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May 26, 2011

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

Re: Case No. U-16566

Dear Ms. Kunkle:

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

Thank you for your assistance in this matter.

Very truly yours,

VARNUM,^{LLP}

Eric J. Schneidewind

EJS/mrr

cc: ALJ
parties

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
for authority to reconcile electric)
revenue pursuant to Pilot Revenue)
Decoupling Mechanism)
and for other relief.)
_____)

Case No. U-16566

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

Q. Please state your name and business address.

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

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

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

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

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

10
11 From March 2002 to December 2003, I was Vice President of Operations for
12 Quest. My responsibilities included the overall direction and management of Quest's
13 power supply to its retail customers. This included power supply planning, development
14 of customized products, negotiation with suppliers, planning and acquiring transmission
15 rights, and scheduling and delivery of power. It also included managing risk with respect
16 to market price movements and variation of customer loads.

17
18 Prior to retiring from Detroit Edison in 2001, from 1998 I was the Director of
19 Power Sourcing and Reliability, responsible for purchases and sales of power for mid-
20 term and long-term periods, planning for generation capacity and purchase power needs,

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

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

6
7 **Q. Have you testified as an expert witness in prior proceedings?**

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

13 **Q. What is the purpose of your Testimony?**

14 A. Consumers Energy has proposed its first reconciliation of projected revenues
15 versus actual revenues under its Pilot Revenue Decoupling Mechanism (“PRDM”). The
16 purposes of my Testimony are:

- 17
18 1. *PRDM Factors to Consider:* To explain the factors that the Commission
19 should consider in assuring that any surcharges or credits due to the PRDM
20 have sound factual and logical bases;

1 2. *Cost Responsibility*: To determine if the reconciliation method proposed by
2 Consumers Energy takes into account the differences in cost responsibility
3 between full service customers and Electric Choice (“ROA”) customers;

4
5 3. *Deficiencies in CE’s Reconciliation Method*: To point out the deficiencies in
6 Consumers Energy’s proposed reconciliation method and explain why its
7 method leads to illogical and unfair results;

8
9 4. *Proposed Solution*: To propose a solution for reconciliation of actual
10 revenues versus projected revenues such that (1) Consumers Energy will
11 recover the amount of non-fuel revenues approved by the Commission and (2)
12 any surcharges or credits are apportioned equitably among the various
13 customer classes.

14
15 **Q. Are you sponsoring any exhibits?**

16 A. Yes. I am sponsoring the following exhibits:

17 Exhibit EM-1 (AJZ-1) Qualifications

18 Exhibit EM-2 (AJZ-2) Estimated Net Change in Revenue

19 Exhibit EM-3 (AJZ-3) Netting Method: PSCR and PRDM

20 Exhibit EM-4 (AJZ-4) Consumers Energy Discovery Response

21
22 **Q. Do you favor or oppose adjustment mechanisms such as the PRDM?**

1 A. I view the existence or non-existence of adjustment mechanisms such as the
2 PRDM as a policy issue that should be decided by the Commission. I am neither
3 favoring nor opposing the PRDM. A utility must be able to collect the reasonable and
4 prudent costs for used and useful investment in facilities, from customers who use those
5 facilities, via rates for service. When costs change or customer use changes, then
6 naturally rates have to change as well. An adjustment mechanism merely establishes a
7 procedure for a change in rates due to specified factors.

8
9 **Q. Did the Commission invite recommendations and alternative proposals for**
10 **Consumers Energy's PRDM?**

11 A. Yes. The PRDM was labeled by the Commission as a "pilot" RDM. Although it
12 sketched out a calculation of the revenue variance based on sales per customer, the
13 Commission stated:

14 "The application of the mechanism upon specific customer groups, customer
15 classes, or a combination thereof, will be determined in the reconciliation
16 proceeding." [U-15645 Order, November 2, 2009, page 53.]

17
18 and:

19 "In future proceedings, the Commission encourages parties to file comments or
20 proposals to address the regulatory lag involved in annual reconciliations,
21 exclusion of revenues (sales) attributable to severe outages or other similar
22 circumstances, risk assessment for both the utility and customers, and
23 recommendations for adjustment and evaluation of the pilot." [U-15645 Order,
24 page 54, *emphasis added.*]

25
26
27 **Q. What should be the focus of a revenue decoupling mechanism?**

28 A. An RDM should focus on one single principle: Is the utility collecting revenue to
29 cover fixed costs in the amount that was authorized by the Commission?

1
2 Rates are not designed by use per customer, but rather by revenues that are to be
3 collected and by the use characteristics of energy delivered. While various methods might
4 be used to determine the change in revenue for which the RDM adjusts, the ultimate test
5 of reasonability of an RDM is the *outcome* effect on revenues – *revenue* decoupling. The
6 Commission recognized the focus on revenues in its Order:

7 “Decoupling is a ratemaking mechanism that removes the link between energy
8 sales, or throughput, and the utility’s non-fuel revenues. With decoupling,
9 differences between projected and actual sales, and the associated differences in
10 the utility’s revenues, are reconciled periodically. A well-crafted decoupling
11 mechanism will likely mean that changes in revenue resulting from changes in
12 consumption will no longer cause a utility to file a general rate case.” [*U-15645*
13 *Order, pages 51-52.*]
14
15

16 **Q. Both the Commission and Consumers Energy apply the qualifier “non-fuel”**
17 **to revenues. What does “non-fuel” mean?**

18 A. “Non-fuel” should mean “excluding the components of revenues and costs that
19 are in the PSCR.” The PSCR mechanism considers not only fuel costs but also purchased
20 power expenses, transmission expenses and Midwest ISO costs and credits, revenues
21 from wholesales sales of energy and ancillary services, some environmental costs, and
22 the line losses associated with these components. I will use the term “non-fuel” with that
23 meaning.
24

25 It should be noted that the Commission order describing the calculation of the
26 revenue variance for the PRDM specified “non-fuel revenue (distribution charge).” [*U-*
27 *15645 Order, page 53.*] The parenthetical “(distribution charge)” appears to be an error.

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1. PRDM Factors to Consider

Q. What elements should the Commission consider in a well-designed PRDM for Consumers Energy

A. There are three factors that the Commission should consider in the PRDM:

1. *There should be separate adjustments for recovery of revenue related to power supply and related to delivery. The utility’s Full Service (“bundled”) customers would be subject to both adjustments, and the utility’s Electric Choice (“ROA”) delivery customers would be subject only to the delivery adjustment.*

2. *The surcharge/credit adjustments should be applied on a total company basis, not on a rate class basis. Otherwise, the rates to customers revised via the PRDM method will diverge from rates revised via a general rate case. This occurs because “fixed costs” are fixed for the company in total, but are not “fixed” for rate classes because costs are allocated to customer classes based on energy use characteristics – and the PRDM is supposed to adjust for changes in energy use. Calculation of the amount to be recovered would be done by reviewing rate class revenues, but application of the surcharge/credit would be company wide.*

1 3. *The sales increase or decrease upon which the PRDM rate adjustment is*
2 *based should be limited by the actual increase or decrease in sales that*
3 *the utility has experienced.*

4
5 **Q. Regarding the first factor to be considered in an RDM, why should there be**
6 **separate RDM surcharges or credits for recovery of power supply and delivery**
7 **costs?**

8 A. The purpose of the PRDM is to recover the fixed costs of the utility independent
9 of the level of actual sales. Consumers Energy has fixed costs related to the supply of
10 power to its customers – primarily from its generation plants. It also has fixed costs
11 related to the delivery of energy over its distribution facilities to customers. Consumers
12 Energy has an Electric Choice program whereby some customers take – and pay for –
13 delivery service only, while traditional full-service utility customers take – and pay for –
14 both delivery service and power supply service.

15
16 Thus, (a) the total amount of energy sales for delivery service is different from the total
17 amount of energy sales for power supply service; and (b) if total sales change, the
18 amount of short or excess revenues to cover fixed delivery costs versus fixed power
19 supply costs will be different.

20
21 Further, when sales decrease, PSCR expenses also decrease, and full-service customers
22 receive credit for the savings via the PSCR process. Electric Choice customers are not
23 subject to the PSCR and therefore would not receive the benefit of PSCR savings.

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Therefore, it follows obviously that if the PRDM is to true up recovery of fixed costs, then those customers that take delivery service should be trued up to only delivery costs based on delivery sales, and those customers that take power supply service should be trued up to power supply costs based on power supply sales.

Since the PRDM is used to charge or credit customers the difference between the utility's authorized fixed charges at a specified sales level and the amount of fixed charges collected at a *different* sales level, the charge or credit needed to fully recover delivery costs will be different from the charge or credit needed to fully recover power supply costs. Therefore, separate charges/credits are required for delivery and for power supply.

Q. What is your recommendation regarding the separation of delivery costs and power supply costs in the PRDM?

A. First, in the determination of the authorized amount of revenue that should be collected, delivery revenues should be separated from power supply revenues. Second, the PRDM surcharge or credit for distribution should be calculated using sales to delivery customers, and the PRDM surcharge or credit for power supply should be calculated using sales to power supply customers. Third, the same delivery surcharge or credit should apply to all delivery customers, both ROA and utility Full-Service customers. Fourth, the power supply surcharge or credit should apply only to utility Full-Service customers.

1 **Q. Does Consumers Energy’s proposed method for surcharges or credits in its**
2 **PRDM separate power supply revenues from delivery revenues?**

3 A. No it does not. I will explain the consequences of this error in Section 2 of my
4 Testimony.

5
6 **Q. Regarding the second factor to be considered in an RDM, you have**
7 **recommended that the adjustments in an RDM should be calculated on a total**
8 **company basis, not on a rate class basis. Would you explain?**

9 A. Yes. The fundamental, underlying reason is that the “fixed” costs that an RDM is
10 intended to recover (or refund) are *not in fact “fixed” for individual rate classes*. Rather,
11 such costs are fixed for the company in total, and then are *allocated* to rate classes by the
12 *relative, proportional* energy use characteristics of each class, such as proportion of total
13 sales or proportion of total peak demand. The great majority of the fixed costs represent
14 facilities, such as generation plants and distribution lines and equipment, that are used
15 jointly by all rate classes at different times, and so are joint economic costs that must be
16 allocated by some reasonable, but not unique, method. The methods of allocation have
17 been established by Michigan law and Commission past orders, and are based primarily
18 on energy use characteristics.

19
20 Therefore, if the energy use characteristics of a rate class change, then the
21 *proportion* of total costs for which the rate class will be *deemed responsible* will also
22 change. To assume that the class will be responsible for the *same* dollar share of total

1 company fixed costs *regardless of the amount of class sales* is contrary to the concept of
2 allocation of fixed costs, which is fairly straightforward arithmetic.

3

4 **Q. Are the rate adjustments proposed by Consumers Energy in the PRDM**
5 **based on customer rate classes or on total company sales?**

6 A. The rate adjustments in the PRDM proposed by Consumers Energy are based on
7 customer rate classes, as explained by Mr. Crutchfield. [*Crutchfield Testimony, page 8,*
8 *line 18, through page 9, line 2, and Exhibit A-9.*]

9

10 **Q. What is the difference in effect on rates if an RDM bases adjustments on rate**
11 **classes versus total company sales?**

12 A. Both the rate class method and the total sales method calculate the same amount
13 of dollars to be recovered, but they differ in how surcharges are calculated and applied.
14 Having modeled examples of the rate class method, the total sales method, and typical
15 rate case increases, I have concluded that applying surcharges via the rate class method
16 for an RDM does not reasonably reflect the class rate changes that would occur in a rate
17 case, while applying surcharges via the total sales method results in an effect on class
18 rates that is much closer to, if not exactly the same as, what would occur in a rate case.

19

20 **Q. What method are you recommending?**

21 A. Calculating the PRDM revenue and charging to customers involve two separate
22 steps. The calculation of total PRDM *revenue to be recovered* should be done by rate

1 class – because the rates designed for various rate classes are different – but with separate
2 amounts for Delivery and for Power Supply for reasons I have explained.

3
4 For *charging the PRDM to customers*, however, I recommend an *equal surcharge*
5 *to all affected rate classes*, again subject to separate charges for Delivery and for Power
6 Supply – there would be *one distribution PRDM surcharge* applied to all distribution
7 kWh sales and paid by all distribution customers, both Full Service and ROA; and there
8 would be *one power supply PRDM surcharge* applied to all power supply kWh sales and
9 paid by all Full Service customers

10
11 The result will be much closer to what would happen in a general rate case and
12 will reduce the volatility of rate changes for customers – up and down, or down and up –
13 between rate cases, due to the PRDM. The total company method will collect or refund
14 the exact same amount of whatever dollars are approved by the Commission, but it will
15 do so more equitably among the various customer classes.

16
17 **Q. Regarding the third factor to be considered in an RDM, you have stated that**
18 **the sales increase or decrease upon which an RDM rate adjustment is based should**
19 **be limited by the actual increase or decrease in sales that the utility has experienced.**
20 **Would you explain?**

21 A. Although this factor may appear to be too obvious to even mention, it is important
22 to keep in mind that if the PRDM includes the effects of an Energy Optimization (EO)
23 program, the effectiveness of the EO program may be judged by computer modeling of

1 energy use or other “but for” estimations of what would have occurred without the EO
2 program, rather than by the difference between rate case forecast sales and actual metered
3 sales. Consequently, it is quite possible that the modeled or estimated effect of the EO
4 program – when used to adjust the design sales level from the previous rate case – results
5 in a sales level different from what the utility actually has metered. In this situation,
6 actual metered sales over a defined time period should be the boundary for sales changes
7 that would be used to revise rates in a PRDM.

8
9 In the PRDM reconciliation proposed by Consumers Energy, it appears that actual
10 metered sales – not modeled EO savings – are being used. So in this proceeding there is
11 no need to adjust for an overestimation of EO savings.

12
13 **2. Cost Responsibility**

14
15 **Q. Does the reconciliation method proposed by Consumers Energy take into**
16 **account the differences in cost responsibility between Full service Customers and**
17 **Electric Choice (ROA) customers?**

18 A. No, it does not. Consumers Energy’s proposed method would impose a charge on
19 ROA customers to recover revenue differences due to power supply service – a service
20 which ROA customers by definition do not take.

21
22 **Q. Does Consumers Energy’s proposed method for surcharges or credits in its**
23 **PRDM separate power supply revenues from delivery revenues?**

1 A. No it does not. Consumers Energy witness Mr. Philip E. Crutchfield has stated
2 that “. . . the Company has combined the decoupled revenue for Secondary Full Service
3 and Secondary ROA customers, and has combined the decoupled revenue for Primary
4 Full Service and Primary ROA customers together for purposes of determining the
5 amount of refund or collection required from those respective groups.” [*Crutchfield*
6 *Testimony, page 10, lines 1-4.*]

7
8 **Q. Is this consistent with what Consumers Energy stated it would do, during the**
9 **creation of the PRDM?**

10 A. No. In Case No U-15645, which created the PRDM, Consumers Energy stated it
11 would have separate surcharges for ROA classes, reflecting only delivery charges:

12 “Q. If the Commission ordered the implementation of the RDM would it apply
13 to ROA sales?

14 A. Yes, the RDM would apply to ROA sales as these customers are included
15 in the Company’s Energy Optimization Programs. ROA sales would be
16 included in their respective rate class, but would have a separate charge
17 that reflected only their delivery charges.” [*U-15645, Rebuttal Testimony*
18 *of Stephen P. Stubleski, page 17, lines 12-16, emphasis added.*]
19

20 **Q. Does Mr. Crutchfield explain the basis for combining Full Service and ROA**
21 **customer groups?**

22 A. The Consumers Energy method combines power supply revenue and delivery
23 revenue. But the explanation speaks mostly about the drawback of using a use-per-
24 customer method that does not account for unanticipated transfer of customers from one
25 group to another. However, this drawback can be remedied while keeping the power
26 supply revenue separate from the delivery revenue.

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The reason that Mr. Crutchfield gives for combining power supply revenue and delivery revenue and charging ROA customers for both is “. . . customers who moved to ROA do not escape obligations for recovery of non-fuel revenue.”

Q. What is your assessment of this reasoning?

A. The reasoning lacks sufficient specificity – it does not distinguish two separate categories of “obligations” but rather lumps them under one label as “non-fuel revenue.” This is an important error.

First, as *delivery customers*, under a PRDM ROA customers should be responsible for a fair portion of the deviation of actual *delivery* revenues compared to authorized *delivery* revenues.

Second, since ROA customers are not *power supply* customers of Consumers Energy, there is no “obligation” on ROA customers to pay for any part of power supply revenues. Mr. Crutchfield has provided no basis for the assertion that ROA customers have an “obligation” to pay any type of charges related to power supply.

ROA customers do not take power supply service. They do not pay for power supply service. They do not receive the benefits of PSCR savings that Full Service customers receive when customers migrate from Full Service to ROA Service. They are not allocated power supply costs because their use characteristics of power supply service

1 are zero. They may in fact be barred from receiving charges not authorized by law for
2 power supply service – a service they do not receive – because of the cost-of-service
3 requirements under PA 286. From any perspective, ROA customers should not be
4 charged for power supply service, either directly or indirectly via reconciliation of the
5 RDM.

6
7 **Q. Would you explain how the remaining Full Service customers receive**
8 **benefits of PSCR savings when other customers transfer to ROA service?**

9 A. Yes. When customers transfer from Full Service to ROA service, the utility's
10 PSCR costs decrease *at the margin*, not at the average PSCR cost. The utility saves on its
11 most costly supply resources – assuming it is acting in prudent manner in its operations –
12 which for Consumers Energy is its purchased power. The utility also saves on
13 transmission costs and Midwest ISO charges. Further, the utility has an increased ability
14 to sell power into the wholesale market.

15
16 Full Service customers capture the benefit of reduced marginal costs of power via
17 the PSCR proceedings, and this benefit is an offset to surcharges under the PRDM.
18 Exhibit EM-2 (AJZ-2) quantifies the estimated net change in revenue when both the
19 decrease in Power Supply revenues and the increase in PSCR savings are considered.
20 Table A shows that under the current rates established in Case No. U-16191 and
21 Consumers Energy's PSCR forecast for year 2011 in Case No. U-16432, the net effect is
22 very small, close to zero.

23

1 Full Service customers are affected by two adjustment clauses: the PRDM and
2 the PSCR. Thus, the *net* effect on Full Service customers must consider both
3 adjustments. Diagram I in Exhibit EM-3 illustrates how both the PRDM and PSCR
4 mechanisms act together such that Full Service Customers get the net effect of both a
5 PRDM surcharge and a PSCR refund from customer transfers to ROA service.
6 Therefore, as a result of Consumers Energy's proposal to apply the same surcharge to
7 both Full Service and ROA customers in a rate class, Full Service customers will see
8 *virtually no change in the net amount* of what they will pay because the PSCR savings
9 will offset the PRDM surcharge; however, ROA customers, receiving no PSCR savings,
10 will get the *full amount* of the surcharge.

11
12 Diagram II in Exhibit EM-3 (AJZ-3) demonstrates that the PSCR Base that is
13 subtracted from Power Supply revenues in the PRDM proceeding does not serve to
14 quantify the actual reduction in Power Supply revenues but rather acts merely as an
15 intermediate calculation point when both the PRDM and PSCR are taken together.

16
17 In summary, ROA customers do not take Power Supply service and so are not
18 included in PSCR proceedings. Consequently, ROA customers do not receive benefits
19 from reduced PSCR costs and so should not be assessed any portion of a shortfall in
20 Power Supply revenues. ROA customers take only Delivery service. This is another
21 reason why it is necessary to have a separate, Delivery-service-only, surcharge/credit for
22 Delivery service customers.

23

1 **Q. Would ROA customers be allocated any power supply costs under cost of**
2 **service provisions in PA 286?**

3 A. No, they would not. PA 286 requires a “50-25-25” allocation method for
4 “production-related and transmission costs.” A “50-25-25” allocation method allocates
5 50% of the costs in question according to the customer class’s proportional contribution
6 to the average of the 12 monthly utility peaks in a given year; it allocates 25% of the
7 costs according to the energy provided by the utility and used by the customer class
8 during the Midwest ISO on-peak hours for the given year; and it allocates the remaining
9 25% of the costs according to the energy provided by the utility and used in total by the
10 customer class in the given year.

11
12 Under the “50-25-25” method required by PA 286, ROA customers would not be
13 allocated any of the utility’s production related or transmission costs. The reason for this
14 is straightforward: ROA customers do not take energy from the utility. Therefore, (a)
15 they do not contribute to the utility’s monthly peaks; (b) they do not take utility energy
16 during the Midwest ISO’s on-peak hours; and (c) they do not take utility energy at all at
17 any time.

18
19 Consequently, if the intent of PA 286 is for all customer classes, including ROA
20 customer classes, to pay rates equal to the cost of providing service to the respective
21 classes, then the rates ROA customers pay should not include any production related or
22 transmission costs.

23

1 **Q. What is the remedy for Consumers Energy’s error of including power supply**
2 **revenues in the surcharges or credits for ROA customers?**

3 A. The Commission should affirm that separate surcharges or credits should be
4 calculated for Delivery and Power Supply and that the Power Supply part of the PRDM
5 reconciliation should apply only to Full Service customers.

6
7 **3. Deficiencies in CE’s Reconciliation Method**

8
9 **Q. What are the deficiencies in Consumers Energy’s proposed reconciliation**
10 **method for the PRDM?**

11 A. There are four areas of deficiencies:

12
13 a. *Improper Allocation of Responsibility to ROA Customers* – Consumers

14 Energy has proposed to charge ROA customers for a portion of the power
15 supply revenue deviation. This is a significant error, which I have explained
16 previously in Section 1 and Section 2 of my Testimony.

17
18 b. *Inequitable Rate Class Surcharges/Credits* – Consumers Energy has proposed

19 separate surcharges/credits by rate class, instead of uniform charges for Power
20 Supply and for Delivery that would more closely fit rate class increases or
21 decreases determined by a typical rate case. The effect on rate classes is
22 inequitable, as I have explained previously in Section 1 of my Testimony.

1 c. *Failure to Use Actual Revenues* – Despite the intent of the PRDM to reconcile
2 authorized non-fuel revenues to actual non-fuel revenues, Consumers Energy
3 does not report or use *actual* non-fuel revenues in its proposed method.
4

5 d. *Lack of Recognition of Rate Class Transfers* – The use-per-customer method
6 that Consumers Energy applies in its reconciliation calculations does not
7 account for transfer of customers among rate classes.
8

9 **Q. You have addressed deficiencies a and b previously in your Testimony.**

10 **Would you explain deficiency c?**

11 A. Yes. I have explained deficiencies a and b – Improper Allocation of
12 Responsibility to ROA Customers and Inequitable Rate Class Surcharges/Credits –
13 previously in my Testimony.
14

15 Regarding deficiency c – Failure to Use Actual Revenues – since the PRDM is
16 intended to decouple actual revenues from the effects of sales such that the utility can
17 collect its authorized non-fuel revenues, it is necessary to take a look at actual revenues,
18 at the minimum to be able to assess the reasonability of the outcome of whatever
19 reconciliation arithmetic is used.
20

21 **Q. Is the outcome of Consumers Energy’s proposed reconciliation, the**
22 **determination of surcharges and credits, reasonable?**

1 A. From the information presented by Consumers Energy in its direct filing, the
2 outcome of determination of surcharges and credits has not been shown to be reasonable.
3 Actual revenues must be reviewed for the Commission to make a final assessment of
4 reasonability.

5
6 Consumers Energy has shown that Delivery sales are up and Power Supply sales
7 are down. This provides additional evidence that there should be separate
8 surcharges/credits for Delivery service versus Power Supply service. Therefore,
9 Consumers Energy's proposal to use the same surcharge/credit for both Full Service and
10 ROA customers is unreasonable.

11
12 Consumers Energy's Exhibit A-8, page 5 of 5 shows that "Actual" total usage is
13 *greater* than "Baseline" – the sum of all "Baseline" usage is 34,924,798 MWh, and the
14 sum of all "Actual" usage is 35,355,736 MWh (adding lines 1, 4, 7, 10, and 13 of
15 columns (a) and (b) respectively). Total usage, for Bundled and ROA combined,
16 represents Delivery service. Yet, Exhibit A-8, page 5 of 5 also shows that Actual usage
17 for "bundled" classes is *less* than Baseline – the sum of all Baseline usage is 33,211,301
18 MWh the sum of all Actual of 31,413,686 MWh (adding lines 1, 4, and 10 of columns (a)
19 and (b) respectively). Bundled usage represents Power Supply service.

20
21 Without knowing the actual revenues, there is no way the Commission can
22 determine whether the *actual* non-fuel revenues for Delivery and Power Supply are less
23 than, equal to, or greater than *authorized* revenues. Actual Delivery revenues and actual

1 Power Supply revenues for the reconciliation period are simple facts that are readily
2 available from Consumers Energy – there is no need to estimate actual numbers when
3 actual numbers are available, no need to estimate revenues when one can measure them.
4

5 In its response to Energy Michigan’s discovery question 5, Consumers Energy has
6 provided actual revenues for the reconciliation period, broken out by rate class and by
7 Delivery service and Power Supply service. Exhibit EM-4 (AJZ-4) contains Consumers
8 Energy’s response. The Commission should compare these actual revenues to the
9 authorized non-fuel revenues to determine the surcharges and credits under the PRDM.
10

11 **Q. Would you explain deficiency d – Lack of Recognition of Rate Class**
12 **Transfers?**

13 A. Yes. The reconciliation method that Consumers Energy proposes relies on
14 calculating average use-per-customer for each customer class based on kWh sales and
15 number of customers in the authorized rate design, and likewise based on kWh sales and
16 customers that actually occurred. The difference between the two use-per-customer
17 averages is multiplied by the number of customers in the authorized rate design to get a
18 calculated increase or decrease in sales for each rate class. Mr. Crutchfield describes this
19 method on page 6, line 21, through page 7, line 6 of his Testimony.
20

21 The shortcoming of this method of calculation is that it does not account for the
22 possibility that the *actual number of customers* may be different from the number of
23 customers in the authorized rate design. In fact, the actual number of customers *is*

1 different from the authorized number in each of the five rate classes that Consumer
2 Energy analyzed. Further, due to transfers from Full Service (“Bundled”) to ROA
3 Service, the number of Full Service customers decreased substantially while the number
4 of ROA Service customers increased substantially.

5
6 The result of this shortcoming is that the outcome of surcharges/credits do not
7 always make sense. For example, Exhibit A-8, page 5 of 5 shows that for Secondary
8 ROA Service actual usage of 266,944 MWh (line 7, column (b)) is *greater* than
9 authorized usage of 229,741 MWh (line 7, column (a)) yet a *revenue shortfall* of
10 \$179,000 has been calculated for the class (line 9, column (d)).

11
12 Similarly, for example, for Primary ROA Service, actual usage of 3,675,106
13 MWh (line 13, column (b)) is *two and a half times* the authorized usage of 1,483,756
14 MWh (line 13, column (a)), yet the revenue credit for the class is only \$51,000 (line 15,
15 column (d)). The outcome is that usage above authorized of 2,191,349 MWh (line 13,
16 column (c)) results in an average credit of \$0.000014 per kWh (= \$51,000 / 3,675,106
17 MWh). This is not reasonable given that Consumers Energy calculates average Primary
18 ROA “non-fuel” rates of \$0.008053 and \$.005222 per kWh in Exhibit A-5, rates that are
19 several hundred times greater than the proposed credit.

20
21

1 **Q. What is your conclusion regarding the failure to recognize rate class**
2 **transfers?**

3 A. Using the average use-per-customer method in the PRDM without recognizing the
4 effects of transfer of customers among rate classes results in the calculation of illogical
5 and unreasonable PRDM surcharges and credits for rate classes.

6
7 **Q. Did not the Commission specify a use-per-customer method in its Order**
8 **establishing the PRDM?**

9 A. Yes, the Commission did. [*U-15645 November 2, 2009 Order, page 53.*] The
10 Commission also recognized that its was establishing a pilot RDM and consequently
11 created an opportunity for change: “The application of the mechanism upon specific
12 customer groups, customer classes, or a combination thereof, will be determined in the
13 reconciliation proceeding.” [*U-15645 Order, page 53.*] Also, the Commission invited
14 “recommendations for adjustment and evaluation of the pilot.” [*U-15645 Order, page*
15 54.]

16
17 If the results of the proposed method turn out to be illogical and unreasonable, for
18 reasons emerging now during the reconciliation when actual results are available, then
19 the pilot method should be should be changed such that (a) the utility receives the proper
20 revenues representing decoupling and (b) application of surcharges and credits to
21 customers are reasonable.

22

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4. Proposed Solution

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Q. Are you proposing a solution to the deficiencies of the PRDM reconciliation method.

A. Yes. The remedy consists of two parts. The first part assures that the utility will receive the proper amount of revenues intended under the PRDM. The second part assures that all customer classes will be surcharged or credited equitably in a manner similar to what they would have experienced in a general rate case.

Q. What is the first part of the solution?

A. I recommend that the amount of revenues that the utility should surcharge or credit under the PRDM should be determined in the following way:

(a) For the rate classes to be included in the PRDM, *both Full Service and ROA*, in aggregate for all classes together, (i) the *total Delivery service revenue* from the authorized rate designs in effect during the reconciliation period should be compared to (ii) the actual Delivery revenue received by Consumers Energy for the reconciliation period. The utility should refund the positive difference of (ii) minus (i) or should collect the negative difference of (ii) minus (i).

(b) For *only the Full Service rate classes* to be included in the PRDM, in aggregate for all classes together, (i) the *total Power Supply service revenue* from the authorized rate designs in effect during the reconciliation period less the PSCR base and factors (if any) included in the rate designs should be compared to (ii) the actual Power

1 Supply revenue received by Consumers Energy less the actual PSCR base and factors for
2 the reconciliation period. The utility should refund the positive difference of (ii) minus (i)
3 or should collect the negative difference of (ii) minus (i).

4
5 **Q. What is the second part of the solution?**

6 A. The surcharge or credit for the Delivery service revenue difference determined
7 from (a) above should be applied as a uniform surcharge/credit per kWh to all Delivery
8 service customers, both Full Service and ROA

9
10 The surcharge or credit for the Power Supply service revenue difference
11 determined from (b) above should be applied as a uniform surcharge/credit per kWh to all
12 Power Supply service customers – these would be the Full Service customers only,
13 excluding ROA customers.

14
15 **Q. What are the benefits of your proposed solution?**

16 A. Using actual revenues and applying uniform surcharges/credits avoids the four
17 deficiencies of the Consumers Energy method. It provides the utility with exactly the
18 “non-fuel” revenues authorized by the Commission. It applies surcharges and credits
19 consistent with the differences in cost responsibility between Full Service and ROA
20 customers, as explained in Section 2 of my Testimony. The solution is also consistent
21 with the features of a well-designed RDM as explained in Section 1 of my Testimony.

22
23 **Q. Does this conclude your Direct Testimony?**

1 A. Yes, it does.

ALEXANDER J. ZAKEM

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

CONSULTANT – MERCHANT ENERGY AND UTILITY REGULATION

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

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

Vice President, Operations

March 2002 to December 2003

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

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

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

Director, Power Sourcing and Reliability

May 1998 to April 2001

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

- **Planning** -- Planned summer power requirements for Detroit Edison, including mix of generation, option contracts, hub purchases, load management, and transmission, which balanced and optimized physical risk and financial risk.
- **Contract Management** – Established decision, review, and approval process for evaluation and execution of power transactions, including mark-to-market valuation.
- **Execution** -- Executed summer plans, contracting annually for purchased power and transmission services. Directed negotiations for customized structured contracts to provide the company with increased operating flexibility, dispatch price choices, and delivery reliability.
- **Risk Management** – Developed an optimizing algorithm using load shapes to minimize corporate exposure to volatile power prices. Developed a hedging strategy to fit power purchases to the corporation's risk tolerance level.
- **Acquisitions** -- Team leader for acquisition of new peakers.
- **Settlements** -- Negotiated and settled liquidated damages claims.

Relevant prior positions within Detroit Edison

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

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

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

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

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

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

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

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

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

Special Assignment Executive Council Staff Mar 90 to Dec 90

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

Pricing Analyst Marketing / Rate Aug 82 to Mar 90

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

Engineer Resource Planning Aug 79 to Dec 81

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

PRIOR POSITIONS: Prior to DTE Energy

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

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

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

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

PUBLICATIONS & PAPERS:

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

PREVIOUS TESTIMONY:

- Michigan Public Service Commission, U-16472
- Michigan Public Service Commission, U-16191
- Michigan Public Service Commission, U-15768.
- Michigan Public Service Commission, U-15744.
- Federal Energy Regulatory Commission, Docket No. EL04-135 & related dockets.
- Michigan Public Service Commission, U-12489.
- Michigan Public Service Commission, U-8871.
- Michigan Public Service Commission, U-8110 part 2.
- Michigan Public Service Commission, U-8110, part 1.
- Michigan Public Service Commission, U-7930 rehearing.
- Michigan Public Service Commission, U-7930.

Estimated Net Change in Revenue: Revenue Reduction vs. Savings Due To Electric Choice

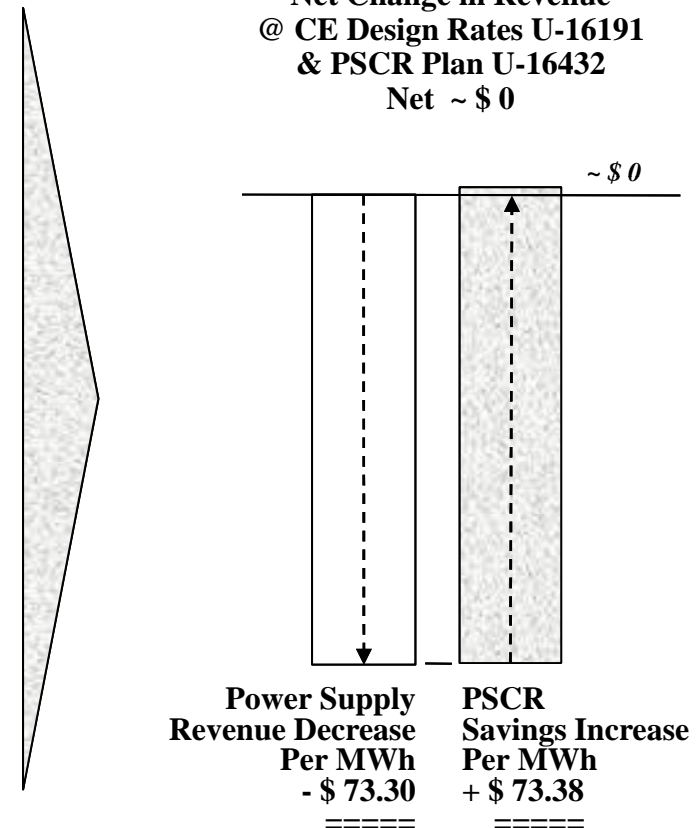
Case No: U-16566
Exhibit: EM-2 (AJZ-2)
Page: 1 of 1

A. Calculation of Net Change

I. Decrease in Power Supply Revenues ¹			
a. Decrease at Average Consumers Energy Rate Design Power Supply Revenues: Secondary + Primary – E-1:			
Design revenues	\$1,488,945,000		
Design sales (MWh)	<u>20,313,935</u>		
<i>Average reduction (\$/MWh)</i>			- \$ 73.30
			=====
II. PSCR Savings ²			
a. Increase in Wholesale Sales at Average Sale Price:			
Total revenues	\$39,140,000		
Total sales (MWh)	<u>642,414</u>		
<i>Average increase (\$/MWh)</i>			\$60.93
b. Transmission Savings:			
Net transmission expense	\$242,920,285		
System requirements (MWh)	<u>36,573,385</u>		
<i>Average savings (\$/MWh)</i>			\$6.64
c. Total Average Savings = a + b			
			\$67.57
d. x Line Loss Savings			
			<u>x 1.086</u>
e. Total PSCR Average Savings (\$/MWh)			
			+ \$ 73.38
			=====
III. Net Change in Revenue			
			~ \$ 0
			=====

B. Illustration of Net Change

**Net Change in Revenue
@ CE Design Rates U-16191
& PSCR Plan U-16432
Net ~ \$ 0**

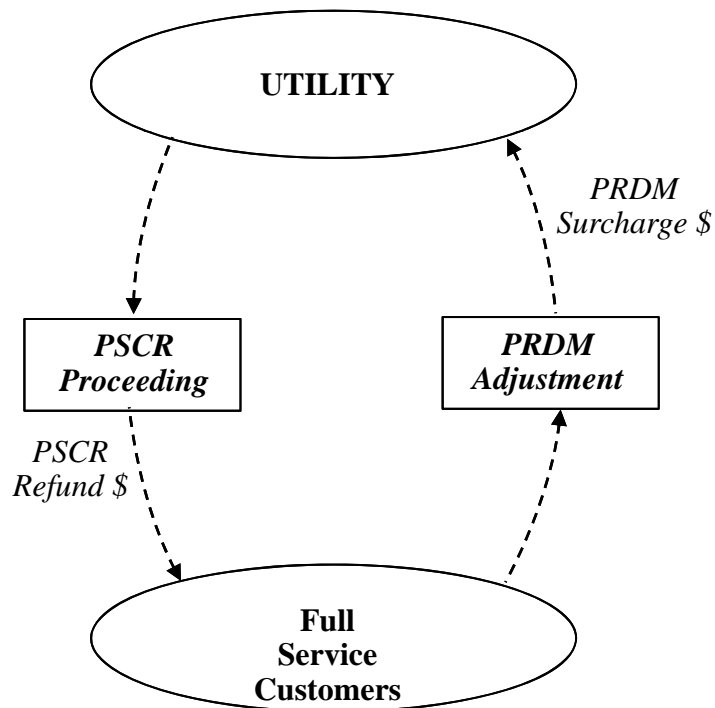


1. Source: CE U-16191 Order, 4Nov2010: Attachment A, Schedule F-2.
2. Source: CE U-16432 PSCR Plan for 2011: Exhibit A-1; Exhibit A-14, pages 2 & 3.

Netting Method: Power Supply Cost Recovery and Pilot Revenue Decoupling Mechanism

Case No: U-16566
Exhibit: EM-3 (AJZ-3)
Page: 1 of 1

I. PSCR Savings & PRDM Surcharge Are Netted Via Two Proceedings



Customers receive: PSCR Refund \$
Customers pay: PRDM Surcharge \$



II. PSCR Base is the Intermediate Benchmark for Adjustments in the Two Proceedings

- A. PSCR Refund = Incremental Savings - PSCR Base \$
 - B. PRDM Surcharge = Power Supply Tariff Revenues - PSCR Base \$
 - C. Net paid by Full Service Customers = B - A
- $$= \text{Tariff Rev} - \text{PSCR Base} - (\text{Incremental Savings} - \text{PSCR Base})$$
- $$= \text{Tariff Rev} - \text{PSCR Base} - \text{Incremental Savings} + \text{PSCR Base}$$
- $$= \text{Tariff Rev} - \text{Incremental Savings}$$
- ~ 0 ~ very small for year 2011



Conclusion:

- The effect on remaining full service customers of migration to Electric Choice depends on the *difference between Power Supply tariff revenues and incremental PSCR savings.*

16566-EM-CE-26

Question:

6. a. Does Mr. Clifford use the terms “non-fuel revenue” and “non-fuel rate” to mean excluding exactly the components of revenue or costs that are included in the PSCR base and factor – for example, transmission costs, Midwest ISO costs, purchased power, power sales?

- b. If the answer to 6.a is “no,” then explain all differences between what is excluded under “non-fuel” and what is contained in the PSCR.

Response:

6. a. Yes. The non-fuel revenue is that portion of approved tariff revenue remaining after PSCR costs are removed as shown on Exhibit: A-5(PEC-1).

- b. N/A


Philip E. Clifford
May 10, 2011

16566-EM-Ce-25 - Attachment

Actual Revenue Breakdown

Period: December 2009 - November 2010

	(a)	(b)	(c)	(d)	(e)	(f)	(g)
	<u>Sales</u>	<u>Total Revenue</u>	<u>PSCR Base / Factor</u>	<u>"Non-Fuel" (1)</u>	<u>Power Supply</u>	<u>Delivery</u>	<u>Surcharges</u>
1 Residential	13,017,545,289	\$ 1,663,729,474	\$ 704,532,314	\$ 827,179,342	\$1,158,519,371	\$373,192,285	\$ 132,017,817
2 Secondary Bundled	7,581,697,939	\$ 897,607,334	\$ 410,078,706	\$ 431,516,069	\$633,297,734	\$208,297,041	\$ 56,012,559
3 Secondary ROA	266,944,513	\$ 6,879,623	\$ -	\$ 5,643,918	\$15,289	\$5,628,630	\$ 1,235,705
4 Primary Bundled	10,814,430,511	\$ 951,104,418	\$ 582,257,918	\$ 322,586,524	\$600,612,246	\$304,232,196	\$ 46,259,977
5 Primary ROA	<u>3,675,110,131</u>	<u>\$ 46,516,925</u>	<u>\$ -</u>	<u>\$ 31,373,564</u>	<u>\$145,482</u>	<u>\$31,228,083</u>	<u>\$ 15,143,361</u>
6	35,355,728,383	\$ 3,565,837,774	\$ 1,696,868,938	\$ 1,618,299,418	\$ 2,392,590,121	\$ 922,578,235	\$ 250,669,418

(1) "Non-Fuel" = Revenue less PSCR Base, Factor and Surcharges

Source:

- (a) General Ledger
- (b) General Ledger
- (c) PSCR Base = (a) x .05285, PSCR Factor = General Ledger
- (d) (b) - (c) - (g)
- (e) General Ledger
- (f) General Ledger
- (g) (b) - (e) - (f)

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56600041

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
CONSUMERS ENERGY COMPANY)
for authority to reconcile electric)
revenue pursuant to Pilot Revenue)
Decoupling Mechanism)
and for other relief.)
_____)

Case No. U-16566

PROOF OF SERVICE

STATE OF MICHIGAN)
) ss.
COUNTY OF INGHAM)

Monica Robinson, the undersigned, being first duly sworn, deposes and says that she is a Legal Secretary at Varnum LLP and that on the 26th day of May, 2011, she served a copy of Direct Testimony of Alex J. Zakem on Behalf of Energy Michigan, Inc. upon those individuals listed on the attached Service List by email at their last known addresses.

Monica Robinson

CASE NO. U-16566 SERVICE LIST

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