitigated by the plan to deskew, and the Staff agrees. ABATE and Dow/Hemlock argued that the TPR tariff should be allowed to run its planned three year course, because the utility still seeks to increase base rates and rate shock is still a possibility.

In light of the proposed rate increase, the length of the rate alignment plan, and the fact that three years is a relatively short amount of time for adjusting facilities and processes, the ALJ recommended that the Commission allow the provision to remain in effect until January 11, 2009, as originally planned.

The Staff takes exception to this recommendation. The Staff points out that the TPR tariff sheet (Original Sheet No. D-127.00) states, "This rate commences January 11, 2006 and remains in effect for three years or until changed by a Commission rate order whichever occurs sooner." The Staff argues that this language indicates that the TPR tariff terminates whenever the Commission issues a rate order for Consumers prior to January 11, 2009. The Staff maintains that this language envisions that the Commission will set just and reasonable rates for all similarly situated C&I customers as part of the new rate order, so the TPR tariff becomes unnecessary.

Consumers also takes exception to the ALJ's recommendation, and adds that if the TPR tariff remains in effect through 2008, the test year revenue deficiency must be increased by the remaining portion of the annualized amount of $14.8 million that the company is allowed to recover for the discount. *See,* 6 Tr 271, 274; Exhibit A-64. Consumers argues that the proponents of the TPR tariff no longer need discounted rates in light of the proposal to eliminate rate class subsidies.

In reply, Dow/Hemlock argues in favor of the PFD. Dow/Hemlock points out that Consumers is proposing an overall rate increase, and argues that the special rate is therefore still needed to mitigate rate shock. Dow/Hemlock points out that cost of service based rates are still a long way off.

The Commission agrees with the Staff that with the issuance of this final rate order, the TPR tariff should terminate. While the tariff language does not require the Commission to terminate the rate simply because a rate order is issued, the Commission finds that the rate has served its purpose over the two and one-half years that it has been in effect, and the new rates that will result from this order are just and reasonable for those customers that were on special contracts three years ago. Any rate shock that may have occurred as a result of an abrupt change to full service rates has been mitigated by the passage of time and the corresponding opportunity for affected companies to adjust their operations. The TPR tariff terminates effective with the issuance of the Commission's order adopting rates resulting from this order.

10. General Service Primary Demand System Access Charge

The ALJ recommended that the Commission authorize Consumers to institute the proposed system access charge that will replace the existing customer charge for those taking service on the rate schedules that are being consolidated into the new General Service Primary Demand (GPD) rate. Consumers proposed a charge of $400. The ALJ recommended adoption of the Staff's proposed charge of $509, which is based on the COSS prepared by the Staff's expert witness. No party filed exceptions to this finding. Although there were no exceptions, the Commission finds that it is reasonable to rely on the company's expertise concerning its needs, and approves the charge based on Consumers' own proposal of $400.

11. General Educational Institution Credit

Consumers proposed to offer to C&I customers a per kWh credit to be applied to all electricity consumed by an educational institution, defined as any public or private building or facilities used for the sole purpose of educating children grades K-12 and adults at the community college or university level. This credit would be available to all current ROA and full service customers in Consumers' service territory. The credit is computed by finding the difference between the average cost per unit of the customers within the general rate class and that of the corresponding educational institution as shown in the utility's COSS.

The Staff advocated adoption of its proposed GEI credit instead (using the Staff's COSS), and Consumers agreed.

The ROA intervenors objected to the credit, arguing that it would be discriminatory and confusing to offer the credit to schools but not to commercial enterprises with the same electric use patterns, and that the credit conflicts with cost based pricing.

The ALJ found that education is an investment in human capital that benefits all Michigan residents and businesses. The ALJ recommended that the Commission adopt the GEI credit.

The ROA intervenors take exception to this recommendation. They argue that the fair and non-discriminatory way to reduce school electric bills is through use of a seasonal rate. They argue that a seasonal rate will provide the same discounts and benefits to all customers with the same usage characteristics (such as low usage during summer peak periods). The ROA intervenors contend that the GEI credit violates MCL 460.557(4), which requires the Commission to set equal rates for "like contemporaneous service rendered under similar circumstances and conditions."

The ROA intervenors further contend that traditional ratemaking principles were not used in calculating the GEI credit, which, they state, will cost non-participant customers almost $19 million. They state that ROA service is currently provided to about 24% of school load. They argue that Consumers is simply engaging in anti-competitive tactics because the new discounted rate will lure customers away from ROA service. The ROA intervenors further object to the calculation of the rate because retail rates are made on a marginal cost basis, while the discount is being offered on an embedded cost basis. They maintain that their witnesses discredited the manner of computing the discount, and no rebuttal was offered to their testimony.

In reply, Consumers argues that the GEI credit makes sense because "providing assistance to such an endeavor is justified in a manner similar to the way in which economic development rates are used to attract new business to the state." Consumers' replies to exceptions, p. 36.

In reply, Energy Michigan again argues for seasonal rates and points out that pending legislation is likely to address this issue.

The Commission agrees with the ALJ and the Staff, and adopts the GEI credit.[17] As the ALJ correctly pointed out, investment in education has untold benefits for the state. The method for calculating the credit simply recognizes the fact that schools demand less energy during peak times

[17] The GEI credit, along with other rates, will require recalculation as a result of the Commission's decision on rate realignment.

and therefore should see a corresponding discount. The Commission finds that present economic circumstances warrant the provision of this form of assistance to educational institutions.

12. General Economic Development Provision

Consumers proposes to eliminate an existing economic development rate and replace it with a general economic development (GED) rate that would be available to all business customers. Under the proposed GED rate, any customer that adds at least 1 MW of new demand and maintains at least 75% of that new demand over a five year period would receive a credit to its base rates in diminishing percentages over the following five years. The objective of the rate is to promote long term investment in Michigan.

The Staff, Dow/Hemlock, and ABATE[18] supported the proposal. Dow/Hemlock noted that the GED rate will not result in any new subsidy as long as the new load's resulting rate recovers the incremental cost of providing that additional service. ABATE argued that the rate is only needed until cost of service based rates are accomplished.

The ROA intervenors raised the same concerns as were raised with respect to the GEI credit. They argued that the rate conflicts with cost of service principles, and could be abused by a customer who simply switches fuels or replaces an old process. Kroger also opposed the provision as simply creating another subsidy.

The ALJ recommended that the Commission approve the GED rate. The ALJ found that it constitutes a reasonable incentive for the expansion of business in Michigan over the long term, and will operate more quickly and easily than the special contract process. The ALJ further recommended adoption of language providing that the GED rate would not apply to fuel switching or process replacement situations.

[18]In its replies to exceptions, ABATE notes that it supports NEMA's positions on deskewing, rate GEI, rate GED, line loss, and access to customer billing information.

The ROA intervenors take exception to these recommendations. Like the GEI credit, they argue that the GED rate is discriminatory by treating customers within the same class and with the same usage rates differently. They maintain that it is unfair to require existing businesses to subsidize new competitors. The ROA intervenors assert that neither the Staff nor Consumers offered testimony or evidence to support the claimed benefits of the GED rate. They contend that the rate will not allow for recovery of the incremental costs incurred when new load begins to be served. They agree with ABATE that the GED rate, if adopted, should be phased out on the same schedule as the residential subsidy.

In reply, Consumers points out that the GED rate should result in added jobs in the state, which in turn will benefit other C&I customers through the "spending multiplier effect." Consumers' replies to exceptions, p. 37. Dow/Hemlock also supports the PFD, arguing that the Commission should continue to support job creation and business growth in Michigan. Dow/Hemlock points out that no party presented evidence showing that the proposed GED rate would result in new load being served at rates below its incremental costs. Dow/Hemlock asserts that any shortfall, in any case, is justified by the societal benefits accruing from economic growth.

The Commission agrees with the Staff and the ALJ, and approves the GED rate with the proviso that it will not apply to fuel switching or process replacement situations. The rate creates no new subsidy as long as the new load's resulting GED rate recovers the incremental costs of providing service. Even if there are isolated cases where it does not, the Commission is persuaded that the time is right for encouraging business development, job creation, and economic growth in Michigan. Economic development, particularly in the difficult economic times that we are currently experiencing in Michigan, is in the best interests of all ratepayers.

13. ROA Loss Adjustment

Line loss refers to the amount of power that is lost as electricity travels over transmission and distribution lines. Calculation and application of the line loss factor allow the utility to recover the costs associated with generation of electricity that never reaches the point of use. The ROA intervenors objected to the line loss factors proposed by Consumers for ROA customers, because they were higher than the factors proposed for full service customers, and because the ROA intervenors found the 2004 loss study (the most recent study) to be unreliable. The Staff supported Consumers' proposal, but stated their belief that the higher factor is applicable to all customers, not just ROA customers.

The ALJ recommended that the Commission authorize Consumers to rely on the 2004 loss study, and adopt the proposed line loss factor, albeit uniformly for all customers.

The ROA intervenors take exception to this recommendation. They argue that the 2004 study is not supported by the load forecast projections used in this proceeding, and there should be no increase in the loss factor. The ROA intervenors contend that the sudden rise in the factor should prompt the Commission to order further study of the issue.

In reply, Consumers supports the PFD.

The Commission adopts the findings and recommendations of the ALJ, and approves the use of the 2004 loss study for setting a uniform line loss factor for all customers.

14. Electric Space Heating Insulation Requirements

Consumers proposed to eliminate all residential space heating rates. In conjunction, Consumers proposes eliminating tariff language that sets forth insulation requirements that were prerequisite to receiving the residential space heating rate. MEC/PIRGIM opposed this proposal on grounds that it would be preferable to use this opportunity to mandate that Consumers file revised tariffs requiring all new home construction to meet applicable state and local building codes for energy efficiency as a prerequisite for receiving gas or electric service. The ALJ, noting that the record was devoid of evidence on the subject of what constitutes best practices and how they would be adopted and enforced, found that MEC/PIRGIM's proposal was overbroad and should be rejected, and recommended that the Commission authorize Consumers to delete the referenced language.

MEC/PIRGIM takes exception to this recommendation, arguing that rather than eliminating any tariff language that encourages the use of insulation, the Commission should require Consumers to revise its tariffs to promote energy efficiency. MEC/PIRGIM complains that new homes are being built in Michigan that will create "a long-term legacy of energy waste," and urges the Commission to use this proceeding as an opportunity to end this practice.

In reply, Consumers points out that there are many issues involved in MEC/PIRGIM's request, such as whether the Commission has the authority to impose building requirements on builders and homeowners, which are currently enforced by local building inspectors through building codes, not electric tariffs.

The Commission agrees with the ALJ that the language regarding insulation that was associated with the now defunct space heating tariff should be eliminated. There is no point in retaining the insulation requirement, when the tariff and its associated class of customers no longer exist. The Commission declines MEC/PIRGIM's offer to make sweeping changes to Consumers' tariffs designed to place some responsibility for ensuring compliance with Michigan's building codes on public utilities as not supported by the record.

15. Metal Melting Rate

As part of the movement towards cost based rates and simplification of tariffs, Consumers proposed to remove its furnace and metal melting rate (Schedule J and J-1), and include customers currently on those rates with other industrial customers. Consumers proposed to close the existing discount to new customers, and to offer a credit to existing customers that would extend until the company's next general rate case. The credit would be a $4.33/kW discount from the on-peak billing demand rate and a $0.67/kW discount from the maximum demand rate.

The Staff supported the proposal. No party to the case opposed the proposal. The ALJ characterized the proposal as non-controversial, and no exceptions addressed this issue. PFD, p. 105.

After issuance of the PFD, the Commission received three letters, two from metal melters and one from the Foundry Association of Michigan (docket item nos. 497, 498, and 501), expressing opposition to the proposal. These entities indicate that the threat of global competition from subsidized foreign imports has put relentless pressure on U.S. foundries, and has made raw materials more costly. They point to the testimony of Consumers' witness indicating that the loss of the discounted rate would result in rate shock. *See,* 10 Tr 1459. They also point out that the Michigan Economic Development Corporation has worked diligently in the last three years to preserve the viability of Michigan foundries.

Consumers provided testimony indicating that according to the index of return in the company's COSS, the largest of the Schedule J rates (J-1 Trans, representing 68% of the revenue for this class) has an index of negative 29. 10 Tr 1459. This means that these customers are paying only a small fraction of what their service costs. Additionally, according to the Staff's calculations of the effect of Consumers' proposed rate design, four of the five metal melting rate classes that have customers in them would see their rates go down under the proposal, and the remaining class (J-1 Trans) would see a rate increase of 36.44%. Exhibit S-6, page 1(c) of 11. The credit proposed by Consumers substantially mitigates the rate increase. The Commission approves the new rate design. The Commission further approves the credit to mitigate rate shock; thus, this category of the industrial class will still not be paying its cost of service, but it will be substantially closer to this goal.

16. Power Efficiency Factor

Consumers proposed an adjustment for power efficiency factor (APF) that would impose an added charge for power factor levels less than 80%. The ALJ recommended rejection of this proposal. No party filed exceptions to this finding, and the Commission adopts the recommendation of the ALJ.

C. <u>ROA Tariff Issues</u>

1. Complete Billing Option

Consumers proposed to remove tariff provisions that allow an AES to contract with the utility to jointly bill ROA customers for generation and distribution, because this complete billing option (also known as the structured billing option) has never been used by any AES. The Staff and the ROA intervenors opposed this suggestion, on grounds that AESs may wish to make use of it in the future, particularly with residential customers. The ALJ agreed with the Staff and intervenors and recommended rejection of this proposal. No party filed exceptions to this finding, and the Commission adopts the recommendation of the ALJ.

2. Release of Customer Information

Consumers proposes to amend ROA Tariff Sheet F-5.00 to include language requiring written consent from a residential customer to the utility to provide his or her billing data to an AES.

Alternatively, the customer could provide the information by forwarding a copy of a utility bill to the AES. The Staff supported this proposal because it will serve to better advise all parties of a customer's right to privacy.

CNE and Energy Michigan objected to this proposal. They argued that there is no evidence that customer privacy is currently being compromised. They contended that all parties would benefit from making it easier, rather than more difficult, for customer billing information to flow between the utility and the AES.

The ALJ recommended that the Commission adopt the utility's proposal, finding that the protection of customer privacy outweighs the burden associated with requiring the customer to forward a copy of a recent electric bill to the AES.

CNE and Energy Michigan take exception to this recommendation. These intervenors argue that there have been no problems with the current rule, and that, absent a record of abuse, the Commission should not make the residential AES enrollment process more difficult. They argue that customer authorization should continue to be sufficient for release of billing records.

The Staff and Consumers filed replies in support of the PFD. Consumers contends that CNE has mistakenly characterized this proposal as a change to a current rule or an imposition of new burdens on AESs. Consumers states that the proposal is neither a revision to a current rule nor a change in past practice, but rather an attempt to codify the company's current practice of providing requested data to an authorized party or an authorized representative after the customer has provided the utility with written authorization to do so.

The Commission agrees with the ALJ and adopts the proposed tariff change. It will serve to put customers on notice of what is required in order for their individual billing information to be released to an AES. The Commission finds that the language simply mirrors what is already in practice and does not impose new burdens on AESs or utility customers.

3. Purchase of Receivables Program

As an adjunct to the complete billing option, NEMA proposes a purchase of receivables (POR) program that would require Consumers to purchase the receivables of AESs. NEMA contends that adoption of a POR program would eliminate the cost of credit checks and reduce other administrative expenses otherwise borne by AESs, and thus would help attract AESs to Michigan's residential ROA market, which, NEMA argues, is currently underserved. Energy Michigan and CNE support this proposal.

Consumers opposed the program. Consumers pointed out that bad debt allowance does not reflect real time recovery of uncollectibles, and its current annual uncollectibles already exceed the cost level built into base rates. Consumers argued that the proposal is simply a windfall for AESs.

The ALJ recommended adoption of NEMA's proposal, noting that bad debt expense is recovered from ROA and full service residential customers through the uniform distribution charge. The ALJ found that the POR program would pose little danger to Consumers' bottom line. The ALJ noted that the gas customer choice program includes both a complete billing option and a voluntary POR program. The ALJ found that the proposed POR program has the potential to increase the availability of ROA to residential and small commercial customers.

The Staff takes exception to this recommendation, finding that the POR program is untimely because no residential or small volume commercial customers are currently being served, and the choice program is under review by the Legislature. The Staff believes that the program should be considered in a more thorough manner at a future date.

Consumers also takes exception, arguing that the Commission cannot and should not require the company to act as a guarantor to the AESs of all residential customers' payment obligations. Consumers notes that the gas choice program was different in that it was voluntary. Consumers further contends that increasing uncollectibles expense for the residential class will serve to increase costs for that class at the same time that deskewing is occurring and power costs are rising. Consumers points out that neither it nor the Commission have control over the pricing and marketing plans of the AESs, and that a guaranty of payments may exacerbate inappropriate marketing strategies. Finally, Consumers contends that NEMA provided so little detail regarding the costs, benefits, and risks of the POR program that no real evaluation of the program is feasible. Consumers urges the Commission to reject the proposal.

In reply, Energy Michigan argues that growth of the residential and small commercial ROA market is hampered by the costs of credit verification, and collection and bad debt expense. Energy Michigan argues that ROA customers already pay a uniform distribution charge that covers bad debt expenses related to retail generation and distribution. Thus, Energy Michigan argues, the POR program would prevent ROA customers from paying this expense twice. CNE states that Illinois has recently taken the step of requiring electric utilities to establish tariffs that permit utilities to purchase the receivables of competitive retail electric suppliers, provide consolidated billing, and purchase two months of uncollectible receivables. CNE contends that the Staff did not present testimony or evidence opposing the POR proposal, and that Consumers has failed to identify what additional details are needed. NEMA asserts that the mere fact that residential participation in ROA is low is not a reason to reject a program designed to increase participation at no cost to the utility. NEMA states that POR programs have been successful in several states.

The Commission is not persuaded that implementation of a POR program is needed at this time. There are no residential ROA customers; thus it is disingenuous to argue that such customers are already paying bad debt expenses. The Commission agrees with the Staff, however, that the concept for such a program should be investigated more thoroughly in the future. The Commission encourages the parties to continue to explore this option.

4. Notice and Minimum Stay Provisions

NEMA asserted that the current return to full service provisions are overly burdensome on residential ROA customers, because they require a two-year minimum stay on ROA service, a 30-day advance notice to the utility to return, and a six-month advance notice to the utility in order to return to bundled service during the summer, with penalties for failure to comply with any of these provisions. Energy Michigan and CNE supported NEMA's proposal that, for residential customers, the notice and minimum stay rules be eliminated. The Staff also supported the proposal with the proviso that returning customers should stay with the utility for at least 12 months. Consumers opposed the proposal, arguing that the current notice and minimum stay rules allow for better supply planning.

The ALJ agreed that the current rules place an excessive burden on residential customers, who cannot be expected to be able to make long-range predictions of market conditions in the same way that C&I customers can. The ALJ recommends that the Commission approve NEMA's proposal to exempt residential customers from all notice and minimum stay provisions, and the Staff's proposal to require returning residential customers to remain on full service rates for at least 12 months. No party filed exceptions to these findings, and the Commission adopts the recommendations of the ALJ.

5. Customer Education Regarding Choice

NEMA advanced, and Energy Michigan, CNE, and the Staff supported, a proposal that the Commission stand ready to provide more information to residential customers regarding the choice program and the role of AESs, in light of the fact that ROA service may become more attractive to residential customers in the near future and they may begin receiving new offers from AESs. The Staff indicated that this could be done through the Commission's website, consumer alerts, mailed brochures, news releases, and community forums. No party opposed this proposal, and the ALJ recommended that the Commission adopt it.

NEMA and AARP both filed exceptions to the ALJ's recommendation and urge the Commission to take further steps to re-establish the funding mechanism for electric utilities and AESs to carry out an educational program for customers to provide information on the availability of choice, as was required by MCL 460.10r(2). NEMA argues that an order to stand ready to provide information is an order "without consequence," and urges the Commission to re-establish funding in the program that was authorized by the Commission under the statutory mandate in a series of orders in 2001 and 2002 in Case No. U-12133. AARP argues that Consumers and Detroit Edison never implemented any education program, and that the time is overdue for the Commission to properly carry out the statutory mandate.

The Commission finds that it is not appropriate at this time to revive the customer education program previously commenced in Case No. U-12133; however, the Commission agrees with the Staff, the ALJ, and the ROA intervenors that the Commission should stand ready, utilizing those avenues described by the Staff, to provide information as necessary regarding ROA to the public, and, in particular, to residential customers who may become increasingly interested in the ROA program in the near future.

6. Balancing and Energy Delivery Requirements

NEMA proposed that ROA tariffs should be amended to require Consumers to provide AESs with all current balancing and energy delivery requirements data, either when the AES enters the market or when requirements change. Energy Michigan and CNE supported this proposal. The Staff opposed it, arguing that AESs already have access to this information through either the usage data printed on a customer's monthly bill or a customer's request to the utility for a copy of its historical usage data.

The ALJ recommended approval of NEMA's proposal. The ALJ found that provision of demand profiles to AESs would serve to protect AESs from penalties for mismatches, and would follow the process used by Detroit Edison. The ALJ recommended that the Commission direct Consumers to include within its ROA tariffs a provision requiring the utility to provide AESs with all current balancing and energy delivery requirements data either when the AES enters the competitive residential electric market or when the requirements change.

Consumers takes exception to this recommendation, arguing that the Staff has shown that AESs already have access to this information. Consumers points out that the "aggregate data is already available from end-use customers on an individual basis via various means, or on an aggregate basis." Consumers' exceptions, p. 88.

In reply, the ROA intervenors argue that it is not possible to estimate residential customer demand, as a class, through reference to a few individual residential billings, even if those billings have historical usage data. They contend that only actual demand profiles, or the estimated profiles that are used by Consumers itself, can provide an AES with the information necessary to schedule generation in an accurate and timely way. They further contend that Consumers should encourage AESs to avoid imbalances because they can cause either excess or inadequate deliveries. The ROA intervenors point out that Consumers has not posed any administrative objection to providing the information, but merely argues that it is unnecessary.

The Commission agrees with the ALJ and approves NEMA's proposal. Provision of demand profiles to AESs will prevent imbalances and serve to protect AESs from penalties for mismatches between energy deliveries and actual ROA customer consumption. The Commission directs Consumers to include within its ROA tariffs a provision requiring the utility to provide AESs with all current balancing and energy delivery requirements data, to an individual AES that newly enters the competitive residential electric market, and to all AESs when the requirements change.

7. Shut Off Notification

Consumers is currently required to provide an AES with a 10-day prior written notice before shutting off an AES's customer for nonpayment. Consumers proposed to modify this tariff requirement to state that the utility need only notify the AES after the ROA customer has been shut off. The ALJ recommended rejection of this proposal on grounds that it could cause serious operational problems and pose a financial danger to AESs. No party filed exceptions to this finding, and the Commission adopts the recommendation of the ALJ.

8. Electronic Data Interchange Enhancement

Energy Michigan urged the Commission to order Consumers to implement enhanced electronic data interchange (EDI) capability, in order to facilitate the exchange of electronic data between the utility and the AESs. The ALJ recommended rejection of this proposal, on grounds that the utility is in the process of implementing a new integrated electronic system, including the replacement of ROA platforms, that may address the AESs' concerns. No party filed exceptions to this finding, and the Commission adopts the recommendation of the ALJ.

9. Metering and Telephone Requirements

Energy Michigan and CNE urged the Commission to require Consumers to adopt the same metering and telephone requirements as are currently in use by Detroit Edison as a result of the collaborative process undertaken in Case No. U-13808. The ALJ recommended rejection of this proposal on grounds that Consumers has already announced plans to begin implementation of an advanced metering infrastructure (AMI) system in 2008, and that it did not make sense to simply import Detroit Edison's requirements into Consumers' ROA tariffs. No party filed exceptions to this finding, and the Commission adopts the recommendation of the ALJ.

10. Separate Meter Requirement for Rate E-1

Dow/Hemlock suggested adding language to Consumers' proposed primary service open access rate (Rate ROA-P) that specifically recognizes that customers using Rate E-1 (the economic development rate) are excluded from the separate metering requirement that otherwise applies to all ROA customers. Hemlock Semiconductor (HSC) is Consumers' only Rate E-1 customer, and no other customer is eligible for the rate at this time.

The Rate E-1 tariff gives the customer the option of setting its base usage by contract. HSC has contractually established base usage levels. HSC does not currently take ROA service for either its base usage or its Rate E-1 service. However, if it took ROA delivery for either service, HSC contends that it should not be required to install a second meter. Because base usage amounts are established by contract, Dow/Hemlock argues that there is no need to incur the costs of separately metering base usage. Dow/Hemlock contends that the utility's proposed language constitutes an impediment to competition, and that the proposed ROA-P tariff should be amended to add the sentence, "Separate metering is not required for any customer receiving service pursuant to Rate E-1." ABATE supported the proposal.

Consumers and the Staff opposed the proposal. They contended that separate metering is necessary to ensure against cost-shifting, and is essentially required by MISO in order to measure the amount of energy provided to the customer, and to allow for reporting of the customer's actual aggregated load on an hourly basis to MISO.

The ALJ recommended that the Commission adopt Dow/Hemlock's proposal. The ALJ found that, under HSC's existing situation, all possibility for cost shifting is eliminated by the fact that the AES would deliver a flat, fixed amount of power every hour of every day. The ALJ found that the single meter located at the customer's facility would be sufficient to determine the amount of usage that would be billed at Rate E-1 (rather than the contractual rate), where the base usage is a known quantity. The ALJ recommended that the Commission direct the utility to include, as part of Rate ROA-P, the sentence, "Separate metering is not required for any customer receiving service pursuant to Rate E-1, so long as the customer maintains a contractually-established level of base usage described on both a demand and energy basis."

Consumers takes exception to this recommendation. Consumers contends that the ALJ failed to consider the potentially adverse effect that a shared meter could have on the utility's power supply costs and the utility's ability to comply with the requirements of MISO's FERC-approved tariff. Consumers argues that the additional sentence may be sufficient to protect the utility from cost shifting in situations where the utility provides both the existing base usage service and the Rate E-1 service, but will not protect the utility when an AES provides the base usage and Consumers provides the Rate E-1 service. Consumers asserts that separate meters will prevent customers from allocating more energy consumption to the utility when market prices are high and to the AES when market prices are low.

Consumers contends that, recognizing the potential for disputes, MISO requires market participants to utilize separate meters. MISO processes require hour-by-hour scheduling and delivery information that is used in the reconciliation process. Consumers asserts that without separate metering this will not be possible. For example, Consumers contends, without a separate meter, the ROA supplier may claim to deliver the base service during off-peak or other low cost hours, allowing the ROA supplier to game the market and shift costs to full service customers. Consumers further asserts that it "is not currently possible to have MISO base its billing and settlement process on a combination of metered and estimated values." Consumers' exceptions, p. 91.

In reply, Dow/Hemlock states that Rate E-1 already contains an unambiguous exception to the separate metering requirement of Rate ROA-P. The current Rate E-1 states that load may be measured either by separate metering or by establishing a kWh base, and that customers "may choose to have the new load separately metered." Eighth Revised Sheet No. E-30.00. Dow/Hemlock explains that Consumers currently bills HSC for the base usage that is contractually established under Rate F with a TPR adjustment, and all energy above that amount is billed at Rate E-1. Dow/Hemlock asserts that the separate metering requirement is an arbitrary and costly barrier to competition. Dow/Hemlock contends that Consumers has failed to explain how HSC's delivery arrangement could allow for the alleged cost shifting.

Dow/Hemlock further asserts that the lack of a second meter will not cause billing problems. Dow/Hemlock maintains that a single meter currently establishes HSC's total usage, and that the contractually established base usage amount is billed at one rate, and all remaining power is billed at Rate E-1, with no problems. Dow/Hemlock asserts that there are no estimates involved in the billing process, although, they point out, MISO routinely accepts estimated values in its settlement process. Dow/Hemlock also points out that its relevant metering information, for MISO reporting purposes, is aggregated at the transmission level; and that Consumers provides no citation to any MISO authority for its position.

The Commission agrees with the ALJ and approves Dow/Hemlock's proposal. HSC currently operates with a single meter on two separate rates, and the Commission fails to see why this operation will not continue to work if HSC chooses to have either part of its service provided by an AES. There is no need to meter a contractually fixed amount of power, and the Commission is not persuaded that the second meter is required by MISO. Consumers is directed to include in its Rate ROA-P, "Separate metering is not required for any customer receiving service pursuant to Rate E-1, so long as the customer maintains a contractually-established level of base usage described on both a demand and energy basis."

11. Return to Service

Consumers proposed to amend Rule F2.5(c) to clarify that only the customer may initiate its return from ROA service to full service. No party opposed this proposal and the ALJ recommends its adoption. The Commission agrees.

D. Rate Implementation Issues

In its exceptions, Consumers indicates that, due to the ongoing overhaul of its computer system, the company may not be able to implement all aspects of the rate design that results from this order, and the company will work with the Staff on transitional solutions, until final rates can be implemented.

In reply, the Staff urges the Commission to direct Consumers to assess the approved rates in a manner consistent with the terms of this order, and to inform customers when the amount charged on the customer's bill is not consistent with the order, and that an adjustment to the correct amount will be effected as soon as possible.

The Commission agrees with the Staff's suggestions. The Commission is well aware of Consumers' ongoing Comprehensive Enterprise Application (CEA) initiative that will replace the utility's existing core business processes and information technology, which should bring with it a vast improvement in customer service. The CEA initiative began in 2005 and is "scheduled for production installation in January 2008." 8 Tr 924. While the Commission is mindful that this is a long and complex process involving the company's entire information technology system, the Commission continues to expect the company to provide the same level of customer service during the transition period that has been provided historically, including implementing redesigned rates in a reasonable time period. Any charges to customers resulting from this order that cannot be implemented during the transition to the new billing system shall not accrue during that time, and shall be implemented no later than December 1, 2008. Customer credits resulting from this order that cannot be implemented during the transition shall accrue with interest during that time, and shall be implemented no later than December 1, 2008. The company shall provide information detailing these credits, the reason for their accrual, and the mechanism for their accrual and ultimate payment with interest to all affected customers within 30 days of the Commission's order approving Consumers' transitional tariffs.

Consumers shall redesign rates using the Staff's COSS. Consumers shall file two sets of rates and modified tariff sheets, one showing transitional rates and one showing final rates, by June 13, 2008. These tariff sheets shall conform to the Commission's findings in this order. At the same time, the company shall serve copies of its new transitional and final rates and tariff sheets on all parties to this proceeding. Intervenors may file comments on the filed rates and tariff sheets by

June 17, 2008. The Commission will issue an order indicating the effective date of the transitional tariffs following a review and acceptance of the rate schedules and revised tariffs.

X. Miscellaneous Issues

A. Satisfaction of Filing Requirement

In its December 22, 2005 order in Case No. U-14347, the Commission directed Consumers to file an electric rate case, including a full cost of service study, no later than July 1, 2008 based on operating data from calendar year 2007. (Order, p. 91). Consumers contended that the filing of this case satisfied that filing requirement and thus eliminates any need for an additional filing by July 1, 2008. Noting no objection to this proposal, the ALJ agreed and recommended that the Commission find that the filing requirement was satisfied. The Commission agrees and finds that Consumers satisfied the filing requirement from the December 22, 2005 order in Case No. U-14347.

B. Ludington Decommissioning Trust

As part of a settlement with various state and federal agencies over fish mortality issues relating to the Ludington pumped storage plant, Consumers agreed to perform and file with the FERC, a Ludington End State Study addressing various alternatives. The settlement further directed Consumers to include, in its first general rate case following completion of that study, costs related to the establishment of trust funds to recover from ratepayers future expenses arising from (1) permanent nonpower operation; (2) partial project removal; or (3) complete project removal.

Consumers stated that the FERC has not yet addressed the alternatives in the Ludington End State Study and that it would therefore be premature to consider establishment of a Ludington trust at this time. The ALJ agreed and recommended that consideration of this issue should be deferred to a future rate case. There was no objection to this recommendation. The Commission therefore adopts the ALJ's recommendation and defers consideration of the establishment of a Ludington trust.

C. Residential Billing Rules Implementation Costs

Consumers briefly mentioned that it did not include any costs associated with the implementation of the revised Consumer Standards and Billing Practices for Electrical and Gas Residential Service approved in the October 26, 2007 order in Case No. U-14851 and estimated that the cost to implement the revised rules would be over $4 million. Consumers requested that the Commission authorize deferral of these costs. In response, Dow/Hemlock argued that the Commission should make clear that any costs associated with residential rules should be collected from residential customers only.

The ALJ found that this issue was not ripe for decision and recommended that it be deferred until a future proceeding. The Commission agrees and adopts the ALJ's recommendation.

THEREFORE, IT IS ORDERED that:

A. Consumers Energy Company is authorized to increase its annual electric revenues by $27,468,600 as directed by this order.

B. The $69,500,000 surcharge authorized by the December 18, 2007 order for costs associated with the purchase of the Zeeland Generating Station shall be terminated effective the date of the rate increase approved by this order.

C. The pension and other post-employment benefits trackers authorized in Case No. U-14347 shall be terminated effective the date of the rate increase authorized by this order.

D. Having removed all costs associated with owning and operating Palisades Nuclear Power Plant from base rates, Consumers Energy Company shall longer implement the power supply cost recovery crediting mechanism effective the date of the rate increase authorized by this order.

E. Consumers Energy Company shall file a final Palisades Nuclear Power Plant reconciliation within 30 days of the date of issuance of this order. The reconciliation shall address final amounts of transaction costs, identify all decommissioning and other funds relating to Palisades, compute interest on amounts subject to refund, and set forth a computation of a negative surcharge to spread the refund over nine months.

F. Transaction costs associated with the sale of the Palisades Nuclear Power Plant in the amount of $26,497,319 were reasonably and prudently incurred and shall be netted against the remaining sale proceeds to be distributed to all customers, except customers taking service under Rate E-1, after the final reconciliation.

G. Consumers Energy Company's proposed Electric Choice Incentive Mechanism is approved.

H. Consumers Energy Company shall file an application for a reconciliation of all Big Rock Point related transactions, including a review of transactions costs and decommissioning costs and revenues by October 1, 2008.

I. Consumers Energy Company shall redesign rates using the Commission Staff's cost of service study as rerun by the Commission Staff's consultant to reflect changes resulting from this order.

J. Consumers Energy Company shall file two sets of rates and modified tariff sheets, one showing transitional rates and one showing final rates, by June 13, 2008, and shall serve copies of the new transitional and final rates and tariff sheets on all parties to this proceeding on that date.

These rates and tariff sheets shall conform to the Commission's findings in this order. Intervenors may file comments on the filed rates and tariff sheets by June 17, 2008.

K. Any charges to customers resulting from this order that cannot be implemented during the transition to the new billing system shall not accrue during that time, and shall be implemented no later than December 1, 2008. Customer credits resulting from this order that cannot be implemented during the transition shall accrue with interest during that time, and shall be implemented no later than December 1, 2008. The company shall provide information detailing these credits, the reason for their accrual, and the mechanism for their accrual and ultimate payment with interest to all affected customers within 30 days of the Commission's order approving Consumers' transitional tariffs.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, under MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

Orjiakor N. Isiogu, Chairman

Monica Martinez, Commissioner

Steven A. Transeth, Commissioner

By its action of June 10, 2008.

Mary Jo Kunkle, Executive Secretary

P R O O F   O F   S E R V I C E

STATE OF MICHIGAN)

Case No. U-15245

County of Ingham)

E. David Lechler being duly sworn, deposes and says that on June 11, 2008, A.D. he served a copy of the attached Commission order by first class mail, postage prepaid, or by inter-departmental mail, to the persons as shown on the attached service list.

E. David Lechler

Digitally signed by E. David Lechler
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Date: 2008.06.11 10:59:51 -04'00'

E. David Lechler

Subscribed and sworn to before me
this 11th day of June 2008

Sharron Allen

Digitally signed by Sharron Allen
DN: cn=Sharron Allen, c=US, o=MPSC, ou=Exec. Sec. Section, email=allens1@michigan.gov
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Sharron A. Allen
Notary Public, Ingham County, MI
My Commission Expires August 16, 2011

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DATE OF PREPARATION: 06/11/2008

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