



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

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

ERIC J. SCHNEIDEWIND

E-MAIL ejschneidewind@varnumlaw.com

April 1, 2009

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

Re: Case No. U-15744

Dear Ms. Kunkle:

Attached for paperless electronic filing is Direct Testimony of Alex J. Zakem on Behalf of Energy Michigan. Also attached is the original Proof of Service indicating service on counsel.

Thank you for your assistance in this matter.

Very truly yours,

VARNUM, RIDDERING, SCHMIDT & HOWLETTLLP

Eric J. Schneidewind

EJS/mrr

cc: ALJ
parties

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
pursuant to Section 10a(16) of)
Public Act 286 of 2008 for Revisions)
to Stranded Cost Recovery Surcharges)
_____)

Case No. U-15744

DIRECT TESTIMONY
OF
ALEXANDER J. ZAKEM
ON BEHALF OF
ENERGY MICHIGAN

ALEXANDER J. ZAKEM
DIRECT TESTIMONY

Q. Please state your name and business address.

1 A. My name is Alexander J. Zakem and my business address is 46180 Concord,
2 Plymouth, Michigan 48170

3 **Q. On whose behalf are you testifying in this proceeding?**

4 A. I am testifying on behalf of Energy Michigan.

5 **Q. Please state your professional experience.**

6 A. Since January of 2004 I have been an independent consultant providing services
7 to Integrys Energy Services, Inc., Quest Energy (a wholly-owned affiliate of Integrys
8 Energy Services), and other clients. Integrys Energy Services is a member of Energy
9 Michigan.

10

11 From March 2002 to December 2003, I was Vice President of Operations for
12 Quest. My responsibilities included the overall direction and management of Quest's
13 power supply to its retail customers. This included power supply planning, development
14 of customized products, negotiation with suppliers, planning and acquiring transmission
15 rights, and scheduling and delivery of power. It also included managing risk with respect
16 to market price movements and variation of customer loads.

17

18 Prior to retiring from Detroit Edison in 2001, from 1998 I was the Director of
19 Power Sourcing and Reliability, responsible for purchases and sales of power for mid-
20 term and long-term periods, planning for generation capacity and purchase power needs,

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1 strategy for and acquisition of transmission rights, and related support for regulatory
2 proceedings.

3
4 Additional experience, qualifications, and publications are contained in Exhibit
5 EM-1 (AJZ-1).

6
7 **Q. Have you testified as an expert witness in prior proceedings?**
8 A. Yes. I have testified as an expert witness in several proceedings before the
9 Michigan Public Service Commission (“Commission”), on topics such as standby rates,
10 retail rates and regulations, and the effects of rate restructuring. I have also testified
11 before the Federal Energy Regulatory Commission. Case citations are in Exhibit EM-1
12 (AJZ-1).

13 **Q. What is the purpose of your testimony?**
14 A. The purpose of my testimony is to recommend a design of a charge for the
15 collection of Consumers Energy’s (“Consumers”) remaining 2002 and 2003 stranded
16 costs, including interests, in accordance with the specifications of PA 286.

17
18 **Q. Have you formed an opinion on a reasonable and proper charge?**
19 A. Yes, I have.

20

ALEXANDER J. ZAKEM
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1 **Q. What is the design of the charge that you are recommending?**

2 A. I recommend that the Commission replace the current surcharge on ROA
3 customers with a surcharge applied equally to all Consumers distribution customers on a
4 per-kWh basis of sufficient magnitude to recover the remaining stranded costs and
5 interest within the five-year time period required under PA 286.

6

7 **Q. Upon what do you base your opinion?**

8 A. My opinion is based on the consideration of three factors:

9

1. Main elements of rate design.

10

2. The fact that the current surcharge has proven to be unworkable in complying
with PA 286.

11

12

3. Given the findings in 1 and 2 above, equitable treatment of Consumers
customers.

13

14

15 **Q. Would you explain how the elements of rate design affect the determination**
16 **of a reasonable and proper surcharge?**

17 A. There are three main elements to consider. I will explain how each applies to the
18 current situation of recovery of past stranded costs.

19

20 a. *Does the design or charge collect the required revenue?* This is a simple standard
21 to apply, because the magnitude of a surcharge needed to collect the required
22 revenue within the specified five-year time period can be readily calculated.
23 Consumers illustrates the calculation in its Exhibit A-2 in this proceeding.

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1 Further, because a surcharge based on kWh use over a future period is subject to
2 under-collection or over-collection if the actual kWh use is different from the
3 forecast, a reconciliation, as proposed by Consumers, assures that the exact
4 amount intended to be collected is actually collected.

5
6 b. *Does the design or charge apportion the burden of payment reasonably fairly on*
7 *the customers who benefit from the services?* In the situation of recovery of past
8 stranded costs, the collection of money is not for services currently being
9 provided to customers, but rather is just the collection of a fixed quantity of
10 dollars. Thus, the issue of fair cost apportionment is moot.

11
12 c. *Does the design or charge send the proper price signals, that are consistent with*
13 *economically justifiable, but not uneconomic, use?* In this situation of recovery of
14 a fixed quantity of dollars, there are no energy use characteristics – incentives or
15 disincentives – that the design of the surcharge is expected to achieve.

16
17 As a result of considering the above three elements, my conclusion is that, in the
18 absence of any basis to allocate costs or to design price signals, the remaining concern is
19 only the equitable apportionment of monies to be collected. Therefore, an equal
20 surcharge spread over all of Consumers customers is the most logical, if not the only
21 reasonable, approach. There are no cost allocation principles to be followed, and
22 likewise no production pricing incentives or disincentives to be considered. The
23 controlling element of rate design is simply to collect the total dollars.

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The surcharge could be either a per-kWh charge or it could be a percentage adder to the distribution charge. The percentage adder has the disadvantage of being less accurately forecastable because the amount collected would be affected by not only the amount of energy use but also by any change in distributions rates, which over a five year period is quite possible. Therefore, a per-kWh surcharge is the preferred method.

Q. In what way is the current surcharge not compliant with PA 286, and how does that affect your recommendation?

A. Continuation of the current surcharge will not collect the required amount of money in the required five-year time period. The fact that the current surcharge is unworkable is an important consideration. Given an unworkable current charge, the question for the Commission therefore becomes: Since the current method will not work, what method should be instituted that does work? The only purpose of the current surcharge is to collect money. There is nothing else that has to be “preserved” by continuing the current surcharge – if that is not working as intended, then another, different method can be implemented. In essence, the Commission has the ability to start with the proverbial “clean sheet of paper” to implement a charge that will work for all customers.

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1 **Q. You have testified that the design element is simply to collect the total desired**
2 **money and that the fact that the current surcharge is not working allows the**
3 **Commission to implement a new design for the collection. How do these findings**
4 **affect the design of an equitable charge to recover the desired money?**

5 A. Designing a charge to collect a fixed sum of money from customers – unrelated to
6 services provided – is a straightforward decision. Since no one customer is responsible
7 for any more or less than any other customer, based on relative use characteristics, the
8 only logical method of allocation that remains is an equal charge that affects all
9 customers relatively the same. As noted previously, this could be either an equal per-
10 kWh charge or an equal percentage adder. The equal per-kWh charge is the better of the
11 two, for reasons also noted previously.

12
13 **Q. Have you calculated the value of the required equal surcharge?**

14 A. The required surcharge depends on several assumptions, such as sales levels,
15 discount rate, and time period of collection. I am not rendering an opinion on these
16 assumptions. I have not made a separate exact calculation, however for comparison I
17 have made an estimate based on the assumptions in the Consumers Energy Exhibit A-2,
18 page 2 of 3. The estimated equal surcharge is \$0.000724 per kWh, compared to
19 Consumers Energy's proposal of \$0.000666 for bundled customers and \$0.001866 for
20 ROA customers.

21

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1 **Q. What method did you use to estimate the equal surcharge?**

2 A. Looking at the three-year period over which Consumers Energy proposes its
3 surcharges, I calculated the proposed direct revenue from the bundled customers as
4 approximately \$70.7 million and from ROA customers at approximately \$10.1 million,
5 for a total of approximately \$80.8 million collected. Total sales from both bundled and
6 ROA customers were approximately 111,568,000 MWh. Dividing \$80.8 million by
7 111,568,000 equals \$0.724 per MWh, equivalent to \$0.000724 per kWh as an equal
8 surcharge.

9

10 **Q. So, would your recommended equal surcharge replace the Consumers**
11 **Energy proposal?**

12 A. Yes. Under my recommended equal surcharge, the Consumers Energy proposal
13 of \$0.000666 per kWh for bundled customers and \$0.001266 for ROA customers would
14 be replaced by a surcharge of approximately \$0.000724 per kWh applied to both bundled
15 and ROA customers.

16

17 **Q. Could not the Commission continue the current surcharge of \$0.0012 per**
18 **kWh that applies only to Retail Open Access (ROA) customers?**

19 A. The logic of continuing the current surcharge on ROA customers would be that
20 the Commission, based on evidence and orders in previous cases, has determined that
21 current ROA customers' "fair share" of 2002 and 2003 stranded costs has already been
22 decided -- \$0.0012 per kWh – and should not change. Consequently, at this point the
23 remaining decision at hand would be the "fair share" of customers *other* than current

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1 ROA customers, such that total 2002 and 2003 stranded costs are recovered in
2 compliance with PA 286. While continuing the current charge to ROA customer is not
3 my recommendation from a rate-making perspective, from the Commission's regulatory
4 perspective it can be tied to previous findings.

5
6 **Q. If the Commission were to decide to maintain the current charge of \$0.0012**
7 **to ROA customers, should some portion of the additional charge necessary to**
8 **recover 2002 and 2003 stranded costs in five years also be assessed to ROA**
9 **customers?**

10 A. No. Neither from a rate-making perspective nor from a regulatory perspective
11 would this make sense. One has to decide first whether or not the current charge of
12 \$0.0012 is the appropriate share for ROA customers. If the Commission determines the
13 current charge is the appropriate share – for example, based on previous findings – then
14 nothing more should be added – the ROA “fair share” as determined by the Commission
15 continues to be the ROA “fair share.”

16
17 If the current charge is thrown out as unworkable, then from a rate-making
18 perspective an equal surcharge to all customers is the most logical outcome, based on the
19 reasons I have explained previously in my testimony.

20

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DIRECT TESTIMONY

1 **Q. At present, there is a “differential” between what is paid for 2002 and 2003**
2 **stranded costs by ROA customers – which is \$0.0012 per kWh – and what is paid by**
3 **Consumers bundled customers – which is zero. Should this differential be**
4 **maintained?**

5 A. Maintaining a “differential” merely for the sake maintaining a differential in this
6 situation is completely backwards. The surcharge to ROA customers was not put into
7 place to establish a “differential.” It was put into place to collect money from ROA
8 customers. Thus, the differential itself is merely the result of a charge placed on ROA
9 customers – the differential is a *consequence*, not an intended remedy for some,
10 unspecified problem. Preserving a consequence makes sense only if the consequence is
11 the intended remedy for another problem and that problem continues to exist, and I do not
12 see those circumstances applicable to the present situation of collection of 2002 and 2003
13 stranded costs.

14
15 **Q. Does this conclude your Direct Testimony?**

16 A. Yes, it does.

17

18

ALEXANDER J. ZAKEM

**46180 Concord
Plymouth, Michigan 48170
734-751-2166
ajzakem@umich.edu**

CONSULTANT – MERCHANT ENERGY AND UTILITY REGULATION

Provide strategies and technical expertise on competitive market issues, transmission issues, state and federal regulatory issues involving the electricity business, and associated legal filings. Scope includes the Midwest ISO Energy Market and Resource Adequacy, FERC proceedings on the elimination of transmission charges across transmission seams, state rules for competitive supply, and negotiation of settlements.

PRIOR POSITIONS: Quest Energy, LLC – a subsidiary of Integrys Energy Services

Vice President, Operations

March 2002 to December 2003

Responsible for the planning, acquisition, scheduling, and delivery of annual power supply and transmission, to serve competitive retail electric customers.

- **Power Planning** -- Designed and negotiated customized long-term power contracts, reducing power costs and exposure to spot energy prices.
- **Transmission** -- Revamped transmission strategy, reducing transmission costs.
- **Load Forecasting** -- Instituted formal short-term forecasting process, including weather normalization, reducing excess power purchases.
- **Risk Management** -- Developed summer supply strategy including call options to minimize physical supply risk at least cost. Instituted probabilistic assessment of forecast uncertainty to minimize transmission imbalance costs.
- **Contract Management** – Negotiated and recovered liquidated damages for power supply contracts. Included cost of transmission losses into customer contracts.
- **Operations Capability** -- Expanded the Operations staff, developing personnel with multiple skills. Oversaw daily activity in spot market purchases. Instituted back-up capability, including equipment and processes, enabling the company to schedule and deliver virtually all power during the August 2003 blackout in the Midwest.

PRIOR POSITIONS : DTE Energy / Detroit Edison — 1977 to 2001

Director, Power Sourcing and Reliability

May 1998 to April 2001

Director of group responsible for monthly, annual, and long-term purchases and sales of power for Detroit Edison, including procuring power for the summer peak season.

- **Planning** -- Planned summer power requirements for Detroit Edison, including mix of generation, option contracts, hub purchases, load management, and transmission, which balanced and optimized physical risk and financial risk.
- **Contract Management** – Established decision, review, and approval process for evaluation and execution of power transactions, including mark-to-market valuation. Developed methodology for financial evaluation of non-standard call options. Developed strategy to acquire transmission paths matching power purchases.
- **Execution** -- Executed summer plans, negotiating and contracting annually for purchased power and transmission services. Negotiated customized structured contracts to provide the company with increased operating flexibility, dispatch price choices, and delivery reliability.
- **Wholesale Innovation** -- Developed, negotiated, and executed an innovative “alternative delivery” swap with an Ohio utility to retain use for DE of leased Michigan power generation at critical times of transmission unavailability. Developed, negotiated, and executed unit power transactions with merchant generators under construction, structuring contracts to protect corporation.
- **Retail Innovation** -- Developed innovative seasonal dispersed generation option offering, educating and signing contracts with large retail customers.
- **Risk Management** – Developed an optimizing algorithm using load shapes to minimize corporate exposure to volatile power prices. Developed a hedging strategy to fit power purchases to the corporation’s risk tolerance level.
- **Acquisitions** -- Team leader for acquisition of new peakers.
- **Settlements** -- Negotiated and settled liquidated damages claims.

Relevant prior positions within Detroit Edison

<u>Position</u>	<u>Organization</u>	<u>Time Period</u>
Director, Special Projects	Customer Energy Solutions	Apr 97 to May 98

Leader of several special projects involving the transformation of the corporation’s merchant energy functions into competitive business units, including merger explorations and the start up of DTE Energy Trading (DTE’s power marketing affiliate).

Directed filings to the Federal Energy Regulatory Commission to establish DTE Energy Trading as a power marketer and to gain authority for sales, brokering, and code of conduct. The FERC used DTE's flexible utility/affiliate code of conduct as precedent for rulings for other power marketers.

Director, Risk Management Huron Energy (temp affiliate) Jan 97 to Apr 97

Leader of team responsible for competitive pricing of wholesale structured contracts and for acquiring risk management hardware and software to support risk management policy. Prepared Board resolutions to implement risk management policy.

Director, Contract Development Customer Energy Solutions Jan 96 to Dec 96

Leader of team which formulated a business strategy for the corporation in competitive power marketing. Team leader on project evaluating an existing steam and electricity contract, recommending and gaining Board approval for revamping the corporation's Thermal Energy business and strategy.

**Project Director Executive Council Staff Jan 91 to Dec 95
& Corporate Strategy Group**

Project leader for competitive studies, including business risk, generation pooling, and project financing in the merchant generation industry. Team member and/or team leader for analyses of merger and acquisition opportunities

Special Assignment Executive Council Staff Mar 90 to Dec 90

Special assignment related to long-term industry strategies and mergers and acquisitions.

Pricing Analyst Marketing / Rate Aug 82 to Mar 90

Developed, negotiated, and implemented an innovative standby service tariff. Testified as an expert witness in regulatory proceedings and in state legislative hearings.

Engineer Resource Planning Aug 79 to Dec 81

Member of the company's electric load forecasting team, responsible for SE Michigan energy and peak demand forecasting, and for risk analysis. Developed the company's first residential end-use forecast model.

PRIOR POSITIONS: Prior to DTE Energy

Lear Siegler Corporation, ACTS Computing division, systems analyst and programmer from January 1973 to July 1977.

EDUCATION: M. A. in mathematics, University of Michigan, 1972
B. S. in mathematics, University of Michigan, 1968

MILITARY: U. S. Army, September 1968 to June 1970.
Viet Nam service from June 1969 to June 1970.
Honorably discharged.

PROFESSIONAL: Member, Engineering Society of Detroit (1979-present)

PUBLICATIONS & PAPERS:

- "Competition and Survival in the Electric Generation Market," published in *Public Utilities Fortnightly*, December 1, 1991.
- "Measuring and Pricing Standby Service," presented at the Electric Power Research Institute's "Innovations in Pricing and Planning" conference, May 3, 1990.
- "Assessing the Benefits of Interruptible Electric Service," presented at the 1989 Michigan Energy Conference, October 3, 1989.
- "Principles of Standby Service," published in *Public Utilities Fortnightly*, November 24, 1988.
- "Progress in Conservation," a satirical commentary published in *Public Utilities Fortnightly*, October 27, 1988.
- "Comparing Utility Rates," published in *Public Utilities Fortnightly*, November 13, 1986.
- "Uncertainty in Load Forecasting," with co-author John Sangregorio, published in *Approaches to Load Forecasting*, Electric Power Research Institute, July 1982.

PREVIOUS TESTIMONY:

- Federal Energy Regulatory Commission, Docket No. EL04-135 & related dockets.
- Michigan Public Service Commission, U-12489.
- Michigan Public Service Commission, U-8871.
- Michigan Public Service Commission, U-8110 part 2.
- Michigan Public Service Commission, U-8110, part 1.
- Michigan Public Service Commission, U-7930 rehearing.
- Michigan Public Service Commission, U-7930.

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
pursuant to Section 10a(16) of)
Public Act 286 of 2008 for Revisions)
to Stranded Cost Recovery Surcharges)
_____)

Case No. U-15744

PROOF OF SERVICE

Monica Robinson, being first duly sworn, deposes and says that on this 1st day of April, 2009 she served a copy of the Direct Testimony of Alex J. Zakem On Behalf of Energy Michigan, Inc. upon those individuals by email and regular mail to those listed on the attached Service List.

Monica Robinson

Subscribed and sworn to before me
this 1st day of April, 2009.

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

SERVICE LIST U-15744

MPSC Staff
Kristin Smith
Assistant Attorney General-PSC Division
6545 Mercantile Way, Suite 15
Lansing, MI 48911
smithkm@michigan.gov

Consumers Energy Company
H. Richard Chambers
Jon R. Robinson
One Energy Plaza
Jackson, MI 49201
mpscfilings@cmsenergy.com
hrchambers@cmsenergy.com
jrrobinson@cmsenergy.com

Constellation NewEnergy
Jennifer Copland
Dickinson Wright, PLLC
215 Washington Square, Suite 200
Lansing, MI 48933
jcopland@dickinsonwright.com

Midland Cogeneration Venture
Richard J. Aaron
Fahey Schultz Burzych Rhodes PLC
4151 Okemos Road
Okemos, MI 48864
raaron@fsblawyers.com

Ada Cogeneration Limited Partnership
Michigan Power Limited Partnership
David E.S. Marvin
Fraser, Trebilcock Davis & Dunlap, PC
124 W. Allegan, Suite 1000
Lansing, MI 48933
DMarvin@fraserlawfirm.com