April 21, 2010

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

Re: Case No. U-15986 - In the matter of the application of Consumers Energy Company for authority to increase its rates for the distribution of natural gas and for other relief

Dear Ms. Kunkle:

Enclosed for filing in the above-docketed proceeding is “Consumers Energy Company’s Reply to Exceptions”. I have enclosed a Proof of Service showing electronic service upon the parties. This is a paperless filing and is therefore being filed only in a PDF format.

Sincerely,

H. Richard Chambers

cc: Hon. Mark D. Eyster, ALJ
Parties per Attachment 1 to Proof of Service
STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of
CONSUMERS ENERGY COMPANY
for authority to increase its rates for the
distribution of natural gas and for other relief

Case No. U-15986

CONSUMERS ENERGY COMPANY’S
REPLY TO EXCEPTIONS

Dated: April 21, 2010
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CONSUMERS ENERGY COMPANY’S
REPLY TO EXCEPTIONS

In accordance with the schedule established by the Administrative Law Judge (“ALJ”), Consumers Energy Company (“Consumers Energy” or the “Company”) files this reply to the exceptions of other parties. Failure to address any individual argument presented by another party should not be interpreted as acquiescence to that argument; in such instances, Consumers Energy relies upon its Exceptions, Brief, Reply Brief, and the evidentiary record.

I. REPLY TO MPSC STAFF

A. Capital Structure and Rate of Return

1. Long-Term Debt Cost Rate

At page 1 of its exceptions, Staff states:

“Staff does not agree with the ALJ’s decision to modify its recommended cost rate from 5.86% to 5.87% to account for the ALJ’s adjustment to the Company’s PCRB fees. The ALJ included 35 basis points to reflect his decision accepting the Company’s PCRB fees that Staff removed in its analysis.” (Footnote omitted).

The record evidence supports the ALJ’s recommendation on this issue. This issue is discussed at pages 26-28 of the PFD.

1 The Company at pages 2-4 of its Exceptions disagrees with the ALJ’s recommendations that the DOE Liability be included in the gas ratemaking capital structure and that the DOE Liability letter of credit fees be excluded if the DOE Liability is included. The issue raised by Staff related to the PCRB fees is a different issue.
Consumers Energy presented evidence explaining that the PCRB fees are costs which Consumers Energy must incur in order to maintain the Pollution Control Revenue Bond (“PCRB”) debt securities. Consumers Energy’s witness Mr. Rao testified:

“Consumers Energy incurs certain on-going fees to maintain our PCRB debt securities which are included in the long term debt for ratemaking purposes. These fees include (i) ongoing bond remarketing expense and the trustee expense and (ii) the cost of letters of credit required under the bond agreements. . . . Historically, the Company incurred the cost of an insurance premium to obtain the required insurance from monoline bond insurers. However, since the refinancing in 2008, the Company is required to provide Letters of Credit pursuant to the bond agreements and incurs a cost to do the same. . . . These fees are prudent, reasonable, and customary for these types of tax-exempt securities and I believe are properly recoverable from ratepayers.” 3 TR 179  (Emphasis added).

“The ALJ’s recommendation to include the 35 basis point spread is consistent with the Commission Order in Case No. U-15645, is supported by the record evidence presented by the Company in the current case, and is necessary in order for the Company to fully recover its costs.

Staff presented testimony indicating that Staff reduced the long-term debt PCRB letter of credit fees from 47.5 basis points to 12.5 basis points based on the belief that the 35 basis point spread was being recovered in the short term debt cost calculation. 4 TR 709.
Mr. Rao explained in rebuttal that neither the Company nor Staff short-term debt cost calculations included the 35 basis point PCRB fees. See 3 TR 221-222. The ALJ quotes from Mr. Rao’s testimony at page 27 of the PFD. Exhibit A-64, which addresses the cost of short-term debt, explicitly states at the bottom of pages 1 and 2, with respect to the letter of credit fees: “‘No letters of credit relating to Palisades or PCRBs are included in this line and are rather included in the cost of long-term debt in [Exhibit A-62] DVR-4, Schedule D2.” (Emphasis added). The validity of this statement can be determined by referring to the dollar amount of $68 million that the fee is applied to in calculating the short-term debt letter of credit fee expense.2 This is the short-term debt amount only.

At page 28 of the PFD, the ALJ concluded: (i) no PCRB fees were included in the calculation of the short-term debt cost, (ii) the PCRB fees should be accounted for in long-term debt, and (iii) the cost for the PCRB fees should be increased to $611,000. These conclusions are supported by the record and should be adopted.

2. Short-Term Debt Cost Rate

At page 3 of its exceptions, Staff states:

“Staff disagrees with the ALJ’s decision to adopt the Company’s recommended short-term debt cost rate of 8.26%.”

At page 5 of its exceptions, Staff requests that the Commission adopt instead a short-term debt cost rate of 1.94%. Staff’s exception should be rejected and the ALJ’s recommendation adopted.

Short-term debt cost is discussed in the PFD at pages 22-26. After a thorough discussion of the issues, the ALJ concluded:

“Review of Staff’s and Consumers’ methodologies leads me to conclude Consumers’ should be adopted. It appears that Staff’s

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2 Staff also used the $68 million letter of credit amount to calculate short-term debt costs, as do the Company’s revisions to the Staff short-term debt cost calculation. See Exhibit S-4, Schedule D-3, p. 1, note (1) and Exhibit A-84, note 1, 3 TR 222, 231.
calculations do not provide Consumers the opportunity to cover the fees and interest associated with projected revolver borrowings. As testified to by Consumers’ witness, Roa [sic], Staff’s methodology would result in recognizing only $314,000 of a $3.84 million cost. This result appears primarily due to Staff’s methodology that divides costs by the limits of the revolvers rather than the average debt. Therefore, Consumers’ short-term debt cost rate of 8.26% is adopted.” PFD, p. 26. (Footnote omitted).

These conclusions are supported by competent, material, and substantial evidence. Calculation of the 8.26% is shown on Exhibit A-84.

Consumers Energy incurs two types of costs for amounts borrowed under the revolving credit facilities. 3 TR 180. The first is interest expense, which is comprised of a base rate and an applicable spread. The Company and Staff short-term debt rate calculations both use a three-month LIBOR rate 1.03% and a revolver interest rate spread of 0.35%. See Exhibit A-84, 3 TR 228. The second type of cost is for revolver fees. Company witness Mr. Rao testified:

“The Revolver Fees consist of two parts:

1) Annual Revolver Fees – This cost consists of Annual Revolver Commitment Fees, which the Company is required to pay quarterly to the banks on the ‘unused’ portion of the revolver, and other required annual fees under the Revolving Credit agreement. The Revolver Commitment fees are associated with maintaining fund availability.

2) Amortization of Upfront Revolver Fees – At the inception of a revolving credit facility, the borrower is required to pay upfront fees and issuance costs to the lenders. These issuance and upfront costs are amortized over the life of the revolver.

“These fees and costs are customary in revolving credit agreements. It is important to allow for the recovery of revolver fees in addition to the interest expense since these are necessary costs to secure the availability of the financing and to keep the facility available for the financing needs of the Company.” 3 TR 180-181.
The ALJ concluded that Staff included only a portion of the fees that Consumers Energy incurs for revolving credit facilities associated with short-term debt. The record evidence supports this conclusion.

Mr. Rao presented evidence that the following three adjustments should be made to the Staff’s calculation of the short-term debt cost rate:

(i) A fee of 47.5 basis points should be used in determining the cost of the $68 million of letters of credit rather than the 12.5 basis point amount used by Staff;

(ii) The cost rate impact for the projected revolver fees should be calculated by dividing the amount of fees by the average borrowing amounts rather than by the total revolver amounts; and

(iii) The weighting methodology that Staff proposes be applied to the fees is inappropriate and should be rejected.

3 TR 228. Making these three adjustments to the Staff calculation of the short-term debt cost rate increases the resulting cost rate from 1.94% to the 8.26% recommended by the ALJ.³ See 3 TR 228, Exhibit A-84.

Mr. Rao testified that the revolver fees cannot be avoided:

“The revolving credit facility is the primary source of Company’s liquidity. The Company can not avoid incurring these costs except by giving up the revolving credit facility, which would not be a sound business decision.” 3 TR 181. (Emphasis added).

“If Consumers Energy is going to maintain the revolving credit facilities, then the revolver fees and revolver amortization are unavoidable. These fees are required by financial institutions in order to provide credit and are increasing in light of the current economy and the current tightening of credit.” 3 TR 182. (Emphasis added)

³ As noted above, both cost rates assume use of the Staff’s three-month LIBOR rate of 1.03%. 3 TR 228.
At page 5 of its exceptions, Staff quotes from testimony at 4 TR 713 indicating that Staff did not reject any of the Company’s estimated fee items. However, that is the effect of its methodology. 3 TR 229.

Mr. Rao described the basis for each of his three areas of disagreement and why he concluded that the Staff position is incorrect at 3 TR 230-234. With respect to the first item, Mr. Rao clarified that there are two 35 basis point fees. He explained that the 35 basis point fee which was incurred in order to have the letter of credit in place is in addition to the 35 basis point fee which is charged on drawn borrowings. 3 TR 231. Staff’s reduction of the fee amount from 47.5 basis points to 12.5 basis points was not correct. 3 TR 231.

Second, in order to recover the fees, they must be allocated to the average outstanding balance. 3 TR 229, 231. Mr. Rao stated that the methodology used by Staff does not provide Consumers Energy with an opportunity to actually recover these costs. 3 TR 229. He testified:

“The only way to recognize these fees in short-term debt is to divide the fees by the average amount of borrowings to calculate a short-term debt rate and then multiplying that rate by the average amount of borrowings. This process allows the Company the opportunity to include these fees in its cost of capital calculations and is consistent with the Commission’s order in case U-15645.” 3 TR 229.

Dividing by the total revolver amounts does not allow for full recovery of the fees. The fixed component must be spread over the average level of borrowing. 3 TR 229.

Finally, Staff’s weighting methodology is inappropriate. 3 TR 233. Mr. Rao illustrated at 3 TR 233 that Staff’s methodology would result in only recovering $314,000 of a $3.61 million cost. The calculation supporting this conclusion is included on page 25 of the PFD.
At page 4 of its exceptions, Staff states that the majority of fees in dispute “are associated with the second $150 million revolver that will likely not be utilized in the 2010 test year.” Whether the revolver will likely be utilized, however, is not determinative of the issues in dispute. Staff presented testimony that:

“The Company has access to two short-term credit revolving facilities, its more established $500 million credit revolver and a newer $150 million revolver obtained in 2008 (renewed in August 2009). The Company secured the second revolver during the height of the 2008-2009 U.S. financial crisis when short-term credit facilities were not only expensive but hard to come by since creditors offering short-term facilities were scarce. The Company obtained the second revolver primarily for security purposes in the event that additional liquidity would be required by the Company.”

Consumers Energy’s witness Mr. Rao in responding to the question of whether it would be reasonable for Consumers Energy to reduce the credit available under revolving credit agreements to something less than $650 million testified:

“Definitely not. It is important that Consumers Energy have ready access to credit if the need arises for additional funds. Internal cash generation is not sufficient to meet the Company’s liquidity needs. Credit has become increasingly difficult to access in the current environment. Michigan’s economy remains weak. Recent announcements by automakers of cutbacks, and ripple effects, create additional risks for Consumers Energy. These factors add uncertainties for Consumers Energy’s gas business and provide added support for the importance of maintaining access to an adequate credit line. Not maintaining access to the revolving credit facility would put Consumers Energy and its customers at risk.”

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⁴ Staff presented evidence calculating the same projected fees for the second revolver as did Consumers Energy. Compare Exhibit S-4, Schedule D-3, p. 1, note (2) with Exhibit A-84, note (2). The difference with respect to the fees associated with the second revolver is attributable to Staff’s methodology of dividing the amount of fees by the average borrowing amounts rather than by the total revolver amounts and from its proposed weighting methodology, not as a result of a disagreement with the underlying fees themselves.
Similarly, Mr. Rao stated:

“It is important for the Company to have ready access to adequate short-term credit if the need arises for additional funds, such as an increase in gas prices or any other unforeseen events. Consequently it is necessary to maintain a line of credit which is larger than the anticipated need. This short-term liquidity is particularly important in the current economy and the potential difficulty in obtaining last minute sources of funding.” Exhibit AG-22, Bates p. 98600033.

No party presented evidence disputing these conclusions.

It is reasonable and appropriate for Consumers Energy to recover the fees associated with the revolving credit facilities. The ALJ’s conclusion that a short-term debt cost rate of 8.26% should be adopted in this case is supported by the evidence. Using a cost rate of 1.94% would not allow Consumers Energy to recover reasonable and appropriate costs which Consumers Energy must incur in order to have the revolvers in place. 3 TR 233-234.

B. Throughput

At pages 5 through 7 of its exceptions, the Staff expresses disagreement with several aspects of the ALJ’s calculation of throughput-related customers, volumes, and revenues. The throughput calculations in the PFD are related to the ALJ’s recommendation that the Commission adopt the Attorney General’s residential customer projection. Consumers Energy believes that the ALJ erred in rejecting the residential customer level projected by Consumers Energy and instead adopting the Attorney General’s residential customer level. This is addressed at pages 21 through 24 of Consumers Energy’s Exceptions. For reasons discussed in the Company’s Exceptions, Consumers Energy requests that the Commission adopt a sales revenue amount, including cost of gas, of $2,235,141,000 (Exhibit S-3, Schedule C-3, line 5 minus line 2)\(^5\) without any adjustments.

\(^5\) $2,358,310,000 - $33,169,000 = $2,235,141,000.
C. **Adjusted Net Operating Income**

1. **Manufactured Gas Plant Amortization**

   At pages 9-10 of its exceptions, the Staff discusses several aspects of the ALJ’s calculation of manufactured gas plant (“MGP”) amortization expense. Consumers Energy agrees with Staff that the net MGP amortization, not including project management costs, for the test year should be set at $3,262,129 as shown on Exhibit S-3, Schedule C-6.1, line 16 and that the incremental increase for MGP amortization expense of $235,129 shown on Exhibit S-3, Schedule C-6.1, line 18, should be included in determining revenue requirements. If the full amount was inadvertently not included, then an adjustment should be made.

   Consumers Energy agrees that the $52,000 incremental amount of MGP Direct Program Management Costs should not be included twice. Attachment A to the PFD indicates that $52,000 was added to the 2008 historical O&M expense for MGP Direct Program Management Costs. This appears appropriate.

2. **Standard Retirement Units**

   Consumers Energy agrees with Staff’s recommendation, on pages 10-11 of Staff’s exceptions, that the Commission should reduce the revenue requirement by $520,000 to account for a reduction in capital expenditures related to the change in the Standard Retirement Units resulting from Case No. U-15629. See Exhibit A-75, line 14.

3. **Accounts Receivable**

   Consumers Energy agrees that the ALJ correctly accepted Consumers Energy’s projected $1,864,000 Accounts Receivables sales costs and that these costs should be reflected in Other O&M expense. This amount should be added to the Adjusted 2008 historical O&M expense as reflected on Attachment A to the PFD.
4. **AMI Program**

Consumers Energy agrees that the ALJ correctly accepted Consumers Energy’s projected $790,000 AMI program costs and that these costs should be reflected in Other O&M expense. This amount should be added to the Adjusted 2008 historical O&M expense as reflected on Attachment A to the PFD.

5. **EICP and Base Salary Expenses**

   a. **The ALJ’s Determination that the Challenged Portion of Base Salary Expense is Recoverable Was Correct**

At pages 44-46 of the PFD, the ALJ recommended that a $1.7 million non-officer base salary expense adjustment be included in rates. The ALJ stated:

   “Consumers feels it appropriate to include this $1.7 million expense because: it is part of employee base salary; base salary compensation is below the market-based compensation level; without this base salary adjustment, base compensation would be further below competitive compensation levels, and, by including the base salary adjustment and the EICP, non-officer compensation is at a competitive level. Tr 3, pp. 115-117.

   “I find Consumers’ argument convincing. No evidence has been presented to rebut Consumers’ position that non-officer base salary is below competitive levels and this argument is accepted. Thus, the $1.7 million expense that was transferred out of the new, more stringent, EICP and into base salaries should not be excluded.” PFD, pp. 45-46.

At pages 12-15 of its exceptions, Staff indicates disagreement with this recommendation, arguing that $1.7 million of base salary employee compensation expense should be treated as if it were incentive compensation rather than base salary compensation and for this reason disallowed. Consumers Energy presented evidence that the $1.7 million at issue is part of base salary compensation expense and that overall compensation expense, including these amounts, is below
competitive levels. Staff’s argument that the expense should, nonetheless, be treated as if it were incentive compensation expense was correctly rejected by the ALJ.

Consumers Energy emphasizes that it is not seeking recovery in this case of any portion of employee compensation expense that is part of Employee Incentive Compensation Program (“EICP”) expense. Consumers Energy in this case is only seeking recovery of base salary compensation expense. The ALJ applied the proper and lawful standard in evaluating the recoverability of this portion of base salary compensation expense. His recommendation is appropriate and should be adopted. Consumers Energy submits that disallowing $1.7 million of base compensation expense in this case would be unlawful and unreasonable.


At page 12 of its exceptions, Staff mistakenly argues that page 56 of Consumers Energy’s Brief included a “concession that ‘base salary’ really was EICP expense.” As support, Staff refers to a portion of testimony from a Company witness that was quoted on page 56 of the Company’s Brief. The testimony quoted on page 56 included the statement: “regardless of how the EICP portion of compensation is handled for ratemaking purposes, the base compensation portion of the expense should be included in determining the revenue requirements in this case.” Staff appears to have misinterpreted the phrase “the expense” as referring to “incentive expense” when what it is referring to is “compensation expense.” The statement appears as part of the following discussion, which begins at the bottom of page 55 of the Company’s Brief and continues to the top of page 57:

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6 When Consumers Energy initially filed Case No. U-15986, it sought recovery both of non-officer EICP expense and the $1.7 million increase to base salary expense. While Consumers Energy believes that the non-officer EICP costs are reasonable and appropriate expenses, Consumers Energy nevertheless adjusted its requested relief in its Brief to exclude non-officer EICP expense.
“Consumers Energy’s witness Ronn J. Rasmussen, Vice President Rates and Regulation, testified that only $1.7 million of the $3.4 million Staff seeks to disallow is attributable to EICP expense:

‘Mr. Welke incorrectly characterizes this expense as being 100% attributable to Consumers Energy’s non-officer Employee Incentive Compensation Plan (EICP). Only half of this amount is attributable to the non-officer EICP compensation. The balance is part of the non-officer base salary expense. Mr. Welke’s disallowance is not appropriate. Regardless of how the EICP portion of compensation is handled for ratemaking purposes, the base compensation portion of the expense should be included in determining the revenue requirements in this case. There is no valid basis to disallow any portion of non-officer base salary compensation.’ 3 TR 111. (Emphasis added).

“Disallowing $1.7 million of base compensation expense in this case (i.e., the half of $3.4 million that is part of base salary expense) would be unlawful and unreasonable. There is no valid basis to disallow any portion of non-officer base salary compensation.

“It should be beyond dispute that Consumers Energy is entitled to recover its reasonable costs of service. It should also be beyond dispute that employee compensation expense is a recoverable expense in rates. The $1.7 million of non-officer base salary that Staff seeks to disallow is an expense which Consumers Energy is currently incurring. 3 TR 113. The expense is both known and measurable. 3 TR 113.

“Consumers Energy’s witness Ronn J. Rasmussen, Vice President Rates and Regulation, summarized the Company position in this case as follows:

‘Reasons that full recovery of base compensation costs should be allowed, with no disallowance of the $1.7 million Staff characterizes as incentive compensation, include the following:

(i) Employee base salary compensation is a reasonable cost of doing business, has been set at a reasonable level, and has been determined using a reasonable methodology;

(ii) The amount of base salary compensation is below the market-based compensation level; and
(iii) The decision of Consumers Energy’s management to allocate a portion of employees’ overall compensation that would otherwise be in base pay so that it is subject to incentives is a management decision and does not provide a valid basis to disallow a portion of the base salary compensation expense.

It is reasonable and prudent for Consumers Energy to pay its employees competitive levels of compensation. The base salary compensation expense that Staff seeks to disallow is a reasonable cost of doing business. I recommend that the Commission reject Staff’s proposal to disallow $1.7 million of base salary non-officer salaried employee compensation expense in this proceeding.” 3 TR-117.

“Staff’s proposal to reduce non-officer base salary compensation by $1.7 million should be rejected. It is not supported by the evidence or the law.” Company Brief, pp. 55-57.

In its Brief, the Company emphasized that the $1.7 million of base compensation was not part of EICP expense, not the other way around. The discussion quoted above supports adopting the recommendation of the ALJ on this issue and rejecting the exception of Staff.7

c. The Level of Non-Officer Base Salary Compensation Expense Requested by Consumers Energy Is Reasonable; The ALJ Applied the Correct Standard in Evaluating Base Compensation Expense

The lawful standard for evaluating utility rates is whether they have been established in a manner that is sufficient “to cover all reasonable costs of doing business.” In General Telephone Co v Public Service Commission, 341 Mich 620; 67 NW2d 882 (1954), the Supreme Court accepted the following standard:

“Insofar as the utility is concerned, rates are just and reasonable when sufficient to cover all reasonable costs of doing business, including interest on the bonded indebtedness and a fair dividend

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7 Staff includes a discussion of various reasons why it believes that the incentive portion of the compensation expense should not be included in rates. Since Consumers Energy is not seeking recovery of the incentive portion of compensation in this case, the question of whether the incentive portion should be recoverable is moot.

The standard for evaluating the “reasonableness” of utility expenses has been unchanged since the United States Supreme Court explicitly stated it in *State of Missouri ex rel Southwestern Bell Telephone Co v Public Service Commission of Missouri*, 262 US 276; 43 SCt 544; 67 LEd 981 (1923). In reviewing the lawfulness of a disallowance of an operating expense, the Court stated:

“So far as appears, plaintiff in error’s [i.e., the utility’s] board of directors has exercised a proper discretion about this matter requiring business judgment. It must never be forgotten that while the state may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies, and is not clothed with the general power of management incident to ownership. The applicable general rule is well expressed in *State Public Utilities Commission ex rel. Springfield v Springfield Gas & Electric Co* 291 Ill. 209, 234, 125 N.E. 891, 901: ‘The commission is not the financial manager of the corporation, and it is not empowered to substitute its judgment for that of the directors of the corporation; nor can it ignore items charged by the utility as operating expenses, unless there is an abuse of discretion in that regard by the corporate officers.’” 262 US at 288-289.

This is consistent with a later United States Supreme Court decision, where the Court again reviewed the lawfulness of an operating expense disallowance:

“Good faith is to be presumed on the part of the managers of a business. [citing *State of Missouri ex rel Southwestern Bell Telephone Co v Public Service Commission of Missouri*, supra]. In the absence of a showing of inefficiency or improvidence, a court will not substitute its judgment for theirs as to the measure of a prudent outlay.” *West Ohio Gas Co v Public Utilities Commission of Ohio*, 294 US 63, 72; 55 SCt 316; 79 LEd 761 (1935). (Emphasis added).

Thus, the applicable legal standard applicable to the review of employee compensation is clear—unless there is evidence supporting a finding that the expenses are excessive, or unwarranted, or made in bad faith, such expenses are properly reflected in rates. There is no evidence in this case
that the compensation expenses at issue are excessive, unwarranted, or made in bad faith; indeed, *all of the evidence is directly to the contrary.*

Mr. Rasmussen provided the following summary in support of the Company’s conclusion that overall compensation levels are reasonable:

“First, Consumers Energy’s management targets overall compensation (including the incentive compensation) to the market median. Second, Consumers Energy’s management actively reviews compensation levels so that employees are neither overpaid nor underpaid relative to market. Third, we use a rigorous survey process which uses valid and reliable data from multiple sources to determine median levels of compensation.” 3 TR 116.

Mr. Rasmussen testified that Consumers Energy participates in two utility industry surveys that are conducted annually on behalf of the American Gas Association and Edison Electric Institute. 3 TR 116. To supplement this data, Consumers Energy uses a reputable national on-line survey resource, CompAnalyst, which has survey data from a number of independent sources. 3 TR 116. Using this data, a comparison of overall compensation is made between the Company’s jobs and comparable survey jobs and a determination made of where the Company’s pay stands relative to the market.

Mr. Rasmussen testified that, using the survey data, the Company looks at the median level of total compensation for each job for which there is a comparable match. 3 TR 116. This helps assure that the Company is matching the relevant market. 3 TR 116. He stated that the Company is best able to attract and retain a qualified, experienced, and motivated workforce when its overall compensation is competitive with market levels. 3 TR 115.

There are two parts of overall compensation for salaried employees of Consumers Energy. The first is base pay. The second is employee incentive compensation (*i.e.*, EICP compensation). 3 TR 112. Prior to 2003, employees below salary grade 19 were not eligible for
incentive awards and their full compensation was included in base pay. 3 TR 112. The Company currently follows an approach of first determining the overall level of compensation that is reasonable, and then taking a portion of this overall level of compensation and making it subject to incentives. 3 TR 112. In 2009 the Company’s management chose to reduce the amount of compensation placed at risk by 50% (i.e., it shifted $1.7 million from base pay to incentive pay rather than shifting $3.4 million from base pay to incentive pay as it did in 2008). 3 TR 114. This was done in conjunction with incorporating additional goals, higher standards, and more stringent evaluation criteria for the EICP in 2009. 3 TR 113. Mr. Rasmussen testified that one of the benefits of allocating a greater portion of compensation to base salary is to provide additional focus on the importance of individual contributions. 3 TR 114.

Mr. Rasmussen testified:

“The overall compounded increase in base salary, as a percent, for Consumers Energy non-officer employees for 2002-2009, including the larger 2009 base salary increase, is approximately the same as the market salary increases for the same time period. The overall compounded base salary increase for Consumers Energy non-officer salaried employees for 2002 through 2009 was 29.8%. This compares to a market salary compounded increase for 2002-2009 of 30.1%.” 3 TR 114.

This evidence provides support that the base salary expense included for the test year is reasonable. Contrary to the arguments of Staff in its exceptions, the ALJ applied the appropriate standard and reached the appropriate conclusion.

**d. Staff’s Proposed $1.7 Million Base Salary Disallowance Should Be Rejected by the Commission**

Reasons to reject the Staff’s proposed $1.7 million base salary disallowance include the following:
Consumers Energy acted reasonably in setting overall compensation levels for its non-officer salaried employees at market levels and 100% of the base salary component of compensation expense should be recovered in rates. 3 TR 112.

Staff has used inappropriate criteria in recommending disallowance of these compensation costs. 3 TR 112.

The position that if compensation was previously allocated as incentive compensation it cannot now be treated as base compensation creates an unreasonable scenario: Compensation which is recoverable when classified as base compensation not only will lose its recoverability if management chooses to allocate it to incentive compensation, but thereafter cannot regain its recoverable status, even if it is allocated back to base compensation. 3 TR 112.

The $1.7 million upward adjustment to base salaries has been made. This is a known and measurable change which will be in effect during the test year and reflects expenses that the Company will incur. 3 TR 113.

The $1.7 million at issue are base pay dollars and are not tied to any incentive program. They are no different from any other base pay dollars. Including this expense is consistent with use of a projected test year. 3 TR 113. Disallowing the expense is not.

The focus should be on whether the level of base compensation for the projected test year, including the $1.7 million that has been allocated to base compensation in this case, is reasonable. Whether or not a portion of the compensation currently included in base compensation was at one time subject to incentive criteria is not an appropriate criterion to use in determining whether or not the base compensation level is reasonable. 3 TR 113.

The overall compounded increase in base salary, as a percent, for Consumers Energy non-officer employees for 2002-2009, including the larger 2009 base salary increase, is approximately the same as the market salary increases for the same time period. 3 TR 114.

Failure to adjust base salaries to include the $1.7 million would reduce employee overall compensation for 2009 to a level below what it was for 2008. Unless an adjustment is made to the base level of compensation that is recovered through salaries, overall compensation will not be at a fair and reasonable level. 3 TR 114.

Consumers Energy needs to be able to attract and retain a competent workforce. Paying a competitive level of compensation is an essential prerequisite. Not making the base salary adjustment would have been detrimental to the ability of the Company to attract and retain a competent workforce. 3 TR 115.
For all of these reasons, the Staff’s $1.7 million base salary disallowance should be rejected and the recommendation of the ALJ to allow recovery adopted.

6. Corporate Services O&M

The PFD rejected Staff’s recommendation that Company Account 923 Outside Services be reduced by $3,300,000 to reflect non-recurring expenses, concluding the Company demonstrated that it had already made that adjustment. PFD at 49. The ALJ is correct.

Staff’s witness Brian A. Welke recommended a $3,300,000 reduction in Account 923 Outside Services in Corporate Services O&M in Exhibit S-3, C-5.2. 4 TR 792. He suggested that the Company included $3,300,000 in non-recurring operation and maintenance expense for 2008, for SAP consultative services related to orienting employees to the new accounting system. Mr. Welke’s basis for the reduction to the test year O&M is that this was a one-time expenditure related to the SAP implementation and will not be incurred again during the test year.

The Company agrees that this expenditure will not be incurred again during the test year and accordingly the Company did not include it in the development of test year O&M. As reflected in the Rebuttal Testimony of Daniel Harry, test year O&M actually decreased $1.7 million from 2008 levels. 4 TR 602-603. In 2008, since the July 2008 initial SAP implementation, the Company has incurred significant break-fix costs in order to maintain the system’s full functionality. The test year reflects the year-over-year decline in these costs from 2008 as the number of these break-fix issues is reduced. Mr. Welke did not recognize the offsetting net increase in computer operating costs for a full year of operations versus a half year.

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8 Mr. Welke also made a modest increase of $166,000 in Account 925, Injuries and Damages in Exhibit S-3, C-5.2, using a five year average for injuries and damages expense. 4 TR 793. The net of these two adjustments is Staff’s position reducing Corporate O&M by $3,134,000.
in the 2008 historical year due to the July 2008 SAP startup. This net increase is a result of higher licensing and maintenance fees versus the in-house developed legacy system.

The Company requests that the Staff’s exception to Corporate O&M of $3,134,000 be rejected and the Company’s reduction of Corporate O&M of $1,671,000 be adopted, as recommended by the ALJ.

D. Other Issues

1. PEM and OPEB Mechanism

The PFD found that the PEM and OPEB expense items are, to a large degree, the result of various factors and market conditions beyond Consumers Energy’s control. PFD at 65. The PFD concluded that it would be advantageous to Consumers Energy and its customers that these expenses be properly and timely funded. The PEM and OPEB should do that. PFD at 65.

Staff opposes such trackers, suggesting that they are not necessary in the current regulatory environment. The Company respectfully disagrees. Such expenses are volatile and difficult to accurately predict. For instance, the significant downturn in security values in the 2008 financial market significantly reduced Pension Plan assets. This change in Plan asset values alone contributed to a $12 million increase in the total 2009 FAS 87 Pension expense. For 2009, this was fortunately offset by a similar reduction in this expense primarily due to the sale of the Palisades Plant and the resulting transfer of pension benefits liability to the new owner for associated Palisades’ employees. However, continued poor investment performance in the financial markets during 2009 and declining interest rates (over which the Company also has no control) will result in another significant increase in the 2010 FAS 87 expense, which is not factored into the pension expenses projection for 2010 submitted with this case. 5 TR 861. On the other hand, if the financial market were to turn around and stabilize, it is possible there will
be a reduction in pension expense which would be of benefit to customers if a pension tracker is in place. A pension tracker will allow recovery of reasonable pension expenses, as well as avoid recovery from customers that is greater than the actual pension expense. 5 TR 860-861.

Likewise, Company witness Herbert Kops discussed the need for a tracker for an Other Post Employment Benefits (OPEB) Equalization Mechanism to allow recovery of reasonable retiree health care and life insurance expenses. These expenses are also heavily influenced by market conditions over which the Company has no control. 5 TR 891. For instance, the significant downturn in security values in the 2008 financial markets reduced OPEB Plan assets significantly by the 12/31/2008 measurement date required under FAS 106 and used to project 2009’s FAS 106 OPEB expense. This change in Plan asset values alone contributed to a $39 million increase in total 2009 FAS 106 OPEB expense. In addition, the assumption change required to properly reflect retiree health care inflation trends created an additional $14 million in FAS 106 OPEB expense in 2009. Continued poor investment performance in the financial markets, declining interest rates and continued health care market inflation during 2009 (all factors over which the Company has no control) will add another significant increase in 2010 FAS 106 expense, which is not factored into the FAS 106 retiree health care and life insurance expense projection for 2010 submitted with this case. 5 TR 892. On the other hand, if the financial markets were to turn around and stabilize, it is possible there will be a reduction in retiree health care and life insurance expense, which would benefit customers if an OPEB tracker is in place. As FAS 106 retiree health care and life insurance expense is heavily influenced by various market factors over which the Company has no control, an OEM or OPEB tracker is necessary to allow recovery of reasonable retiree health care and life insurance expenses by the
Company as well as to avoid recovery from customers that is greater than the actual retiree health care and life insurance expense. 5 TR 892.

The Company disagrees with Staff’s contentions that the Pension Equalization Mechanism and OPEB Equalization Mechanism are not needed because PA 286 of 2008 has greatly diminished the regulatory lag of recovering these costs in rates since companies have the ability to file additional rate cases after previous ones are concluded. Staff exceptions at 17-18. While the ability to implement revised rates in a more timely manner helps reduce regulatory lag, it does not ensure that the customer is paying the actual costs incurred. As such, this can lead to the customer overpaying or underpaying actual pension and OPEB expenses as approved by the Commission in a rate case. 5 TR 895-896.

A description of the timing for rate case approval and when the actual pension and OPEB are known will highlight the point. The calendar year pension and OPEB expense is projected early in each calendar year by the Company’s actuary, followed by a determination of market-driven discount rates and asset values set at the end of the previous calendar year. This projection is adjusted by any known plan changes and updated employee census information, which is received later in the calendar year by the actuary. 5 TR 896. The pension or OPEB expense could be further adjusted for the calendar year if there is a significant event any time before year-end, such as a large asset sale or a significant change in benefits. 5 TR 896-697. As a result, the Company knows its actual pension and OPEB expenses for a given calendar year at the end of that calendar year. Applying this timing to the present case, the actuary’s projected pension and OPEB expenses were submitted for the twelve months ending September 2010 and the Staff has accepted these expenses. However, the actual expenses for 2009 and 2010 will not be known until the end of 2009 and 2010, respectively. Therefore, approval of these expenses
for pension and OPEB by the Commission before the actual cost is determined at year end could result in expenses in rates that are too high or too low. Due to the large size of these two expenses and the variability that they can have from year to year based on market conditions outside the Company’s control, trackers for these expenses are the best way to make sure the actual expense is what is paid and collected in rates. 5 TR 897.

2. **Pooling Program**

The PFD recommended adoption of Constellation New Energy’s (CNE’s) request that the Commission adopt a pooling program for transportation customers. Consumers Energy disagrees with this recommendation and has filed an exception requesting that the Commission reject the pooling proposal. *(See Consumers Energy’s Exceptions, pp. 33-37).* Staff has also filed an exception in which it disagrees with the ALJ’s conclusion that the pooling proposal is reasonable and states that CNE has not met its burden to explain how pooling would enhance the current system in place for the Company’s transportation customers. Staff’s exceptions at 19. Staff observed that Consumers Energy’s transportation program does not use cashout mechanisms, daily nominations and daily balancing charges. Staff’s exceptions at 20. The Company’s program, by comparison, only requires its customers to balance its supplies and usage on a monthly basis. Since customers do not need to balance their gas supplies daily, they do not need a pooling service for operational purposes. Staff noted that Constellation proposed similar tariff amendments in Michigan Consolidated Gas Company’s rate case filing in Case No. U-15985. The ALJ in that docket rejected the identical pooling proposal. PFD dated April 2, 2010 at pages 119-123.

Consumers Energy agrees with Staff that the pooling proposal should be rejected. However, it disagrees with Staff’s recommendation that the Commission encourage parties in the
Consumers Energy and Michigan Consolidated Gas Company cases to collaborate in an effort to reach a compromise. In testimony submitted in this case, Ms. Curtis testified that pooling could have detrimental effects on transportation customers, could result in operational impacts that negatively impact GCR customers, and would cause an administrative burden to the Company. 5 TR 924. Further, daily balancing of transportation supplies and load are not currently required. 5 TR 929. At present few transportation customers have daily metering available. 5 TR 936. Consumers Energy does not think that the record in this case supports holding a collaborative at this time.

E. Rate Design

1. Rate Design Methodology

Staff asserts in its exceptions that "its Rate Design is superior to the Company's", as "the Company inappropriately modified its revenue requirements to equalize the sales rate percent increases." Staff exceptions at 21. The ALJ found that the Company's rate design is reasonable. PFD at 80. The Company has not "modified its revenue requirements to equalize the sales rate percent increases." The Company agrees with Staff's goal of equal percent increases within rate classes, as long as break-even or crossing points are maintained. In order to maintain crossing points or mitigate rate shock, the Company could need to shift revenue requirements from one rate class to another. 4 TR 631-637. Such rate design has been approved by the Commission in the past in order to preserve crossing points.

2. Customer Attachment Program

Consumers Energy agrees with Staff that the rates for the Customer Attachment Program should be calculated so as to correspond to cost rates approved by the Commission in its final order in this case.
II. REPLY TO THE ATTORNEY GENERAL

A. 30-Year Weather Normalization versus 15-Year Weather Normalization

The ALJ adopted the recommendations of the Commission Staff and Consumers Energy to use 15 years of historical data for weather normalization rather than 30 years of data as proposed by the Attorney General, stating:

“The Attorney General argues that the purpose of weather normalization is to eliminate variability and not to predict weather during the future. AG Initial Brief, p. 7. While acknowledging that there has been a warming trend in recent years, the Attorney General notes that, in any single year temperatures can fluctuate significantly. AG Initial Brief, p. 7. In part, the Attorney General favors the 30-year methodology because it would reduce revenue deficiency by $5,732,000. AG Initial Brief, p. 8.

“I do not find the Attorney General’s arguments convincing. It appears clear that weather normalization using 15 years of data produces results more reflective of current warming weather trends. Therefore, I accept Consumers’ and Staff’s weather normalization using only 15 years of data.” PFD, p. 37

The Attorney General’s exception to the ALJ’s recommendation on this issue should be rejected. The record evidence supports a conclusion that use of a 15-year weather normalization period provides a result more reflective of normal weather during the test year than would use of a 30-year period.

The Attorney General states at page 3 of his exceptions that the Company’s witness Ms. Clark “stated that a 30-year methodology is ‘probably less volatile than the 15,...’” and argues this should be construed as an agreement with Mr. Coppola’s recommendation. However, Ms. Clark’s conclusion was the opposite. What Ms. Clark stated was:

“Thirty-year average changes less rapidly than 15, but it also does not respond to a change in trend, so its less – 30-year is probably less volatile than 15, but the 15 is a better predictor.” 3 TR 376 (Emphasis added).
The Attorney General acknowledges at page 3 of his exceptions that Mr. Coppola himself testified that “many weather experts have shown that in the past decade weather patterns have been in a warming trend.”

Reasons to adopt the ALJ’s recommendation and reject the Attorney General’s exception include the following:

- Consumers Energy witness Linda Clark testified that, “for eight of the last eleven years, the 15-year average of heating degree days has been a better predictor of the next year’s weather than the 30-year average.” 3 TR 349.

- Data compiled by the National Oceanic and Atmospheric Administration (NOAA) indicates that “winter (December-February) temperatures have trended warmer for the entire state of Michigan since 1970. The trend has been a gain of +1.0 degrees per decade since 1970.” 3 TR 350. Thus, more recent weather data (i.e., 15 years) is more likely to predict “normal” weather than less recent weather data (i.e., 30 years).

- A review of weather data since 1926 indicates that a 15 year average approach would have been closer to the next year’s average winter temperature 41 times, while the 30 year average would have been closer 37 times. Over the last 30 years, however, the 15 year average is a better predictor 18 times (60%) versus the 30 year average being a better predictor 11 times (37%). Statistically, using the 15 year weather normalization approach is a much better approach than the 30 year approach. 3 TR 360-361.

The Attorney General essentially argues that these facts should be ignored.

The record evidence shows that using a 15-year normal period is a better predictor of the weather that can be expected during the forecast period than occurs using a 30-year normal. 3 TR 348-349, 360-361. The goal is to determine a proxy for normal weather that can be used for the forecast period. The ALJ’s recommendation to use of 15-year normal should be adopted and the Attorney General’s exception rejected.

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9 Ms. Clark noted during cross examination that she does not forecast weather, but rather weather normalizes a historical period to use for the forecast period. 3 TR 375.
B. **Forecast of Gas Sales and Transportation Volumes**

At pages 4 through 6 of his exceptions, the Attorney General argues that the ALJ erred in rejecting the recommendations of his witness Mr. Coppola with regard to the number of commercial and industrial customers to assume for the test year.\(^{10}\) The Attorney General’s exception should be rejected and the recommendation of the ALJ adopted. The gas deliveries forecast that was presented by the Company’s witness Ms. Clark and supported by the Staff better projects deliveries likely to be experienced during the test year and should be used in setting rates in this case.

The methodologies used by Consumers Energy for the customer forecasts are summarized at 3 TR 352-353. The Attorney General argues that his witness “took a more simplified and direct approach” in projecting customers. However, simple is not necessarily better. Mr. Coppola’s “more simplified” approach to determining gas deliveries resulted in a major proposed adjustment to the Company’s forecast.

Consumers Energy utilized a projected test year of the 12 months ending September 30, 2010. At page 8 of his PFD the ALJ recommended adopting this test year. No party has filed exceptions to this recommendation. Underlying Mr. Coppola’s criticisms was his basic contention that the economic outlook for the Company’s service territory has improved markedly since the Company forecast was prepared in May 2009. 6 TR 1130-1131. The record evidence does not support this optimism. 3 TR 362-364.

Mr. Coppola started with 2008 average consumption per customer, used the average number of customers for 2008, and then developed his own “forecasted rate of change.” 6 TR 1132-1133. In her rebuttal testimony, Ms. Clark pointed out that 80% of the resulting

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\(^{10}\) The ALJ recommended adopting the Attorney General’s number for residential customers. Consumers Energy has filed an exception to that recommendation.
difference between Mr. Coppola’s forecast and the Company’s forecast is in the industrial transportation sector. She identified multiple defects with Mr. Coppola’s forecast. These include the following:

- Mr. Coppola used the State of Michigan Real Gross State Product (RGSP) index as a “barometer” of production of goods and economic activity for the industrial customer class. Ms. Clark pointed out that, while this may be one indicator of the overall Michigan economy, it is probably not the best indicator of industrial activity since the manufacturing sector makes up only about 20% of the RGSP. While Global Insight is forecasting RGSP to decline -6.3% from 2008 to 2010, it is forecasting industrial production to decline -22.8% over the same period. Id.

- Weather-normalized industrial transport volumes for the 12 months ending October 2009 were 36.3 Bcf. This is 16.7% (7.3 Bcf) lower than one year earlier. The Consumers Energy test year industrial transport forecast is for a continued decline to 28.3 Bcf. Given that industrial transport gas has declined 6 of the last 7 years, so it seems unlikely that it would grow 1.5 Bcf to the 37.8 Bcf forecasted by Mr. Coppola. 3 TR 364, Exhibit A-79.

- Global Insight’s Michigan unemployment percent forecast in April 2009, for all of 2009 and 2010, was 12.6% and 13.0%, respectively. The October 2009 Global Insight forecast now has worse levels of 14.3% and 15.5% unemployment in 2009 and 2010. While some indicators go up and some go down, overall the economic forecasts from Global Insight are very similar from the spring of 2009 to the fall of 2009. 3 TR 362.

- The University of Michigan economic forecast released October 5, 2009 states that Michigan will have lost about 960,000 jobs from mid-2000 to mid-2011. Adding 16,500 jobs during the second half of 2011 does not offset eleven years of continued job shrinkage. 3 TR 363.

- A survey of top business leaders in Michigan released October 27, 2009, showed that the CEO’s believe the state will continue to lag the nation’s economic performance over the next 18 months. About 90% of the 70 business leaders surveyed predicted flat or lower employment and capital investment in Michigan in the next six months. The leaders were unanimous in predicting that Michigan’s economy will stay the same or get worse in the near term. 3 TR 363.

- The majority of Michigan’s top business leaders do not expect the economy to bottom out until 2011. 3 TR 363, 364.
The basic premise of the Attorney General’s witness Mr. Coppola – that the Michigan economy during the test period has been and will be better than reflected in the Company’s deliveries forecast – is not borne out by the evidence.

Sales forecasts inherently involve professional judgment. The goal is to determine the best number. The Attorney General’s witness Mr. Coppola assumed a reduced level of decline which is not consistent with what has been experienced most recently and is not consistent with what is likely to occur during the test year. The Commission should adopt the commercial and industrial customer recommendations in the PFD and adopt the test year customer levels projected by the Company in determining throughput.

C. **Revenue Decoupling Mechanism**

The PFD recommends approval of Consumers Energy’s proposed Revenue Decoupling Mechanism (“RDM”). PFD at 63. The Attorney General states that the RDM should be rejected or at least limited to natural gas usage reductions due to identifiable energy conservation by customers as a result of the utility’s energy conservation program. The Attorney General is incorrect. Consumers Energy is proposing a revenue decoupling mechanism largely as a result of the significant investment in the Energy Optimization Programs required by 2008 PA 295. These investments will improve customers’ energy efficiency and, in turn, reduce the Company’s sales volume. As reflected in the Energy Optimization Plan filed in MPSC Case Nos. U-15805/15889, annual gas deliveries will be reduced by 1,043,566 Mcf through 2010. Because the Company collects most of its fixed costs through volumetric charges, any reduction in sales below the level used to establish rates increases the likelihood that the Company will be unable to collect the amount of revenue that was authorized in its rates. 4 TR 624-625. A revenue decoupling mechanism can align the interests of customers and the utility, because it
will allow the utility to collect its authorized revenue requirement notwithstanding sales declines due to energy efficiency and other reasons, which in turn provides an incentive for the utility to promote vibrant energy efficiency.

Company witness Rachel Pender testified that when customers’ natural gas usage decreases, gas commodity costs are reduced, but the Company’s fixed distribution costs are unaffected. Consumers Energy’s gas distribution system, like those of other gas utilities, is characterized by high fixed costs that do not significantly vary with changes in customer usage. When sales fall below the level used to establish the utility’s rates in its last rate case, the utility is unable to collect its authorized level of revenue and thus is denied a reasonable opportunity to earn its authorized rate of return. The MPSC Staff’s report on Energy Efficiency, submitted to the Commission on January 31, 2006 in MPSC Case No. U-14667, acknowledges this impact. 4 TR 625.

While Consumers Energy agrees with the PFD’s recommendation to approve its proposed RDM, Consumers Energy does not agree with the recommendation that the RDM be weather-normalized. See Company Exceptions, pp. 27-30. Weather normalization of the RDM is a disincentive to promote energy efficiency if warmer than expected temperatures result in reduced energy consumption.

D. Capital Structure and Rate of Return

At pages 9 through 17 of his exceptions the Attorney General takes issue with the ALJ’s rejection of the Attorney General’s capital structure argument and the ALJ’s rejection of
the Attorney General’s return on equity (“ROE”) recommendation. The Attorney General’s positions on both of these issues were appropriately rejected by the ALJ.11

1. Reply Regarding the Attorney General’s Capital Structure Arguments

a. General Reply

The Attorney General’s disagreement with the ALJ’s capital structure recommendation (pages 9-12) is based on his view that CMS Energy’s capital structure should be imputed to Consumers Energy in this case. The ALJ correctly rejected the Attorney General’s arguments. Both the Staff and the Company presented evidence that the appropriate capital structure to use is Consumers Energy’s actual capital structure adjusted for known and measurable changes. 3 TR 240, 4 TR 707.12 Using the CMS Energy capital structure in this case would not be appropriate. The ALJ’s recommendation that the Commission reject the Attorney General’s argument in the current case should be adopted.

The Attorney General begins the discussion of his disagreement with the ALJ’s rejection of the Attorney General’s capital structure recommendation by reference to his confidential initial brief arguments. Those arguments were filed by the Attorney General under seal and subject to a Protective Order entered on December 16, 2009. In reply to the confidential materials in the Attorney General’s brief, Consumers Energy filed on February 10, 2010 a Confidential Addendum to Consumers Energy’s Reply Brief under seal and subject to the terms

11 Consumers Energy believes that the ALJ’s ROE recommendation of 10.45% is too low and that the record evidence supports adopting a return on equity in this case that is substantially higher than 10.45%. Consumers Energy’s presented arguments in support of this position in its Exceptions at pages 4-20. Included is a discussion of reasons why Consumers Energy believes that the ALJ: (i) erred in not rejecting the Attorney General’s criticisms of the Company’s prospective market risk CAPM application, (ii) erred in accepting the Attorney General’s argument that adopting a Revenue Decoupling Mechanism requires a downward ROE adjustment, and (iii) erred in recommending a downward ROE adjustment if other adjustment mechanisms are adopted.

12 Staff witness Mr. Megginson testified: “Staff’s approach is similar to Consumers approach and consistent with previous Commission orders, in which the Company’s capital structure is forecasted and determined on a stand alone basis.” 4 TR 707.
of the Protective Order. If the Commission reviews the confidential portions of the Attorney General’s initial brief, Consumers Energy respectfully requests that it also review Consumers Energy’s Confidential Addendum to Consumers Energy’s Reply Brief.

Using CMS Energy as a proxy for purposes of establishing a capital structure for Consumers Energy is inconsistent with established Michigan precedent and was rejected in November 2009 by the MPSC when raised by the Attorney General in Case No. U-15645. In its November 2, 2009 Case No. U-15645 Order, at pages 16-18, the Commission summarized the positions of the parties in that case regarding capital structure as follows:

“Consumers and the Staff followed the Commission’s practice of estimating Consumers’ actual capital structure for the test year. . . .

“The Attorney General and ABATE recommended a capital structure designed to reflect more closely the capital structure of Consumers’ parent company, CMS Energy Corporation (CMS Energy). . . . The Attorney General and ABATE argued that although Consumers’ rates have been based on a roughly balanced capital structure, CMS Energy, Consumers’ parent company and equity investor, has a capital structure that is much more heavily weighted toward debt. As such, the Attorney General and ABATE argued that the equity return built into Consumers’ rates at the higher common equity percentage overcompensates CMS Energy equity investors who have a smaller actual equity investment.

* * *

“The ALJ recommended the rejection of the hypothetical capital structure proposed by the Attorney General and ABATE, noting that the Commission has treated Consumers as a stand-alone company and has established as a reasonable goal that Consumers maintain a capital structure roughly balanced between debt and equity.

* * *

“The Commission agrees with the ALJ that the capital structure proposed by the Staff, and agreed to by Consumers, should be adopted.”

In Case No. U-15645, the Commission rejected the argument that a CMS Energy capital structure should be imputed, as it has consistently done when this argument has been raised.
The Attorney General’s position is not supported by the evidence, would increase risk, and is inconsistent with recognized criteria set forth in *Bluefield Water Works and Improvement Co v Public Service Commission of West Virginia*, 262 US 679, 693; 43 S Ct 675; 67 L Ed 1176 (1923) and *Federal Power Commission v Hope Natural Gas Co*, 320 US 591; 64 S Ct 281; 88 L Ed 333 (1944). Further, the Attorney General’s calculations of a proxy capital structure must be rejected on the grounds that they inappropriately mix financial and ratemaking capital structure information, inappropriately mix information for CMS Energy and Consumers Energy, and inappropriately mix information for different time periods.

Additional reasons to reject the Attorney General’s recommendation to use a capital structure reflecting the capital structure of its parent CMS Energy and “which entails a common equity ratio of 27.89% in the permanent capital structure” (Attorney General exceptions, p. 12) include the following:

- The capital structure proposed by Mr. Coppola has no relation to the actual or projected capital structure for Consumers Energy. 3 TR 240.

- The capital structure proposed by Mr. Coppola was developed on a financial basis rather than a ratemaking basis. 3 TR 240.

- The purpose of developing a ratemaking capital structure in this case is to identify the sources of capital for Consumers Energy’s gas rate base and, as such, use of the CMS Energy capital structure is inappropriate. Using Consumers Energy’s actual capital

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13 Exhibit A-94 contains an excerpt from a Maryland PSC case which Attorney General witness Coppola included in a discovery response. 6 TR 1200. In its 2007 Order, the Maryland PSC forcefully rejected efforts to impute a parent capital structure to Potomac Electric Power Company, stating:

“We reject People’s Counsel’s proposed capital structure because it suffers from numerous flaws. First, it assumes that the rate of return depends on the source of capital rather than the risks faced by the capital. Second, a capital structure containing only 29 percent common equity would impose significant risks and would require a considerably higher return on equity than that authorized herein. Third, a capital structure containing only 29 percent equity would be extremely risky and would impair the Company’s financial integrity in violation of applicable legal standards. *See Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).”

The Attorney General’s recommended capital structure contains 27.89% equity as a percentage of permanent capital and 23.81 percent equity as a percentage of total capital. The flaws identified by the Maryland PSC are also present in the current Attorney General proposal and the reasons for rejecting it are equally applicable.
structure with known and measurable changes, as proposed by Consumers Energy, is neither inefficient nor unreasonable. 3 TR 240.

- The Commission has treated Consumers Energy as a stand-alone company for purposes of determining an appropriate capital structure and has established as a reasonable goal that Consumers Energy maintain a capital structure roughly balanced between debt and equity as a percentage of permanent capital. 3 TR 240. The Staff and Consumers Energy have followed this Commission guidance; the Attorney General has not.

- The Commission has previously rejected the argument that CMS Energy’s capital structure should be used in setting rates for Consumers Energy. The MPSC rejected this argument most recently in its November 2, 2009 Opinion and Order in Case No. U-15645.

- The most appropriate capital structure for the Consumers Energy’s utility customers is the projected capital structure of Consumers Energy, which in turn was based on the actual capital structure together with known and measurable changes for the test year. 3 TR 240. This is consistent with Commission practice in prior Consumers Energy rate cases.

The capital structure recommended by the Attorney General is not representative of the actual Consumers Energy capital structure or the projected test year Consumers Energy capital structure.

b. Reply to Various Assertions Made by the Attorney General in his Exceptions Regarding Capital Structure

At pages 9-10 of his exceptions, the Attorney General states that the capital structure used for Consumers Energy “should reflect the capital structure of its parent, CMS Energy, with respect to Long Term Debt, Preferred Equity and Common Equity as reported in its Financial Statements and adjusted for regulatory basis.” (Emphasis added). The Attorney General’s capital structure fails to meet his own criteria that it be “adjusted for regulatory basis.”

The implication that Mr. Coppola’s capital structure has been “adjusted for regulatory basis” is not supported by the record. Mr. Coppola testified as 6 TR 1155 that in his recommended capital structure:
“[t]he first five lines reflect the long term debt, preferred equity and common equity or permanent capital reflected on CMS Energy financial statements as filed on Form 10-Q with the SEC at June 30, 2009.” 6 TR 1155. (Emphasis added).

These permanent capital components (accounting for over 85% of Mr. Coppola’s capital structure as shown on Exhibit AG-12) are shown, therefore, on a financial basis and not on a regulatory ratemaking basis. In addition, they are stated for a historical period rather than for the projected test year. The Attorney General’s witness stated that he used customer deposits, short term debt, other interest bearing accounts, and JDITC amounts based on Mr. Rao’s projections for Consumers Energy for the test year ending September 2010. 6 TR 1155. While these components would be on a ratemaking basis and would correspond to the test year, they account for less than 2% of Mr. Coppola’s capital structure as shown on Exhibit AG-12.

Deferred taxes (which account for almost 13% of Mr. Coppola’s capital structure as shown on Exhibit AG-12) were based on yet a different basis -- Consumers Energy’s financial statements for the period ending June 30, 2009. 6 TR 1179, Exhibit A-88. Mr. Coppola testified on cross examination that he did not make any ratemaking adjustments to deferred taxes in developing the Attorney General’s capital structure. 6 TR 1180. He further stated he was not able to identify what ratemaking adjustments are typically made. 6 TR 1180.

The Attorney General argues at page 10 of his exceptions that his capital structure “reflects the actual situation that public investors perceive.” This conclusion is not supported by

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14 Mr. Coppola’s proposed capital structure has over $2 billion, or 50%, more debt than does the Company’s recommended capital structure. 6 TR 1156, Exhibit AG-12, Exhibit A-59. CMS Energy has poorer credit ratings than does Consumers Energy. Exhibit A-69. CMS Energy’s unsecured debt has credit ratings below investment grade. 6 TR 1178, Exhibit A-69. At 6 TR 1180, Mr. Coppola agrees that the cost of debt increases with increasing debt leverage and that this is a basic tenet of financial theory. Most of Consumers Energy’s long-term debt is secured by first mortgage bonds. Exhibit A-62. Mr. Coppola provides no detail on the makeup of the CMS debt he seeks to impute. Given all of these considerations, the cost of CMS Energy debt should be higher than that of Consumers Energy and the interest rate used by Mr. Coppola is inconsistent with his proposed capital structure.
the record. Mr. Coppola acknowledged on cross examination that when asked the following question in discovery, he provided the indicated response (see 6 TR 1179):

“Prior to the filing of his testimony in this case, did Mr. Coppola perform any statistical analysis of the relationship between the parent company debt to capital ratio and (a) the credit ratings of the utility subsidiary and (b) the credit spreads relative to US treasury bonds for the utility subsidiary. If the answer is yes, please provide a copy of such analyses.

“RESPONSE:
No.”

Exhibit A-88. Senior secured debt of Consumers Energy is secured by the assets of Consumers Energy, not by the assets of CMS Energy. CMS Energy’s 2008 year-end Moody’s and Fitch senior secured debt ratings were Baa3 and BBB-, two levels lower than those of Consumers Energy. Exhibit A-69, 3 TR 198. If Consumers Energy investors did perceive they were investing in CMS Energy, the perceived risk would therefore be higher. See 3 TR 241. The regulated utility is Consumers Energy, not CMS Energy.

The Attorney General asserts on page 10 of his exceptions that “Consumers is indirectly subsidizing the capital structure and financial results of CMS Energy and its non-utility businesses.” He bases this assertion on statements that the common equity on the books of CMS Energy is approximately $1 billion less than the common equity on the books of Consumers Energy. He concludes that this supports use of the CMS Energy capital structure for Consumers Energy. This conclusion does not withstand scrutiny.

First, CMS Energy and Consumers Energy are separate legal entities. The comparison being made is not determinative of an appropriate capital structure for Consumers Energy, which is the regulated utility. Consumers Energy’s rate base is supported by Consumers Energy’s capital structure.
In addition, the Attorney General’s conclusion fails to take into consideration the reasons that the CMS Energy equity balance is lower than that of Consumers Energy. Mr. Rao, when asked about this during cross examination replied:

“The numbers we're referring to are the GAAP equity numbers, book equity numbers, and the parent -- CMS parent company has other -- had other businesses other than Consumers. For example, we [CMS Energy] had large international operations throughout the '90s where substantial amounts were invested. And some of the businesses were risky and CMS did not recover all the investment, so which CMS had to write down all those write-offs, if you will, will hurt the equity. So I'm sure those were a big factor of what the difference between, you know, why that is lower than the Consumers equities. So I would think that's -- and I cannot go into what businesses because it's too much beyond the scope of the case.

* * *

“CMS Energy had a lower equity. . . . [T]hat is lower because of the write-downs that happened at the non-utility businesses.” 3 TR 295-296

The Commission has long-recognized that it would be inappropriate to set rates for Consumers Energy based upon non-utility operations of the parent company.

Further, because the CMS Energy capital structure is skewed due to recent significant write-offs, it cannot serve as a basis for setting a fair rate of return for Consumers Energy. The Commission summarized this principle at page 24 of its November 7, 2002 Order in Case No. U-13000 stated:

“[I]n Case No. U-8924, the capital structure used to set Consumers’ gas rates was the capital structure of Michigan Consolidated Gas Company (Mich Con). The Commission used Mich Con’s capital structure because . . . Consumers’ actual capital structure was so skewed by major write-offs and debt restructuring efforts that is could not serve as the basis for setting a fair rate of return.”
Using a capital structure for Consumers Energy that is based upon the gas utility proxy companies would result in a capital structure almost identical to Consumers Energy’s projected actual capital structure.¹⁵

Mr. Rao testified at 3 TR 166 that Consumers Energy has a goal of maintaining a capital structure with a common equity ratio as a percentage of permanent capital of approximately 50%. From 2004-2007, CMS Energy made $1.8 billion of equity infusions into Consumers Energy toward this goal. 3 TR 165, 167. In explaining the reasons for the 50% equity/50% debt permanent capital goal, Mr. Rao stated:

“It is important to have a reasonable common equity ratio in order to maintain a strong balance sheet and strong investment grade credit rating. Having a strong investment grade rating is essential for the Company to efficiently raise the capital required to maintain its operating systems and assure reliable service to customers. . . . As seen on page 4 of Exhibit A-60 (DVR-2), the proxy group is expected to have an average equity ratio of over 50%. In the current environment, an equity ratio higher than 50% is desirable in a gas utility capital structure as reflected by the proxy companies.” 3 TR 168.

Mr. Rao presented evidence that the proxy company group is projected to have a 50% equity ratio. 3 TR 168. Mr. Coppola admitted that he had recommended a common equity ratio of 50.34% and a long-term debt ratio of 49.61% for Michigan Consolidated Gas Company’s permanent capital structure. 6 TR 1211. The capital structure recommended by the ALJ is reasonable and appropriate.

At pages 10-11 of his exceptions, the Attorney General states that “Exhibit A-91 shows that as a result of CMS Energy higher debt leverage in this [CMS Energy] capital structure Consumers debt has been rated lower and its cost of debt issuance is higher . . . than its

¹⁵ At page 33 of its December 7, 1989 Order in Case No. U-8924 et al, a gas rate case, the Commission concluded that “the hypothetical capital structure should approximate the capital structure of an ‘A’ rated gas distribution utility.” It stated that Mich Con had an A bond rating. Order, p. 33.
peer group of companies with similar capital structure.” This conclusion is not supported by the record. The Attorney General’s witness testified that he did not perform any statistical analysis. 6 TR 1188. In fact, he did not perform any analysis which took into account what may have caused the differences in spreads. 16 6 TR 1185. Exhibit A-91 does not show that there is any statistically significant relationship between a parent company’s debt to capital ratio and a subsidiary utility credit spread. This is illustrated by Exhibit A-92, which shows data points for proxy companies corresponding to Exhibit A-91. Of the A-rated utilities, the company with the highest basis point spread over treasuries – Peco Energy, a subsidiary of Exelon (EXC) – and the company with the lowest basis point spread over treasuries – Nstar Electric, a subsidiary of Nstar (NST) – both have a parent debt to capital ratio of 53%. Exhibit A-91, p. 3 (Attachment CE-AG-8.1), Exhibit A-92. This is inconsistent with the Attorney General’s premise.

A more reasonable conclusion as to why Consumers Energy has a higher debt cost than the average for the A-rated utilities is that the cost of debt to a BBB rated utility during the comparison periods was approximately 120 basis points higher than the cost of debt to an A rated utility because of greater investor perceived risk. This is consistent with Mr. Rao’s evidence that an upward risk adjustment should be made to the proxy group results due to Consumers Energy’s greater risk.

The Attorney General states at page 11 of his exceptions that “There are precedents in other jurisdictions such as Idaho, where regulatory commissions have looked to the capital structure of the utility parent company to set rates for utility subsidiaries.” Regardless of what other jurisdictions may do, there is recent precedent in Michigan, as discussed above, that the capital structure of CMS Energy should not be used in setting rates for Consumers Energy.

16 A review of Exhibit A-70, the information source for Exhibit A-91, shows that the debt issuances had differences in security (either secured or unsecured) and ranged in terms from 5 – 30 years. Mr. Coppola did not consider these factors in his comparison.
See MPSC Case No. U-15645, November 2, 2009 Order, pp. 17-19. However, cases relied on by Mr. Coppola did not support his position, in any event. The Attorney General cites in his brief to an Idaho water company case referred to by his witness at 6 TR 1154. However, cross examination of Mr. Coppola showed that the capital structure adopted by the Idaho commission in that case did not match the publicly traded parent equity ratio cited to by Mr. Coppola. Compare 6 TR 1154 with 1195 and 1196. Rather, the commission in that Idaho case established a capital structure that closely approximated the \textit{proxy} water company capital structures. 6 TR 1194-1196. One of the “other jurisdictions” Mr. Coppola relied upon in testimony for his statement that other commissions looked to the parent company capital structures was an Alaska telephone case. Reliance on the Alaska case was also shown to be misplaced. Mr. Coppola admitted during cross examination that in the Alaska case the commission (i) concluded it should use a hypothetical 50% debt, 50% equity capital structure and (ii) rejected the argument that the capital structure of the parent should be imputed to the subsidiary. 6 TR 1193. Similarly, in a Maryland electric utility decision, the Maryland commission rejected the argument that the capital structure of the parent company should be imputed to the utility and used the utility’s actual capital structure. \textit{See} 6 TR 1200, Exhibit A-94.

The Attorney General asks the Commission to use criteria in establishing a capital structure that would be inconsistent with Michigan precedent and would be unlawful and unreasonable. The ALJ’s recommendation to reject the Attorney General’s recommended capital structure should be adopted.
2. **Reply Regarding the Attorney General’s ROE Arguments**

   a. **General Reply**

   Similar to his recommendation for capital structure, the Attorney General argues in his exceptions (pages 12-17) that the return on equity for Consumers Energy should be based on the return on equity for CMS Energy, which he states is 10.09%. The ALJ correctly rejected the Attorney General’s return on equity recommendation. A return of 10.09% would be unreasonably and unlawfully low.

   Consumers Energy’s witness Mr. Rao identified numerous reasons to reject Mr. Coppola’s 10.09% return on equity recommendation, including: (i) Mr. Coppola used inappropriate criteria and recommended a return that is unreasonably low, (ii) if CMS Energy were to be used as a proxy for Consumers Energy, as suggested by Mr. Coppola, then the return would need to be substantially higher than calculated by Mr. Coppola to reflect CMS Energy’s higher risk, (iii) Mr. Coppola’s 50 basis point revenue decoupling downward adjustment is based on an invalid analysis, (iv) Mr. Coppola’s revenue decoupling adjustment fails to recognize that revenue decoupling is already reflected in the proxy averages, (v) Mr. Coppola uses an inappropriate methodology in calculating a risk premium, (vi) Mr. Coppola’s assumption that capital markets have stabilized is inconsistent with extensive evidence presented in this case demonstrating that markets remain volatile, (vii) Mr. Coppola’s assumption that capital markets have stabilized is inconsistent with the Commission’s conclusions in its January 11, 2010 Case No. U-15768 Order that although markets have stabilized somewhat, access to credit remains uncertain and the risk environment continues to be challenging, (viii) Mr. Coppola’s analyses do

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17 On Exhibit A-68 (DVR-10), pp. 3, 8, Mr. Rao calculated a prospective CAPM return for CMS Energy of 11.46% and a DCF return for CMS Energy of 12.61%. See 3 TR 241.

18 Mr. Rao showed that if Mr. Coppola’s reasoning were applied to his DCF analyses, the group with decoupling would have a DCF ROE that is 0.66% higher than the DCF ROE for the group with no decoupling. This would indicate that companies with decoupling should have an adjustment that increases their ROE. 3 TR 242.
not reflect market conditions for this case, and (ix) the historical market risk premium approach favored by Mr. Coppola does not accurately or adequately capture the current investor risk premium requirements. 3 TR 241-246. Further, Mr. Coppola’s calculations inappropriately mix data for Consumers Energy and CMS Energy and inappropriately mix financial data with ratemaking data. 6 TR 1178-1180. In addition, how investors raise funds that they use to make equity investments is not properly relevant in determining the rate of return for a regulated utility company.

Although Mr. Coppola purports to be determining a CMS Energy return, he did not assess, for purposes of his recommendation, relative risk based upon the ratings assigned by rating companies. The ratings reflect rating agency perceptions of overall risk of a company (both business and financial risk) and reflect the relative risk of CMS Energy to the other companies. Mr. Rao testified:

“[I]f CMS Energy were to be used as a proxy for Consumers Energy’s return on equity, the return should be substantially higher than that calculated by Mr. Coppola. On my Exhibit A-68 (DVR-10), I calculated a prospective 2009-2010 CAPM ROE for CMS Energy of 11.46% (page 3) and a CMS Energy DCF cost of equity of 12.61% (page 8).” 3 TR 241.

These results illustrate that an appropriate return on equity for CMS Energy would be higher than the 10.09% return recommended by Mr. Coppola. Mr. Coppola’s reasoning and conclusion are not valid and his recommended return on equity should be rejected by the Commission.

b. Reply to Various Assertions Made by the Attorney General in his Exceptions Regarding ROE

At pages 13-14 of his exceptions, the Attorney General states that he does not support the Company’s use of a prospective market risk premium in the Capital Asset Pricing Model (“CAPM”) analysis based on his view that markets have stabilized. He does not cite to
the record and this statement is contrary to the weight of the evidence. See e.g., 3 TR 184, 185, 238-239. The record evidence supports a conclusion that markets remain volatile. 3 TR 190, 244-245. This issue is discussed at pages 11-13 of Consumers Energy’s Exceptions.

Much of the Attorney General’s discussion of return on equity issues involves arguments of his witness that certain downward adjustments should be made to the ROE if a Revenue Decoupling Mechanism or other adjustment mechanisms are adopted in this case. At pages 14-16 of his exceptions, the Attorney General refers to his witness Mr. Coppola’s assumption that companies in the proxy group with substantial decoupling have a 0.53% lower return on equity requirement than those without decoupling. At pages 16-17 of his exceptions, he argues for additional downward adjustments if other cost tracking and recovery mechanisms are adopted. Consumers Energy addresses these issues at pages 15-17 and pages 20-21 of its Exceptions.

At page 16 of his exceptions, the Attorney General states, without citation to any record evidence, that “The Commission should also be aware that regulatory commissions in other jurisdictions have applied common equity rate reductions of as much as 50 basis points to take into consideration the diminished business risk from Revenue Decoupling mechanisms.” In contrast, Mr. Rao presented evidence that a survey conducted by the American Gas Association had indicated that only two of 31 states that had authorized non-volumetric rates had tied a utility’s ROE to the type of rate design. 3 TR 243. Those two states adopted a 10 basis point (0.10%) downward adjustment to the authorized ROEs. 3 TR 243. The Attorney General’s arguments as to the commonality and magnitude of adjustments are not supported by the record. Moreover, any risk reduction that does exist would already be accounted for in the results of the analyses since the proxy companies already have some measure of risk protection with respect to
load variations. 3 TR 242-243, Exhibit A-68, p. 1. Any further adjustment would be unwarranted. Mr. Rao showed in rebuttal testimony that Mr. Coppola’s proposed adjustments based on an invalid hypothesis and invalid analyses. See 3 TR 242, Exhibit A-86.

For the above reasons and the reasons discussed in Consumers Energy’s Exceptions, Consumers Energy requests that the Commission conclude that the return on equity recommended by the Attorney General is unreasonably and unlawfully low.

E. **AMI Program**

The PFD recommends that the Company’s AMI expenses be accepted. PFD at 53. The Attorney General requests that further capital expenses for AMI be rejected. Attorney General exceptions at 18. The Company disagrees. The AMI program O&M expenses for the test year 12-months ending September 2010 and the capital expenditures for the year 2009 and the 9-months ending September 2010 are projected based upon the assessment, development and evaluation of system and field equipment to be used in a pilot program. 3 TR 383. The Staff and the Company are in agreement with respect to the appropriate level of AMI expense to include in setting rates in this case.

The proposed AMI program will consist of integrated systems that will measure, collect and analyze customer energy usage information. The system will include “smart” electric and gas meters with a two-way communications network, or the capability to transmit and receive data. Smart meters will provide customers with real-time energy usage information; allowing them to better understand, manage, and control their consumption, giving customers the opportunity to help lower their energy bills. Customers will be able to manage their energy usage with new devices and services, including intelligent communicating thermostats and
computer programs to monitor and manage energy use (i.e. home area networks). An indicative schematic and a brief description of the main components are included as Exhibit A-44.

The Company is taking a careful approach to the roll-out of AMI. The approach focuses on end-to-end process validation across multiple vendors and technologies. The Company has developed an implementation plan that is closely monitoring early adopters and gaining experience from others to mitigate the risk of deploying this new technology. Significant time is required to thoroughly evaluate, develop and test the equipment and systems needed to implement AMI. The systems must be capable of managing high volumes of meter data and a carefully thought-out secure integrated architectural structure is the first step in deploying AMI. 3 TR 415-416. Consumers Energy’s AMI program team has identified an AMI pilot and implementation timeline of 2007-2015, as shown in Exhibit A-43. The initial focus of the program involves a development of functional requirements and the identification of the commensurate enabling technology, including smart meters, two-way communications, data management, software application integration/functionality and customer interfaces. The program’s emphasis for the test year (12-months ending September 2010) will be the assessment, development and evaluation of systems and field equipment including a pilot of approximately six thousand smart meters which will include approximately four hundred pilot gas meters. Transition from the AMI Pilot to full-scale electric smart meter deployment and the addition of communication modules to existing gas meters is anticipated to commence in 2011 and be completed by 2015. 3 TR 416.

The benefits of implementing AMI are amplified given the state of Michigan’s economy. The Company anticipates gas customers will benefit from implementing AMI through more competitive prices because of more reliable, and efficient operations; and through
enhanced customer service and O&M efficiency improvements, together with anticipated uncollectible accounts reductions. Benefits will become available to customers once the supporting systems and communications infrastructure are in place and as smart electric meters and gas meter-modules are deployed across the service area. 3 TR 416-417. The implementation of AMI will provide the opportunity to reduce operating costs and improve effectiveness in meeting customer needs and enhancing customer value. Billing accuracy will improve with the availability of actual meter reads, reducing the number of monthly estimated reads to less than 1 percent. Information including on-demand actual reads will be available to respond to customer move in/move out requests and address questions concerning energy usage. AMI can facilitate and accentuate energy efficiency and conservation by virtue of the enhanced ability for customers to identify savings opportunities and validate the effectiveness of actions taken. Similarly, system losses such as theft and other unidentified system losses are costs borne by all customers. It is anticipated that these costs will be reduced by virtue of enhanced loss detection. 3 TR 417. These reductions should translate into lower costs for the customer.

F. LIEEF

At pages 19-22 of his exceptions, the Attorney General “restates” his legal arguments concerning LIEEF, essentially repeating his argument that the Commission is without authority to implement this program. As the Attorney General notes, at page 19 of his exceptions, the Commission previously ruled in favor of the LIEEF program in Case No. U-14547 and the Michigan Court of Appeals affirmed the Commission’s ruling in its decision In re Application of Consumers Energy, 279 Mich App 180; 756 NW2d 253 (2008).
The Attorney General’s exception concerning the LIEEF program is identical to the argument made by the Attorney General at pages 30-33 of his January 27, 2010 initial brief in this proceeding. In rejecting the Attorney General’s argument the ALJ stated:

“This argument is, almost, word for word, the same that the Attorney General presented to the Commission in Case No. U-15768/15751.

* * *

“The Commissions’ decision in U-15768 is well-reasoned, sound, and adopted in this case. Recognition of the $17,427,000 for LIEEF is accepted.” PFD, p. 54.

The ALJ’s recommendation is consistent with prior Commission orders.

The Attorney General challenges the legality of the voluntary LIEEF program included in the Company’s case. The Attorney General claims that, because the statutes governing utility regulation have “changed” (Attorney General’s exceptions at 19), the legality of this voluntary program is in question and the voluntary LIEEF program is beyond the authority of the Commission (Attorney General’s exceptions at 22).

As noted by the Attorney General, the Michigan Court of Appeals has previously ruled that the Commission did possess the authority to approve the Company’s LIEEF program. See, In re Application of Consumers Energy, 279 Mich App 180; 756 NW2d 253 (2008). Attorney General’s exceptions at 19. The Attorney General’s argument however ignores the portion of Consumers Energy, supra, that determined that the Commission’s authority to approve the LIEEF program also existed under the Commission’s general regulatory authority:

“We conclude that the PSC’s interpretation of its clear and unmistakable authority to administer the LIEEF, as encompassing the power to secure funding, was a reasonable interpretation of the administrative power conferred on it by the Legislature and is consistent with its ratemaking authority pursuant to MCL 460.6”

The Commission has previously concluded that it has jurisdiction to approve a utility’s voluntary LIEEF program. The Attorney General’s legal arguments are inconsistent with these prior determinations.

G. Tracking Mechanisms

The Company requested adoption of tracking mechanism for PEM, OPEB, and uncollectibles. The PFD agreed for PEM and OPEB. PFD at 65. The Attorney General opposes all trackers, alleging such expenses are not volatile and beyond the Company’s control, and contending trackers remove all incentive for the Company to control such expenses. AG exceptions at 22. The Company disagrees. Approval of the expenses for pension and OPEB by the Commission before the actual cost is determined at year end could result in expenses in rates that are too high or too low. Due to the large size of these two expenses and the variability that they can have from year to year based on market conditions outside the Company’s control, trackers for these expenses are the best way to make sure the actual expense is what is paid and collected in rates.

Approval of these trackers reflects a symmetrical risk allocation between the Company and customers. These trackers would assure customers that they will pay the actual

¹⁹The Court further stated that the Commission need not be granted specific legislative authority for each and every action undertaken to manage the LIEEF fund:

“[T]he absence of specific statutory language regarding the authority to secure funds for the LIEEF through operation and maintenance expenses does not serve to preclude the PSC from funding the LIEEF by these means. Moreover, we have found no construction of the ‘clear and unmistakable’ requirement that would necessitate a separate legislative endorsement for each action taken in the course of administering the fund. The Legislature conferred broad authority on the PSC to administer the LIEEF. The Legislature is not required to micromanage the PSC by statutorily delineating every aspect of its administrative power given in the initial grant of authority to manage and oversee this fund.” Consumers Energy, supra, at 279 Mich App 191-192.
cost for these benefits and not over pay or under pay for them. From the customers’ perspective, the trackers are very beneficial in market conditions which include high interest rates and/or rapidly increasing plan asset values. These situations can lead to lower pension and OPEB expenses and, as a result, a reduction in the customer’s costs for these benefits. Without trackers in place during these kinds of market conditions when expenses are calculated, there is no timely way to reduce customer costs for these benefit expenses. In this manner, trackers shift regulatory risks away from customers. 5 TR 898.

H. **Capital Expenditures and Rate Base**

Consumers Energy and the Commission Staff were in agreement that the rate base adopted in this case for the projected test year should be as follows:

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Plant</td>
<td>$1,708,873,000</td>
</tr>
<tr>
<td>less retainers, advances</td>
<td>-764,000</td>
</tr>
<tr>
<td></td>
<td>$1,708,109,000</td>
</tr>
<tr>
<td>Working Capital</td>
<td>$1,025,422,000</td>
</tr>
<tr>
<td>Manufactured Gas Plant</td>
<td>$21,164,000</td>
</tr>
<tr>
<td>Total Rate Base</td>
<td>$2,754,695,000</td>
</tr>
</tbody>
</table>

The ALJ concluded that these amounts were supported by the evidence and should be adopted:

“For the 2010 projected test year, Consumers has adopted Staff’s proposed rate base of $2,754,695,000. This figure includes $1,708,873,000 for net utility plant, $1,025,422,000 for working capital, and $21,164,000 for unamortized MGP expense. This figure is adopted.” PFD, p. 8.

With regard to the Net Plant component, the ALJ stated:

“Based on the evidence presented, it appears that Consumers’ projected expenditures are related to concrete projects that are reasonable.” PFD, p. 15.

Later in the same paragraph, the ALJ stated “I, as an ALJ, feel constrained to find that the capital expenditures projected by Staff and Consumers are reasonable.”
At 24-29 of his exceptions, the Attorney General excepts to the PFD’s recommendation concerning capital expenditures for the Company. The Attorney General acknowledges that the ALJ found that the capital expenditures projected by Staff and Consumers are reasonable (quoting the page 15 language in his exceptions at 25).

The Attorney General claims, however, that the ALJ’s recommendation “places the burden of proving the reasonableness and prudence of the utility's capital expenditures on intervenors rather than on the utility.” Attorney General’s exceptions at 25. In support of this contention, the Attorney General reiterates the argument he made in his January 27, 2010 initial brief in this proceeding. See, January 27, 2010 initial brief of Attorney General at 16-19.

The Attorney General asserts that “[b]ecause of Consumers [Energy’s] failure to support these large increases in capital expenditures with any cost/benefit analysis so as to determine its reasonableness, Mr. Coppola proposed” six specific reductions to Consumers Energy’s proposed capital expenditures. Attorney General’s exceptions at 27. With the exception of the reference to cost/benefit analysis (discussed below), Consumers Energy responded to these contentions on pages 8 through 13 of the Company’s Brief.

The Attorney General argues that “[t]he lack of any cost/benefit analysis alone demonstrates that this large increase in capital expenditures is not reasonable and should not be approved.” Attorney General exceptions at 26. The Attorney General argument that the capital expenditures are not reasonable is in error, as found by the ALJ. The direct and rebuttal testimony of Company witness Hice provides extensive explanations and ample record evidence support for the capital expenditures requested in this case. As noted in Company witness Hice’s rebuttal testimony:

“The testimony I provided in this case describes the necessity of the capital expenditures presented. Mr. Coppola, without any analysis or reasoning
arbitrarily dismisses certain capital expenditures. Mr. Coppola would even recommend the [C]ommission adopt capital expenditures levels below amounts which the Company is obligated to spend under state and federal regulations. As stated in my testimony, these projected expenditures are necessary in order to meet customer reliability, safety requirements and system demands. Mr. Coppola ignores the capital requirements I presented and also ignores the Company’s obligations to our customers and regulators.” 3 TR 423-424.

Mr. Hice explained the necessary major programs, as shown on Exhibit A-34, are for: 1) New Business; 2) Asset Relocation 3) Regulatory Compliance; 4) Material Condition; 5) Capacity/Deliverability; 6) Gas Operations Other; and 7) Gas Business Services. 3 TR 407-408.

The bulk of the differences between the Company’s capital expenditure presentation and Mr. Coppola’s recommendation fall into the following three areas: Regulatory Compliance, Material Condition replacement/upgrades, and Capacity and Deliverability programs. Mr. Hice provided detailed support for each of these three areas.

With respect to Regulatory Compliance, Mr. Hice explained that this includes projects that are “required to comply with federal pipeline safety regulations” 3 TR 409, as well as “Pipeline Integrity” projects that are “driven by assessments of threats and risk translating to a priority-based inspection schedule,’ 3 TR 410, i.e., a “cost-benefit” analysis. Certain of these programs are done in compliance with the federal pipeline and Hazardous Materials Safety Administration requirements. As Mr. Hice noted, the Attorney General’s recommendation would have the Commission “adopt capital expenditure levels below amounts which the Company is obligated to spend under state and federal regulations.” 3 TR 423.

With respect to the “Material Condition” category of capital expenditures, Mr. Hice explained that the increases in this category over historical levels are the result of establishing the requirements in line with “project decision analysis results;” i.e., a cost-benefit
analysis, and restarting a program to replace the remaining cast iron pipe on the Company’s system. Mr. Hice testified that this latter program is especially important in order to replace pipe that is old and more susceptible to freeze-ups in winter, leading to customer hardship. 3 TR 410-411. Application of a strict cost-benefit analysis to expenditures like this, that are designed primarily to protect customers from winter service interruptions, would be an extremely subjective exercise. Certainly the affected customers would say that the investment is well worth the cost.

With respect to the Capacity and Deliverability category of capital expenditures, Mr. Hice explained that, due to geographical population shifts, changes in system conditions due to peak and base demands, and basic inspection requirements, the Company must continually make additional investments in its system. The individual projects are described in some detail in Mr. Hice’s testimony, 3 TR 411-413. These projects are the result of systems analysis that reveals the need for greater deliverability, or greater compression, or improved pressure needs in various portions of the Company’s distribution system. The Attorney General’s broad criticisms ignore the thorough analysis that underlies each of these projects.

The ALJ noted at page 15 of the PFD that “for the most part, the Attorney General’s recommendations are short on specifics” and that his recommendations “seem characteristic of general policy decision that might be made by business executives”. The ALJ appropriately rejected the Attorney General’s arguments. Consumers Energy requests that the Commission also reject the Attorney General’s arguments with respect to capital expenditures.
III. REPLY TO ABATE

A. Capital Expenditures

In its exceptions, ABATE essentially adopts the argument set forth in the Attorney General’s exceptions concerning capital expenditures. The Company will rely on its reply to the Attorney General’s exceptions with respect to capital expenditures, supra, in reply to ABATE.

B. Cost of Service Study

ABATE takes exception with the Presiding ALJ’s recommendation, at page 77 of the PFD, that the Commission should adopt Consumers Energy’s Cost of Service Study (“COSS”) methodology. In the PFD, the Presiding ALJ based his recommendation on “Consumers claims that its approach should be adopted because it ‘is consistent with the method previously approved by the Commission.” PFD at 77 (Citing Consumers Reply Brief at 24). On page 5 of its exceptions, ABATE incorrectly asserts that Consumers Energy simply followed precedent and did not support its position. As discussed below, that simply is not the case.

ABATE asserts that the COSS is flawed because it “wrongly allocated storage costs to transportation customers.” ABATE exceptions at 6. ABATE’s witness Phillips presented ABATE’s argument that transportation customers do not share in the benefit of seasonal cost savings or saving on pipeline capacity by using storage to meet peak demands. 5 TR 963-964. ABATE’s position was correctly rejected by the Presiding ALJ. Company witness Curtis testified that each transportation customer is required to choose an ATL and an ACQ in its transportation contract. 5 TR 935. The ATL multiplied by the ACQ represents the amount of the Company’s storage that the customer is allowed to utilize to balance supplies and usage, taking advantage of seasonal cost savings or to reduce the amount of pipeline capacity
they contract for to meet peak demands. 5 TR 935. Consumers Energy’s integrated system, made up of storage, transmission and distribution is required in its entirety to serve all of its customers. It is not possible to deliver gas to an end-use transportation customer without using all three of those components, including storage. 5 TR 937-938. The allocation of the storage-related costs between utility sales rate classes and transportation rate classes reflected in the Company’s presentation is appropriate. 5 TR 935.

As it did in its initial brief, ABATE asserts that Consumers Energy’s COSS methodology is unfair, and that “storage is almost exclusively used for sales customers, which makes economic sense.” ABATE’s exceptions at 9. As stated in its Reply Brief, Consumers Energy does not disagree that sales customers benefit from the storage available on Consumers Energy’s system. However, the Company allocates 90.6% of the costs for its storage system to sales customers. The amounts allocated to transportation customers are very similar to the amount of the Company’s storage that the transportation customers are allowed to utilize, primarily to balance supplies and usage. The choice of ATL ranges from 6.5% to 10.5% of the customers Annual Contract Quantity (“ACQ”). The default ATL is 8.5% or approximately one month of usage, and 389 of the 452 transportation customers at the end of October 2009 chose an ATL of 8.5%. 5 TR 926. A transportation customer delivers the amount of gas it expects to used during a month, but because it is generally impossible to perfectly match that supply with that which is actually used, any difference is put into or taken out of storage. 5 TR 925. Therefore, the record in this case supports a finding that storage is an integral part of providing service to the Company’s transportation customers, and provides them with flexibility to react to changing use patterns and market conditions.
Throughout this proceeding ABATE has based its COSS arguments on the distinction between ABATE’s preferred “peak day” instead of the Commission ordered “peak month.” e.g., ABATE exceptions at 9, ABATE brief at 8. In its exceptions, ABATE simply restates its briefing position that “Consumers does not have any peak day data, but only the peak month throughput.” ABATE exceptions at 9.\(^{20}\) Once again, ABATE misses the point that the reason Consumers Energy does not have peak “day” data is because the Commission ordered it to use peak month data. As explained by Company witness Yehl:

“Mr. Phillips incorrectly proposes to substitute Consumers Energy’s average and peak allocation method for mains in the Company’s COSS with a peak day demand methodology. The Company’s COSS appropriately uses the average peak methodology, which was approved by the Michigan Public Service Commission in Case No. U-8924. The average and peak methodology recognizes that the Company’s transmission and distribution mains are designed to meet both average usage and peak month usage. Since the transmission and distribution system is available to be used by all customers on a daily basis, the allocation of transmission and distribution main costs must reflect average usage in addition to peak month usage.”

3 TR 490-491. Therefore, Consumers Energy respectfully requests that the Commission adopt the Presiding ALJ’s recommendation that the Commission reaffirm that Consumers Energy should continue to use peak month data in its COSS.

Similarly, ABATE claims that Consumers Energy’s COSS should be disregarded because “the 50% weighting between peak day and storage is a contrived number.” ABATE exceptions at 11. As explained by Company witness Yehl, Consumers Energy used the 50/50 weighing between peak month and storage in compliance with the Commission’s Order in Case No. U-10755. See, 3 TR 484, 507. ABATE continues to ignore the fact that the Commission’s Order itself sets forth the 50/50 weighing, and the fact that the Commission has approved

\(^{20}\) See ABATE brief at 8.
Consumers Energy’s COSS filing since 1996 with the 50/50 weighing. Instead, ABATE continues its attempts to confuse the analysis by talking about the positions the Consumers Energy and Staff took in Case No. U-10755. See, ABATE exceptions at 11, and ABATE brief at 8. As Consumers Energy pointed out in its Initial Brief, the positions that the various parties took in Case No. U-10755 are irrelevant. The Commission issued its Order in that case, and the Order speaks for itself.

Next, Consumers Energy acknowledges that ABATE correctly points out that Consumers Energy should have used Mr. Howard’s more recent exhibit in Case No. U-15454 for the storage capacity allocator calculation. See, ABATE exceptions at 10, ABATE initial brief at 6. As noted in ABATE’s exceptions, Consumers Energy’s witness Mr. Yehl acknowledged the error during the hearing. 3 TR 502. As Consumers Energy pointed out in its Reply Brief, using the more recent exhibit would have only had a minimal impact on the COSS results.

Finally, ABATE attempts to paint Consumers Energy’s COSS as being “flawed…and inaccurate, and produces results which cannot be used in setting just and reasonable rates,” by citing to Mr. Yehl’s acknowledgement that the storage assignment rose for rate XLT in the Test Year, even though throughput was down. ABATE’s exceptions at 10-11 (citing 3 TR 504). A comparison of ABATE’s Exhibits AB-8 and AB-9 shows the reason for rate XLT’s storage assignment increase in the Test Year. A comparison of Lines 21-30 of ABATE Exhibits AB-8 and AB-9 shows that the annual throughput levels for all rate classes decline in the Test Year from the historic period. For the Transportation rate classes, which are shown on line 29 on both Exhibits AB-8 and AB-9, the total Transportation Bcf storage assignment amount is 6.0 Bcf. By comparing line 27 on ABATE Exhibits AB-8 and AB-9, it can be determined that the decrease of throughput for rate class LT results in a change in the
storage assignment from 2.3 to 2.1. In turn, lines 26 and 28 of ABATE Exhibits AB-8 and AB-9 show that rate class ST increased from 1.6 to 1.8, and rate XLT increased from 2.1 to 2.2. Since the total Transportation Bcf storage assignment for both periods is 6.0 Bcf, the increase to rate classes ST and XLT is simply the result of the greater level of decrease in rate class LT (line 27) than in the other two rate classes. Hence, ABATE’s argument that Consumers Energy’s COSS methodology is flawed should be rejected by the Commission.

ABATE failed to present any evidence at the hearing that demonstrated that the COSS methodology was flawed. The COSS methodology used by Consumers Energy was the same methodology previously approved by the Commission. Therefore, Consumers Energy respectfully requests that the Commission adopt the ALJ’s COSS recommendation.

C. **AMI Expense**

The PFD recommends that the Company’s AMI expenses be accepted. PFD at 53. ABATE requests that further capital expenses for AMI be rejected, because the economy is bad currently. ABATE exceptions at 13-14. The Company disagrees and in support references its earlier response, *supra*, to the Attorney General’s exception about AMI funding. The AMI program O&M expenses for the test year 12-months ending September 2010 and the capital expenditures for the year 2009 and the 9-months ending September 2010 are projected based upon the assessment, development, and evaluation of system and field equipment to be used in a pilot program. 3 TR 383. The Commission has consistently recognized AMI’s potential to benefit gas customers and the program should be continued.
D. **LIEEF**

In its exceptions, ABATE makes essentially the same legal argument that the Attorney General has made concerning the legality of the Commission’s LIEEF program. The Company will rely on its reply to the Attorney General’s exceptions, *supra*, in reply to ABATE.

E. **Revenue Decoupling Mechanism**

The PFD recommends approval of Consumers Energy’s proposed Revenue Decoupling Mechanism (“RDM”). PFD at 63. The ALJ also suggested that sales be weather normalized. ABATE, like the Attorney General, states that the RDM should be limited to natural gas usage reductions due to identifiable energy conservation by customers as a result of the utility’s energy conservation program and that average use by customer class be rejected for revenues by customer class. ABATE disagrees with the Company’s proposal to determine average consumption by customer class for the decoupling mechanism contending that additional revenues from new customers are not properly realized. ABATE is incorrect.

The Company’s response to ABATE should be read in conjunction with the Company’s response earlier in this Reply to Exceptions to the Attorney General. As discussed in response to the Attorney General’s exception on this subject, a revenue decoupling mechanism can align the interests of customers and the utility, because it will allow the utility to collect its authorized revenue requirement notwithstanding sales declines due to energy efficiency and other reasons, which in turn provides an incentive for the utility to promote vibrant energy efficiency.

The Company is proposing that the RDM be applicable to all retail and transportation gas customers. The RDM would establish a base line average annual usage per customer for each customer rate class (“baseline average Mcf”) as approved by the Commission
in the most recent general rate case. Annually thereafter, the Company would determine the actual annual average consumption per customer class (“actual average Mcf”) and compare that to the baseline average for each rate class. If the actual average Mcf is below the baseline average Mcf, then Consumers Energy would multiply the difference by the number of customers in that class as established in the most recent general rate case. The resulting volume would then be multiplied by the distribution charge as approved by the Commission in the most recent general rate case, to derive the total amount of revenue to be collected from that rate class. Consumers Energy proposes to collect this amount through an equal per Mcf surcharge applied to all customers in that class over the subsequent twelve months following Commission approval. At the end of the twelve month period, Consumers Energy would determine any over-collection or under-collection of the RDM amount and roll that amount into the determination of the next period RDM adjustment. 4 TR 626-627.

If the actual average Mcf is higher than the baseline average Mcf for a rate class, then Consumers Energy would use the same methodology to determine the over-collection of revenue and calculate a per Mcf credit to be returned to customers in that class over a subsequent twelve month period. Consumers Energy proposes to reconcile the RDM along with its annual EO reconciliation process to permit timely collection or refund of significant amounts. An example of how the revenue decoupling mechanism would be applied is demonstrated in Exhibit A-53, Revenue Decoupling Mechanism-Gas Illustrative Example. The Company proposes to apply the RDM to residential, general sales and transportation customer classes, and include customer choice sales. 4 TR 627.

The Company believes that its proposed RDM will enable Consumers Energy to maintain its traditional rate design (i.e., volumetric-based rates) which maximizes the incentive
to participate in the EO program and continue to motivate customers to improve energy efficiency. The proposed RDM methodology is also administratively simple to implement. An important further benefit is that its adoption will minimize the contentious issue of establishing sales in future general rate cases. 4 TR 628.

ABATE also objects to the Company’s RDM because the Company would receive the additional RDM revenue if the number of customers in a customer class exceeds the number of customers used to establish the baseline rates. ABATE exceptions at 19. However, that perspective ignores the fact that with growth in the number of customers, the utility will have additional expenses necessary to meet the needs of those additional customers. Company witness Rachel Pender explained in cross examination that, when the Company adds additional customers, it also has costs that are associated with serving those customers. These expenses include those associated with the call center, meter readers, and billing department. As the customer base increases, these costs also increase. 4 TR 673-674. Adding new customers and some associated revenue does not substitute for collecting authorized fixed distribution costs since those expenses have to be incurred in order to serve the new customers’ gas needs. On that basis, the Company’s proposed RDM is a reasonable approach. This approach is used by a number of utilities that have implemented decoupling mechanisms across the country. 4 TR 649. The Company’s proposed RDM should be adopted.

F. PEM and OPEB Mechanism

The PFD found that the PEM and OPEB expense items are, to a large degree, the result of various factors and market conditions beyond Consumers Energy’s control. PFD at 65. The PFD believed that it would be advantageous to Consumers Energy and its customers that these expenses be properly and timely funded. The PEM and OPEB should do that. PFD at 65.
ABATE opposes such trackers, suggesting that they are not necessary in the current regulatory environment. The Company respectfully disagrees. Such expenses are volatile and difficult to accurately predict. Further, ABATE contends that such tracking mechanisms are “retroactive ratemaking” and that the MPSC lacks statutory authority to approve such tracking mechanisms. ABATE exceptions at 20-23. ABATE is incorrect. The Commission’s ratemaking authority is clearly broad enough to adopt any of the various decoupling mechanisms that have been proposed. The law is clear in Michigan that the Commission is not bound by any particular type of ratemaking methodology, and can make pragmatic adjustments to respond to any particular circumstances in any given case. The Michigan Court of Appeals has concluded that an Uncollectibles Expense Tracking Mechanism “does not involve retroactive ratemaking because the deferred expense is deemed an expense of the year to which it is deferred and, thus, is recovered on a prospective basis.” In re Application of Michigan Consolidated Gas Company, 281 Mich App 545, 549 (2008). See also Attorney General v Public Service Commission, 189 Mich App 138 (1991); In re Application of Detroit Edison Company, 276 Mich App 216 (2007). Ratemaking mechanisms similar to the PEM and OPEB mechanisms approved in this case have uniformly been upheld by the Court of Appeals as being within the Commission’s ratemaking authority. See e.g., In re Application of Consumers Energy Co., 279 Mich App 180 (2008) which upheld the lawfulness of a pension and other post-employment benefits cost adjustment mechanism:

“The Attorney General asserts that the PSC had no clear and unmistakable statutory or other authority to approve an equalization mechanism it described as follows:

‘The trackers would allow the annual difference between the pension expenses included in rates, and the actual annual pension expense recorded by Consumers, to be deferred. Consumers claimed that if the annual pension expense is
greater than the expense authorized in rates, the difference would be recognized as a regulatory asset for future recovery. Similarly, if the annual pension expense is less than that approved in rates, Consumers would recognize a regulatory liability for distribution to customers.’

The Attorney General asserts that approval of this equalization mechanism constituted prohibited retroactive ratemaking. The PSC concluded that pursuant to its general ratemaking powers it was authorized to adopt a ratemaking formula that included this equalization mechanism, which was designed to ensure, to the extent possible, that rates would match expenses. We note that the rate is presumed, prima facie, to be lawful and reasonable. In re Detroit Edison Application, supra at 224. The Attorney General has failed to overcome this presumption. In Attorney General v Pub Service Comm, 262 Mich App 649, 656; 686 NW2d 804 (2004), this Court held that deferred expenses were an expense of the year to which they were deferred, and were therefore prospective. Specifically, this Court noted, “when capitalized expenditures are amortized, the amortization becomes a current expense even though it reflects expenditures that were capitalized in the past.” Id., quoting Ass’n of Businesses Advocating Tariff Equity v Pub Service Comm, 208 Mich 248, 261; 527 NW2d 533 (1994). There is no sound basis for distinguishing the equalization mechanism approved by the PSC in this case from deferred expenses affirmed in prior caselaw. Accordingly, the deferral of pension and other post-employment benefit expenses to a subsequent year did not constitute retroactive ratemaking.” 279 Mich App at 193-194.

OPEB mechanisms are symmetrical and protect the Company and its ratepayers from the volatility of these expenses which are beyond the Company’s control. They are not retroactive ratemaking.

IV. CONCLUSION

Consumers Energy requests that the Commission issue a final order consistent with the positions set forth above and in Consumers Energy’s Exceptions.

Respectfully submitted,

Dated: April 21, 2010

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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of 
CONSUMERS ENERGY COMPANY 
for authority to increase its rates for the distribution of natural gas and for other relief 

Case No. U-15986

PROOF OF SERVICE

STATE OF MICHIGAN )
) SS
COUNTY OF JACKSON )

Sharon K. Davis, being first duly sworn, deposes and says that she is employed in the Legal Department of Consumers Energy Company; that on April 21, 2010 she served an electronic copy of “Consumers Energy Company’s Reply to Exceptions” upon the persons listed in Attachment 1 hereto, at the e-mail addresses listed therein. She further states that she also served a hard copy of the same document to the Hon. Mark D. Eyster at the address listed in Attachment 1 by depositing the same in the United States mail in the City of Jackson, Michigan with first-class postage thereon fully paid.

Subscribed and sworn to before me this 21st day of April, 2010.

Mary K. Polack, Notary Public
State of Michigan, County of Jackson
My Commission Expires: 09/09/12
Acting in the County of Jackson
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