In the matter, on the Commission’s own motion, to implement the provisions of Section 10a(10) of 2000 PA 141. Case No. U-12639

At the December 20, 2001 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. Laura Chappelle, Chairman
Hon. David A. Svanda, Commissioner
Hon. Robert B. Nelson, Commissioner

OPINION AND ORDER

I.

HISTORY OF PROCEEDINGS

On October 24, 2000, the Commission issued an order commencing this case to implement Section 10a(10) of 2000 PA 141 (Act 141), MCL 460.10a(10), which requires the Commission to determine the net stranded costs created by permitting customers to purchase generation services from alternative electric suppliers.

On November 27, 2000, a prehearing conference was held before Daniel E. Nickerson, Jr. (ALJ), who granted petitions for leave to intervene filed by Consumers Energy Company (Consumers), The Detroit Edison Company (Detroit Edison), the Association of Businesses Advocating Tariff Equity (ABATE), Energy Michigan, Attorney General Jennifer M. Granholm (Attorney General), the Midland Cogeneration Venture Limited Partnership (MCV), Indiana

At the prehearing conference, the ALJ ruled that the scope of the case was to determine a methodology for determining stranded costs and not to determine the stranded costs for any particular utility. ABATE and the Attorney General appealed that ruling. On January 4, 2001, the Commission issued an order clarifying that the case was to address both the methodology for determining stranded costs and the computation of stranded costs for Consumers and Detroit Edison.


On July 16, 2001, the evidentiary hearing was held. The parties stipulated to bind in the testimony of all witnesses and to waive cross-examination. The record consists of 722 pages of transcript and 73 exhibits.
On August 20, 2001, Consumers, Detroit Edison, the Staff, the Attorney General, ABATE, Energy Michigan, and CPR filed briefs. On September 4, 2001, Consumers, Detroit Edison, the Staff, the Attorney General, ABATE, Energy Michigan, and the MCV filed reply briefs.


II. PROPOSED METHODOLOGIES

Consumers

Consumers proposed that the Commission compute net stranded costs using the methodology adopted in Case No. U-11290, updated with more current forecasts of load, retail open access (ROA) participation, and market prices. Consumers proposed to calculate the annual revenue requirement associated with generation-related regulatory assets, nuclear plant capital costs, and above-market contract capacity costs of power purchase agreements (PPA). The transition charge set in Case No. U-11290 would be adjusted to reflect the difference between the actual market price for the year and the market price assumed in Case No. U-11290. For 2002, Consumers calculated a stranded cost transition charge of 0.88¢ per kilowatt-hour (kWh) for all ROA sales.

Detroit Edison

Detroit Edison proposed that the Commission compute net stranded costs on the basis of the economic harm it experiences from the loss of generation revenues when customers take service from alternative electric suppliers. It proposed to measure the harm as the difference between the
full service generation rate and the market price at which it sells the power. It acknowledged that there would be a net economic benefit if it sells the power in the wholesale market at a price above the full service generation rate. It proposed to calculate the net harm or benefit for each customer class month-by-month, and proposed a 10% deadband within which it would absorb the economic harm and retain the economic benefit, up to $25 million in economic harm per year. For 2002, Detroit Edison proposed a stranded cost transition charge of zero. For 2003, it proposed that the charge to be calculated on the basis of the actual harm or benefit experienced in 2002.

**Staff**

The Staff proposed that the Commission annually compute net stranded costs on a historical basis. Stranded costs would be the difference between each year’s revenue requirement associated with fixed generation assets, generation-related regulatory assets, and capacity payments associated with PPAs and that year’s revenues available to cover those costs. In calculating the revenue requirement, it excluded variable costs because those can be avoided when customers take service from alternative electric suppliers. In calculating revenues available to cover fixed generation costs, it included the generation component of current rates and net revenues from third-party sales. The Staff used cost of service studies from Consumers’ and Detroit Edison’s most recent rate cases, with test years of 1993 and 1994, respectively, to estimate the portion of rates that covers fixed generation costs. When the revenue requirement for a specific year exceeds the revenues available to cover those costs, the utility has stranded costs for that year. For Consumers in 2000, the Staff calculated negative stranded costs (or stranded benefits) of $97 million. For Detroit Edison in 2000, it calculated negative stranded costs (or stranded benefits) of $320 million. The Staff recognized that there would be a delay in the recovery of stranded costs
due to the historical nature of its methodology, although it did not intend for the delay to inhibit the utilities’ ability to recover any costs that could be shown to be stranded.

**ABATE**

ABATE proposed that the Commission compute net stranded costs as the difference between the market value of the utilities’ generating assets and the book value of those assets. It used the discounted cash flow methodology and the comparable asset sale approach to determine the market value of the assets. Under both approaches, it concluded that Consumers and Detroit Edison have net stranded benefits. For Consumers, ABATE calculated stranded benefits of $31 million without Palisades. For Detroit Edison, it calculated stranded benefits of $3.1 billion excluding Fermi 2 and $760 million including Fermi 2. It recommended that the Commission approve a stranded benefit credit of 4.18 mills per kWh for all of Detroit Edison’s ROA customers.

**Energy Michigan**

Energy Michigan argued that stranded costs can occur only if current utility sales are less than the sales level used in the utility’s last rate case and current revenues associated with generation assets are less than the revenue requirement established for fixed generation assets in the last rate case. When there are stranded costs, it proposed that the Commission compute net stranded costs as the difference between the generation revenue requirement from the last rate case and current generation revenues collected from full service customers, plus revenue from sales of wholesale power and any stranded benefits created when customers choose an alternative supplier. Energy Michigan concluded that neither Consumers nor Detroit Edison had any stranded costs in 2002 and 2003 because sales in 2000 and 2001 exceeded the sales levels used in the last rate cases.
Attorney General

The Attorney General did not propose a specific stranded cost methodology. Rather, the Attorney General urged the Commission to consider all generation assets and PPAs, not just those evaluated in previous stranded cost recovery cases. The Attorney General recommended that stranded benefits be included in the calculation of the net stranded cost and be allocated to all customers. The Attorney General proposed to defer the credits and to amortize them after the rate freeze ends.

CPR

CPR did not advocate a specific methodology for determining stranded costs. Instead, it argued, based on its members’ experience in the marketplace, that the utilities have stranded benefits that enabled them to recover their costs and substantial profits while charging rates that are below the rates that other suppliers can offer.

III.

DISCUSSION

Methodology

MCL 460.10a(1) provides as follows:

No later than January 1, 2002, the commission shall issue orders establishing the rates, terms, and conditions of service that allow all retail customers of an electric utility or provider to choose an alternative electric supplier. The orders shall provide for full recovery of a utility's net stranded costs and implementation costs as determined by the commission.

With respect to the determination of net stranded costs, Act 141 provides as follows:

The commission shall consider the reasonableness and appropriateness of various methods to determine net stranded costs, including, but not limited to, all of the following:
(a) Evaluating the relationship of market value to the net book value of generation assets and purchased power contracts.
(b) Evaluating net stranded costs based on the market price of power in relation to prices assumed by the commission in prior orders.
(c) Any other method the commission considers appropriate.

MCL 460.10a(10).

The ALJ concluded that the statute provides the Commission with almost complete latitude in determining stranded costs, provided that the costs are netted and the utilities are afforded full recovery of their stranded costs and implementation costs. He recognized that the Commission must strike a balance among the purposes of the act, which include providing full recovery of stranded costs and implementation costs, ensuring safe and reliable power at reasonable rates, and promoting financially healthy and competitive utilities. He concluded that the conflict among the purposes of Act 141 significantly narrowed the choice of methodologies. Further, he concluded that a definition of net stranded costs helped in resolving the issue, and adopted the definition from Case No. U-11290: “costs incurred during the regulated era that will be above market prices and those costs necessary to facilitate the transition to competitive markets.” June 5, 1997 order, Case No. U-11290, p. 7.

Among the competing proposals, the ALJ found the Staff’s methodology to be the most fair and reasonable, although he recommended several modifications. He said that the Staff’s approach determined stranded costs when the costs were in fact stranded and correctly required the Commission to review all of the utilities’ generating facilities. The ALJ rejected the argument that the methodology would result in protracted litigation and controversial true-up cases each year.

Consumers excepts to the ALJ’s failure to recommend that the Commission reaffirm the methodology approved in Case No. U-11290. It says that the Legislature ratified that stranded cost methodology when it provided, in MCL 460.10a(5), that the “orders issued by the
commission before the effective date of . . . this section . . ., including orders that determine and authorize recovery of net stranded costs and implementation costs . . ., are in compliance with this act and enforceable by the commission.” Because it says that its proposal is the same as previously approved and is the only approach that has been legislatively approved, its proposal has a clear advantage over all other proposals. It says that, as intended by the Commission when it first adopted this methodology, netting occurs because the market clearing price adjustment captures the full market value of all of the generation that is available to be marketed when customers switch to ROA service.

Consumers also argues that the Staff’s methodology, even if modified as recommended by the ALJ, is still a second-best solution. It says that the Staff’s methodology has a fundamental flaw in that it computes stranded costs independent of the amount of ROA load and market prices, which it says casts great doubt on the reasonableness of the proposal. On the other hand, it acknowledges that the ALJ’s recommendation may be the closest thing to a compromise that is possible, and says that his recommendation would represent a workable approach if further modified.

Detroit Edison excepts to the ALJ’s failure to adopt its methodology. It says that its proposal properly determines stranded costs when the costs are stranded, as the ALJ said was necessary, and calculates net stranded benefits or costs based on actual, verifiable data. It says that its methodology is economically sound and could be universally applied, but also suggests that the Commission could use different methodologies for different utilities to assure full recovery of stranded costs.

Detroit Edison criticizes the other proposals as result-driven. It says that most of the intervenors would have the Commission disregard the crucial goals of ensuring safe and reliable power at reasonable rates and maintaining healthy and competitive utilities. Detroit Edison
criticizes the Staff’s methodology as inconsistent with Act 141 in failing to isolate the direct effects of ROA sales and failing to recognize that an increase in ROA sales causes a decrease in revenues needed to cover the utility’s costs. It says that the Staff’s proposal unreasonably takes part of the benefit of market rates that are above full service rates to mitigate stranded costs, while leaving all of the risk of market rates below full service rates with the utility. It says that there is nothing in Act 141 that was intended to change the longstanding practice of permitting utilities to use new revenues to offset cost increases. Detroit Edison also criticizes the Staff’s proposal because it uses a 1992 estimate of Detroit Edison’s cost of service for 1994 and ignores changes in plant investment, operating expenses, and fuel costs. Finally, Detroit Edison says that there are errors in the Staff’s calculations.

ABATE excepts to the ALJ’s rejection of its proposal. It says that it proposed to determine net stranded cost by comparing the market value of utility assets to the book value of those assets, as permitted by Section 10a(10)(a). It says that its methodology is the best supported on the record and should therefore be adopted. It also says that its proposal, unlike the Staff’s, promotes certainty about rates, which it says is important to the development of competition. It says that recalculating stranded costs each year for anything other than changes in sales, as the Staff’s methodology requires, makes it extremely difficult for customers to evaluate potential contracts with alternative suppliers because they do not know what the utilities’ rates will be over the term of the contract.

ABATE also criticizes the Staff’s methodology as so vague that it should not be adopted, even if modified as recommended by the ALJ. It notes that the ALJ recommended that the Commission use more current cost of service data when available, but says that there are no more current data on the record to support either a choice of methodology or a calculation. Further, it says that the
Staff acknowledged that some of the information that was necessary for its analysis was not available, that some items in the regulatory asset category were not components of the cost of service studies in the last rate cases, and that factors had changed since those studies were completed. ABATE says that even if more accurate information could be obtained, the Staff’s proposed methodology is subject to abuse because any cost of service study requires decisions about the proper allocation of costs. It says that for the Commission to even consider the Staff’s methodology as a reasonable alternative to its own proposal, there would have to be a fully litigated case to establish the proper allocation of costs.

The Commission finds that it should adopt the Staff’s proposed methodology for determining net stranded costs. The Staff has proposed the most direct approach to determining net stranded costs, i.e., costs that would have been recovered under regulation that cannot be recovered under competition, offset by mitigation (such as market sales of capacity and energy that are freed up when customers choose alternative suppliers) and stranded benefits (such as generation assets with below-market costs). The Staff’s proposal also has the advantage of using the same approach for both utilities.

The Staff’s approach does not require annual rate cases or cost of service studies. The amount of revenues in current rates to cover fixed generation costs can be based on data from prior cases. The Staff’s approach does not violate the prohibition against retroactive ratemaking. As in traditional ratemaking, it relies upon data from a historical period to compute a charge that will be assessed prospectively. The Staff’s proposal does not violate the rate freeze because it does not change any of the rates that have been frozen. The Staff’s approach does not reduce the amount the utilities may earn from third-party sales, although it reasonably requires that the utilities use those sales to mitigate their stranded costs.
The Commission need not adopt Consumers’ proposal merely because it approved that methodology in Case No. U-11290. Consumers cannot square its argument that Act 141 requires the Commission to use that methodology with MCL 460.10a(10), which permits the Commission to consider other approaches. Having looked at alternatives, the Commission now concludes that the approach approved in Case No. U-11290 is not preferable to the Staff’s proposal in this case.

One flaw with the prior approach is that it fails to account adequately for generation assets with below-market costs. The assumption that those plants would have costs equal to the market price by the end of the transition period may no longer be warranted. Consumers seems to concede as much at page 17 of its reply brief, where it says that if it were to divest its generating units or were to sell the power on the market, “the only way it could continue to meet its regulated obligation to serve would be to replace that power from different sources, presumably at market prices that are likely to be higher than regulated prices.” Consumers asserts that its approach results in netting, although it is not apparent that it does so under all likely scenarios.

The Commission rejects Detroit Edison’s proposal because it measures lost revenues rather than stranded costs. The essential difference between the Staff’s methodology and Detroit Edison’s is that the Staff’s approach asks whether Detroit Edison is recovering, in the aggregate, the fixed costs of its generation assets. Detroit Edison’s approach asks whether the utility is recovering, for each kilowatt-hour of ROA sales, the same contribution to the fixed costs of its generation assets as it recovers from full service sales. As Energy Michigan points out, even as full service sales increase, Detroit Edison’s approach, under most circumstances, results in all ROA sales creating stranded costs, regardless of whether Detroit Edison has stranded generation assets. Detroit Edison’s approach will produce a finding of stranded costs unless there are no ROA sales or the market price of power is above the full service price of generation, regardless of
the aggregate amount of stranded costs. As the Staff argues, Detroit Edison seems to want to ensure that it remains in at least the same financial condition after the introduction of competition.

The Commission rejects the other parties’ proposals as well. ABATE’s discounted cash flow analysis depends on myriad inputs and assumptions, many of which are subject to volatility and uncertainty and are inconsistent with actual data. The comparable sales approach is based on limited data and does not account for the effects of the utilities’ rates being frozen and customers’ having the right to return to full service. With rates frozen and the utilities obligated to provide full service at regulated rates, the utilities cannot realize the market value that ABATE calculates by selling the plants at market prices or by selling the electricity generated at market rates. At a minimum, the utilities would have to enter into contracts to purchase power at rates that would permit them to recover the costs embedded in the frozen rates or expose themselves to the same price squeeze that utilities in California faced. Further, despite the uncertainty and volatility underlying its calculations, ABATE seeks to determine stranded costs, on a one-time basis, and to credit those amounts to ROA customers. It bears noting that its witnesses’ firm previously estimated the value of Detroit Edison’s generation assets to be $2.4 billion and now estimates a value of $5.4 billion. 7 Tr. 339-340. Energy Michigan’s approach suffers from a lack of specificity, and Energy Michigan now conditionally supports the Staff’s proposal, which is similar to its own.

Proposed Modifications

Although the ALJ recommended that the Commission adopt the Staff’s methodology, he concluded that changes were required.
a. **Updated Data**

The ALJ concluded that the Staff’s approach was flawed in its reliance on data that was not current. He recommended that the Commission use more current cost of service studies when they are available.

The Staff excepts, and argues that the modification is inconsistent with the methodology. It says that the cost of service studies from the last rate cases were used because the purpose of the analysis was to determine the amount of fixed generation costs embedded in the rates that customers are currently paying. It argues that the fact that those rates were approved years ago does not change the fact that customers are currently paying those rates, and hence, the cost of service studies used in setting those rates determine the amount that those rates contribute to fixed costs.

Energy Michigan excepts, and argues that there is no evidence that any more recent data are available that could or should be used.

In its replies to exceptions, Consumers says that the February 5, 1996 order in Case No. U-10685, its last rate case, indicates that the Commission used a 1996 projected cost of service study rather than the 1993 study that the Staff relied upon in this case. February 5, 1996 order, Case No. U-10685, pp. 5-6. It also argues that actual PPA costs for 2000 are not reflected in its current rates because its power supply costs have been frozen at 1997 levels. It says that the Staff also double counted a portion of its PPA costs. In a footnote in its exceptions, it had raised this claim less clearly, and alleged that the Staff should have calculated net stranded costs of $25 million. It now calculates net stranded costs of $54 million. If the Commission adopts the Staff’s methodology, it says that the Commission must provide an opportunity to correctly calculate its stranded costs.
In its replies to exceptions, Detroit Edison also argues that the rates set in Case No. U-10102, its last rate case, reflected an updated cost of service study, not the study that the Staff relied upon in this case.

The Commission agrees with the Staff that the modification is not consistent with its methodology. On the other hand, some adjustment to the data from the last rate case might be appropriate, and the actual studies that were used in those cases should be used in calculating net stranded costs. The difficulty is that both utilities seek, at this very late stage of the case, to offer argument and data that should have been offered on the record and in their briefs. Given the procedural status of the case, the relatively low level of ROA participation at this time, and abundant reason to conclude from the record that neither utility has stranded costs in 2000, the Commission defers the issues of refining the methodology, and recalculating net stranded costs for 2000, to the case where the transition charges for 2001 will be calculated. This is a further demonstration that this is an evolving process, and checks should not be written for refunds at this time.

b. Increased Sales

The ALJ concluded that the utilities should be allowed, as in the past, to retain the margin (revenue less cost) from increased sales to fund the investment required to serve those increased sales, to provide financial incentives to do so, and to offset the effects of inflation. The ALJ therefore recommended that there be a mechanism to segregate the revenues that result from well-managed business endeavors. He recognized that this would complicate the calculation of net stranded costs and the annual true-up cases. However, he found that this modification was essential to promote financially healthy and competitive utilities.

The Staff excepts, and argues that the modification is actually a repudiation of its methodology. It argues that if sales to new customers and increased sales to existing customers are
ignored, the utilities can claim that they have stranded costs even when they recover all of their costs. It says that there cannot be stranded costs if new sales replace sales that are lost to customers who choose to take ROA service.

Energy Michigan excepts, and notes that, from 1997 through 2000, Consumers’ sales increased by 7% and Detroit Edison’s by 11%. Exhibit I-66. It says that if revenues from increased sales are excluded, stranded costs will be unreasonably increased. It notes that when sales increase, costs and revenues also increase, but that if the Staff methodology is modified, cost increases will not be matched by revenue increases.

ABATE excepts, and argues that this modification discriminates against customers. It says that actual sales are used to calculate the securitization charges and actual sales should likewise be used to determine stranded costs. Further, it says that there is nothing in the record that would support the ALJ’s conclusion that this modification is necessary to protect the financial health of the utilities. It also notes that Consumers and Detroit Edison have not engaged in any recent construction, and asserts that encouraging utilities to construct new generating capacity by allowing them to remove from the calculation of stranded costs the margins that result from increased sales is inconsistent with the purpose of Act 141 to encourage the construction of merchant power plants.

Detroit Edison excepts to the ALJ’s failure to specify the mechanism for making this adjustment.

The Commission agrees with the Staff that the modification is not consistent with its methodology. If the utilities recover all of their fixed generation costs, they do not have stranded costs that they need to recover. For this purpose, it does not matter whether they recover costs that might otherwise be stranded from existing or new customers, from increased sales to existing
customers, or from sales to third parties. If they recover all of their costs, they do not have stranded costs. There is nothing in Act 141 that requires a contrary conclusion, particularly when there is no evidence that either utility’s financial health has been impaired. Furthermore, the combined utilities have enjoyed the benefits of billions of dollars from securitization that makes them whole for recovery of the securitized assets.

c. Variable Costs

The ALJ concluded that it was necessary to include “all-in” generation costs (all fixed and variable costs) when computing net stranded costs because the fixed and variable components change over time. He recommended that an accurate split be made between fixed and variable costs, and found Consumers’ approach in Exhibits CE-4, CE-5, and CE-6 to be a well-reasoned and practical solution.

The Staff excepts, and argues that the ALJ’s recommendation amounts to a rejection of the Staff’s proposal. It argues that the ALJ’s acceptance of Consumers’ approach amounts to approval of a variation on Detroit Edison’s approach, which the ALJ had rejected. It says that the flaw in those approaches is that they equate stranded costs to the difference between the full service cost of generation and the market price without providing an offset for the benefits of sales growth and third-party sales.

Energy Michigan and ABATE except to the ALJ’s recommendation as incompatible with the Staff’s proposal and illogical in including variable costs in the calculation. They say that, with this modification, the transition charge plus the market price always equals the utility’s cost of production, and customers would not choose ROA service because there would be no savings. Further, they say that the modification permits the recovery of costs that are not stranded because it
includes variable costs that can be avoided and the costs of short-term purchases that can be foregone.

The Commission agrees with the Staff that the recommended modification is inconsistent with its methodology. Variable costs are avoidable, and thus not stranded. Likewise, contracts for the purchase of unneeded capacity and energy are avoidable, and thus not stranded. Furthermore, the modification would result in a methodology that would likely defeat the introduction of competition. The result of the modification would be to effectively equate the utilities’ costs to the sum of the market price and the transition charge, which would eliminate any incentive for customers to consider ROA service, unless they can find a source of supply at less than the market price. This is hardly a prescription for a successful ROA program.

d. Other Modifications

Detroit Edison excepts to the ALJ’s failure to address what it sees as shortcomings in the Staff’s proposal. In particular, it says that the ALJ failed to correct the inclusion of the effects of securitization in the Staff’s determination of the company’s cost of capital and the recognition of revenues from sales to third parties. It says that the issuance of the securitization bonds resulted in a rate decrease for all customers. It says that further reducing the company’s rates to capture the effect of this financing, as the Staff proposes, amounts to double counting the same benefit. It also argues that because its frozen rates include a frozen power supply cost recovery (PSCR) factor, and that frozen PSCR factor includes a credit for the third-party sales, its rates already reflect a credit for third-party sales.

The Commission finds that it should make one of the changes that Detroit Edison requests. The updated rate of return should not be used because it reflects changes that occurred after 2000, the year for which the calculation of stranded costs is being made. On the other hand, it is not
likely that the Staff has significantly double-counted revenues from third-party sales. Although the frozen PSCR factor includes some amount for those sales, the revenues from third-party sales can be expected to increase as customers choose ROA service and the utilities sell the freed-up capacity and energy on the market. More important, Detroit Edison could have offered evidence on the record to support its position, but did not.

Calculation of Stranded Costs and Setting the Charge

The ALJ noted that the Staff recommended that the net stranded cost or benefit be rolled over to the next year. He found that the Staff’s proposal was reasonable, and he therefore did not calculate any net stranded cost or benefit for 2002 and did not specify a transition charge for 2002, which had the effect of recommending a charge of zero.

Energy Michigan excepts to the ALJ’s failure to adopt the Staff’s stranded benefit calculations. It also excepts to his failure to recommend that the Commission implement a zero transition charge for 2002 and carry forward the stranded benefits to offset any future stranded costs. It notes that no one advocated a transition charge above zero for Detroit Edison in 2002. As for Consumers, it argues that all parties, except Consumers, advocated a transition charge of zero or less. Because it argues that Consumers’ approach does not comply with Act 141, it asks that the Commission adopt a zero charge for Consumers in 2002 as well.

ABATE excepts to the ALJ’s failure to calculate the stranded benefit. It also excepts to the ALJ’s recommendations that there not be a negative transition charge in 2002 and that the net stranded benefit be rolled over.

CPR excepts to the ALJ’s failure to establish stranded cost credits. It says that the Commission should quantify once and for all the utilities’ stranded benefits and establish credits to allow ratepayers to recover those benefits, with annual true-up proceedings to reflect changes in sales. It
argues that MCL 460.10a(1) establishes January 1, 2002 as the deadline for setting the charges and does not permit the Commission to issue orders annually addressing net stranded costs on a year-to-year basis. It argues that setting the stranded cost transition charges once and for all would provide customers with more certainty about future energy costs and would avoid the time, expense, and controversy inherent in annual reassessments of stranded costs. In the alternative, if the Commission decides that there should be annual proceedings, it proposes that the Commission apply the credit due for 2002 in 2002 rather than roll it over.

In its exceptions, Consumers says that the Staff’s methodology is deficient in that it defers recovery of the current year’s stranded costs. It says that this can result in stranded costs being paid by customers different from those responsible for the costs and makes it more difficult to predict the likely stranded cost charge in the future. It argues that the Legislature did not intend the Commission to adopt a stranded cost methodology that deferred collection of the current year’s stranded costs and did not intend the true-up mechanism to do more than adjust past collections to reflect actual results. Consumers therefore argues that the Staff’s methodology should be modified to provide for the development of a surcharge based upon estimated stranded costs, with a subsequent true-up to reconcile the transition charge based on actual levels of ROA participation and actual market prices. Further, Consumers says that if the Commission decides to use the Staff’s approach, it must recognize the accounting issues that would be presented. It asserts that to avoid impairing utility earnings, the stranded cost formula must be stated clearly enough that calculations can readily be made, and there must be a clear commitment to permit recovery of the amounts produced by those calculations.

The Commission agrees that it is necessary to explicitly establish the stranded cost charges to be in effect as of January 1, 2002, and sets the charge at zero for both Consumers and Detroit
Edison. The record shows both utilities to have stranded benefits at this time. The utilities bear
the burden of proof to establish any charge greater than zero, and neither has carried that burden in
this case. Rather, they have offered methodologies that the Commission finds fundamentally
flawed, and have not offered data upon which to make revised calculations. Furthermore, Detroit
Edison has requested that the Commission approve a charge of zero for 2002 in any event. The
utilities are free to offer and support adjustments, consistent with the methodology adopted in this
order, for calculating the stranded cost charges or credits for 2001.

The Commission acknowledges that the Staff’s methodology does not seek to estimate 2002
stranded costs for recovery in 2002, but rather calculates stranded costs for 2000 and provides for
recovery in 2002, subject to a reconciliation in 2003 pursuant to MCL 460.10a(9). By not seeking
to estimate 2002 stranded costs, the calculation is made less complex. By providing for a
reconciliation, the methodology assures that the utilities will collect the amount calculated. The
result may be, to some extent, that stranded costs will be paid by customers different from those
responsible for the costs. In light of the advantages of the Staff’s methodology, that is not a reason
to adopt another methodology. MCL 460.10a(10) requires the Commission to consider the
“reasonableness and appropriateness” of alternative net stranded cost methodologies. In the
context of the gas cost recovery mechanism, the Court of Appeals upheld the Commission’s
choice of a refund methodology because it was reasonable. The Court held that the statute did not
require the Commission to adopt the most precise methodology because it was appropriate for the
Commission to consider other consequences of a more precise approach. Attorney General v
of plant that is in fact stranded as mandated by Act 141 and so as not to have an adverse effect on
the financial books of the companies, the Commission authorizes Consumers and Detroit Edison to
use deferred accounting to recognize future recovery of plant determined to be stranded by application of the Staff’s methodology.

The Commission recognizes that not setting the transition charges once and for all leaves uncertainty about future rates. The Commission would only point out that certainty is not possible when customers evaluate the choices made available under Act 141. The transition charges, implementation costs, utility rates after the rate freeze, and future market prices, among other things, are all subject to more or less uncertainty. The risks associated with permanently setting the transition charges at the wrong level are not warranted in light of the uncertainties that customers will face anyway and the benefits of being able to adjust the charges as circumstances warrant. In reaching that conclusion, the Commission rejects the argument that Act 141 requires that the charges be unchangeable after January 1, 2002. Rather, it concludes that Act 141 requires only that the methodology be established and that the charges be established for 2002.

The Commission also rejects the arguments that it should set the transition charges at a negative amount so as to credit to ROA customers the stranded benefits that result from the Staff’s calculations. It is not necessary to establish a negative charge to accomplish the competitive purposes of Act 141. Furthermore, because rates are frozen, granting a credit to ROA customers when a credit cannot be granted to full service customers would create an inducement to choose ROA service that is not based on competitive market conditions. In addition, there is no assurance that the methodology will not yield a finding of stranded costs in a later evaluation. It would be poor policy, not required by Act 141, and inconsistent with the principle of gradualism in rate-making to establish credits now only to later impose charges. Finally, the Commission believes that there are other legal and policy issues about the granting of credits to customers and the roll-over of the stranded benefits to later years that the parties should address in greater detail in future
Proceedings. The Commission thus concludes, to preserve the issues for further consideration, that the net stranded benefits calculated by the Staff for 2000 should be rolled over to the 2001 calculation, and should not be credited to customers at this time. Proponents of any alternative method would inject unnecessary volatility into Michigan’s infant market.

**Offset for Securitization and Tax Charges and Rate Reduction Equalization**

Energy Michigan, ABATE, and CPR except to the ALJ’s failure to address their proposals that the Commission continue to offset fully the securitization and tax charges with a credit and continue to grant ROA customers the same rate reductions that other customers have received under Act 141.

Consumers’ and Detroit Edison’s full service and ROA customers pay securitization and tax charges for each kilowatt-hour of energy. In approving those charges, the Commission ruled that the charges would be offset by an equal credit and that the rate reductions that securitization produced for full service customers would also be granted to ROA customers through a credit. October 24, 2000 order, Case No. U-12505 (Consumers’ securitization case), p. 42 (securitization offset) and pp. 43-44 (rate reduction equalization); November 2, 2000 order, Case No. U-12478 (Detroit Edison’s securitization case), p. 29 (securitization offset), pp. 32-33 (rate reduction equalization). The net effect of securitization was thus the same for full service and ROA customers. In its prior orders, the Commission assumed that this case would establish a transition charge before January 1, 2002 that would recognize the effect of securitization on stranded costs and render the securitization offset unnecessary. January 4, 2001 order, Case No. U-12505, p. 7; January 4, 2001 order, Case No. U-12478, p. 7.

Energy Michigan says that if the Commission continues these two adjustments, it can support the Staff’s methodology for calculating stranded costs. It argues that the offset for the
securitization and tax charges does not require a funding source because when fixed generation revenues are adequate to pay all fixed generation costs, including securitization bond and tax charges, as implied by the finding that there are no stranded costs, collecting the securitization and tax charges from ROA customers without the offset would give the utilities surplus revenues. It argues that the rate reduction equalization can be funded with the negative stranded costs and Consumers’ and Detroit Edison’s residual securitization savings.

CPR says that if the Commission decides not to establish final transition charges in this case that reflect the value of the credits that offset the securitization and tax charges, the Commission must extend the credits. It says that the offsetting credits should be larger than the securitization and tax charges because securitization reduced the utilities’ costs, as the utilities have represented and as common sense suggests. Further, it notes that the Commission lacked statutory authority to approve securitization unless there were net benefits to customers. Thus, it argues that ratepayers, including ROA customers, are entitled to a credit that more than offsets the securitization and tax charges. At a minimum, it argues that the Commission must extend the existing credits.

ABATE recommends that the Commission establish an offset to the securitization charges so as not to severely impede the development of a competitive electric utility market. ABATE asserts that the stranded benefit credit for ROA customers should be larger than the securitization and tax charges. If the Commission is unwilling to implement that larger credit, ABATE recommends that the Commission implement a credit that is equal to the securitization and tax charges.

In its replies to exceptions, Detroit Edison opposes the continuation of both the securitization offset and the rate reduction equalization. In support, it quotes its petition for rehearing in Case No. U-12478:

The reduction in revenue requirement resulting from the securitization of qualified costs is what enables Edison to reduce all bundled rates by the
5% approved in the Order. This reduction in revenue requirement will be reflected in the determination of net stranded cost and will ultimately flow through as a reduction to the transition charge for choice customers.

Therefore, once the transition charge is established, choice customers will receive an equal benefit from securitization to that which they would have received had they remained bundled customers. Once the transition charge is established reflecting that reduction, the equalization adjustment will no longer be necessary and will either be set to zero or eliminated. This interpretation is essential to Edison’s acceptance of the Commission’s November 2, 2000 financing order.

Detroit Edison’s November 22, 2000 petition for rehearing, Case No. U-12478, p. 9. It says that the Commission approved Detroit Edison’s interpretation, and made all of the terms of the order irrevocable. January 4, 2001 order, Case No. U-12478, pp. 6, 8-9. It therefore asserts that the Commission may not continue the securitization offset and rate reduction equalization.

Detroit Edison has argued that the Commission cannot lawfully continue the offset for the securitization and tax charges and the rate reduction equalization because the Commission irrevocably committed to end them as of January 1, 2002. However, that commitment depends on a finding that the transition charge fully reflects the effects of securitization and gives ROA customers at least the same benefits as full service customers receive from securitization. Detroit Edison has not offered any computation that would demonstrate that to be the case, much less documentation consistent with the methodology approved in this order. Instead, it bases its claim on a comparison of its proposed transition charge and the charge approved in Case No. U-11290, which was based on very preliminary and highly qualified estimates and a different methodology. Moreover, the Commission’s commitment, at least with regard to securitization and tax charges, was dependent on the Commission’s determination of a transition charge that recognized the effect of securitization on “total stranded costs,” a determination that has yet to be made.
Nonetheless, the Commission need not continue the operation of the rate reduction equalization adjustment and the securitization and tax offset in the present form. Section 10d(5) of Act 41 allows the Commission to use securitization proceeds not specifically allocated to other purposes “to further rate reductions or to reduce the level of any charges authorized by the commission to recover an electric utility’s stranded costs.”

The Commission intended in its order on rehearing in Cases Nos. U-12478 and U-12505 to incorporate into the transition charge, from January 1, 2002 forward, whatever offsets were necessary to keep ROA customers on an equal footing with bundled customers. Since we have determined that the transition charge for both Consumers and Detroit Edison is zero, we will do so by use of a Section 10d(5) adjustment to the transition charge. Since the finding in this order establishing a transition charge is predicated on the use of 2000 actual experience, which did not include the effects of securitization, this adjustment will only be applied until the transition charge for both companies is revisited in the next stranded cost proceeding. The adjustment will encompass both the securitization and tax charge offset and the rate reduction equalization previously ordered for the period preceding January 1, 2002.

The Commission finds that there is nothing about the recovery of stranded costs that changes the policy goal in the prior orders to treat ROA and full service customers on an equal basis. At least with respect to the securitization and tax charges, Consumers recognizes this fact because it has agreed that ROA customers should receive an offset for the securitization charges. 7 Tr. 177. In the absence of a clear showing that the calculation of the transition charges gives ROA customers the same benefits from securitization as full service customers, the offset and equalization adjustment should continue for now. Thus, ROA customers will be treated the same as full service customers after January 1, 2002, just as they were before that date.
The Commission declines to address the issue that CPR raised in its replies to exceptions, where it requests that the Commission rule that Consumers’ special contract customers are entitled to the offset for securitization and tax charges. To the extent that there may be a dispute about whether the Commission’s prior orders resolve the question, it is improper for CPR to raise an issue that is unrelated to the calculation of net stranded costs and to do so at this late stage of the case.

The Commission concludes that the Section 10d(5) adjustment, at least insofar as it incorporates the securitization and tax charge offset, does not require a funding source. Because neither utility has stranded costs at this time, the Commission has found that each is recovering all of its fixed generation costs, which includes the costs that were securitized. Thus, there is no basis for requiring ROA customers to pay the securitization and tax charges without a full offset. The portion of the Section 10d(5) adjustment that encompasses the previous rate equalization adjustment should be funded to the extent possible by proceeds securitization not specifically allocated for other purposes, as provided by Section 10d(5).

Residual Securitization Savings and Accounting Authority

Detroit Edison excepts to the ALJ’s failure to address issues related to the recovery of ROA implementation costs, the use of residual savings from securitization, and the accounting for the economic harm or benefit for 2002. It says that the Commission must rule on the company’s proposals because these matters must be decided by January 1, 2002 pursuant to MCL 460.10a(1). Detroit Edison proposes to recover the implementation costs for 2000 by using the residual savings associated with the issuance of the company’s securitization bonds. It acknowledges that the details and accounting for those costs are presently under review in Case No. U-12892, but says that its proposal complies with the statutory requirement that it recover the costs and also reduces
the transition charge without causing any retail customers to incur additional charges to implement retail access through 2000. In addition, Detroit Edison says that it will be able to use additional residual savings to recover post-2000 regulatory assets as well as other categories of stranded costs previously approved by the Commission. If the residual savings are not sufficient to cover those costs, it proposes to seek recovery consistent with the expiration of the rate freeze. Finally, Detroit Edison requests accounting authority to record the net economic harm or benefit in 2002 and 2003 as regulatory assets for future rate recovery.

Energy Michigan excepts to the ALJ’s failure to address its proposal to use securitization savings to fund transition charge reductions and rate equalization reductions rather than to pay implementation costs. It argues that the proposal to use securitization savings to pay implementation costs is inconsistent with the Commission’s prior orders. It also notes that the Commission has already stated that recovery of implementation costs is conditioned upon the success of the utilities in implementing ROA programs, and argues that recent Staff audits of both Consumers and Detroit Edison have concluded that neither program is functional. It thus argues that approval to recover the implementation costs should be denied at this time. It also says that the Commission should be aware that, at some future date, the utilities may have stranded costs that would justify positive transition charges and that the residual securitization savings could be used to offset any future transition charges.

ABATE excepts to the ALJ’s failure to address its recommendation that all of Detroit Edison’s residual securitization savings be returned to retail customers. ABATE notes that it recommended that there be a credit equal to the stranded costs, so that the only remaining use of the residual securitization savings under Act 141 would be to reduce rates further. ABATE recommends that the Commission require Detroit Edison to separately account for any residual
securitization savings and to accrue an annual carrying charge equal to its weighted cost of capital until rates are reduced.

In its replies to exceptions, Consumers indicates its understanding that, to the extent the savings already allocated to reduce transition charges exceed the amount of stranded costs, the balance would be applied toward recovery of implementation costs.

The Commission has addressed, consistent with MCL 460.10d(5), the uses of the residual securitization savings in prior orders, and finds no reason to change those determinations at this time. Act 141 provides that securitization savings beyond those needed to fund the 5% residential rate reduction and the low-income and energy efficiency fund may be used for “further rate reductions or to reduce the level of any charges authorized by the Commission to recover an electric utility’s stranded costs.” MCL 460.10d(5). The Commission has ordered Consumers to use 50% of the savings to reduce distribution charges for non-residential customers and 50% to reduce the transition charge imposed on ROA customers. October 24, 2000 order, Case No. U-12505, p. 32. The Commission has ordered Detroit Edison to use residual securitization savings to reduce transition charges. November 2, 2000 order, Case No. U-12478, p. 25. As discussed above, the utilities may use a portion of the residual savings, or the net stranded benefits, to fund the rate equalization adjustment. The Commission will address the use of any additional residual savings to fund further reductions in transition charges at a later time.

The Commission rejects Consumers’ and Detroit Edison’s proposals to use a portion of the securitization savings to pay implementation costs. The Commission has addressed the recovery of implementation costs in prior orders, and finds no reason to change those determinations at this time. The Commission has ruled that recovery of implementation costs is conditioned upon the success of the utilities in implementing the ROA programs. July 11, 2001 order, Case
No. U-12358, p. 10, and October 24, 2000 order, Cases Nos. U-11955 and U-12956, p. 5. The record in this case does not provide a basis for concluding that the utilities’ programs have been sufficiently successful to merit full recovery of previously reviewed implementation costs, much less costs that are at issue in pending cases or costs that have not even been incurred.

The Commission reaffirms that it will permit the utilities to recover prudently incurred implementation costs as provided for in the Commission’s prior orders. It expects to provide recovery at the conclusion of the rate freeze. Except for any costs that should be assigned solely to ROA customers, implementation costs will be recovered from all customers. The Commission may provide for residual securitization savings to fund all or a portion of the recovery.

Although the Commission has rejected Detroit Edison’s stranded cost methodology, it has determined that stranded benefits will not be credited to customers at this time. Therefore, as discussed above, Consumers and Detroit Edison may use deferred accounting for the net stranded benefits or costs calculated through the Staff’s methodology.

**Future Rate Reductions**

ABATE excepts to the ALJ’s failure to address its recommendation that the Commission order automatic rate reductions when the funding requirement for the low-income and energy efficiency fund expires in 6 years.

The Commission finds no reason to rule at this time on how those securitization savings will be used.
**Future Stranded Cost Recovery**

In its exceptions, Consumers argues that the Commission must make clear that, after the rate freeze ends, any stranded cost methodology adopted in this order will be supplemented by, if not completely superseded by, standard ratemaking procedures.

The Commission finds no reason to rule at this time on the precise mechanism by which utilities will be permitted to recover their prudently incurred costs after the rate freeze expires. At an appropriate time, the Commission will resolve those questions in full conformity with all legal and policy considerations.

**Removal of Skewing Adjustment and Equalization Transition Charge Adjustment**

Consumers and Detroit Edison proposed to adjust the transition charges to remove the effects of rate skewing. They said that the purpose is to provide all customer classes with similar savings when considering ROA service and to prevent customers from shifting responsibility for the subsidies in full service rates to other customers by choosing ROA service. Consumers used the phrase “removal of skewing adjustment” (ROSA), and Detroit Edison used the phrase “equalization transition charge adjustment” (ETCA).

The ALJ found that the adjustments were contrary to the plain language of the act as well as anticompetitive. He also rejected the notion that the ROSA and ECTA were necessary to provide for the recovery of stranded costs.

Consumers and Detroit Edison except, and argue that the adjustments are necessary because residential customers pay less than the cost of service, while secondary and primary customers pay more than the cost of service. As a result, they say, residential customers have relatively less incentive to switch to ROA service, while commercial customers have a greater incentive to do so, and the utilities experience a disproportionate loss of generation revenues when commercial
customers switch to ROA service. They assert that the effect of the adjustments is to provide each class of customers with an equal opportunity and incentive to participate in ROA, and thereby to neutralize the anticompetitive effect of skewing.

They also contend that, far from precluding adoption of the adjustments as the ALJ found, Act 141 requires the adjustments: “The commission shall allocate approved securitization, transition, stranded, and other related charges and credits in a manner that does not result in a reallocation of cost responsibility among the different customer classes.” MCL 460.10d(5). They say that the adjustments actually preserve existing cost allocations by ensuring that the amount of the skewing by which each customer class is currently benefited or burdened continues even under ROA service. Consumers says that if the Commission does not approve the adjustment, then the calculation of stranded costs must be performed on a customer class basis.

The Commission concludes that MCL 460.10d(5) does not permit the proposed adjustments. It is difficult to square the language of the statute with the utilities’ claim that the Legislature intended the Commission to eliminate any rate skewing that might exist in current rates, at least for customers considering ROA service, and it is clear that the adjustments reallocate cost responsibility. The Legislature must be presumed to have been aware of the relationship of existing rates to the cost of service. If it had intended that the Commission move rates to the cost of service, it would have so indicated. Rather, the Legislature provided that the Commission was to leave any subsidies unchanged. Further, the adjustments are anticompetitive because they increase rates to the customer classes most likely to consider ROA service. Finally, the adjustments are not related in any fashion to the statutory requirement that the Commission approve recovery of net stranded costs, and thus violate the rate freeze. If the adjustments are to be made, that should occur in a full rate case.
Bundled Rate Stranded Benefit Credit

Detroit Edison excepts to the ALJ’s failure to explicitly reject the Attorney General’s proposal that a stranded benefit credit be applied to full service customers as well as ROA customers.

The Commission has rejected the argument that stranded benefits should be credited to ROA customers in 2002, and will consider the issue more fully at a later date. It therefore rejects the Attorney General’s proposal at this time as well.

Valuation of the River Rouge Unit No. 1

Detroit Edison asked the Commission to affirm the $6.6 million valuation for the transfer of its ownership of the River Rouge Unit No. 1 Power Plant to an affiliate. Initially, the Commission had required that the transfer price be redetermined if legislation were enacted in 2000 specifying methodologies for valuing generating plants. February 3, 2000 order, Case No. U-12266, p. 9.

Act 141 did not address the issue. Later, the Commission deferred the valuation issue to this case. October 24, 2000 order, Case No. U-12266, p. 2.

Detroit Edison argued that there is no single approach to determining the value of power plant, and suggested that each plant be valued on a case-by-case basis. It asserted that the previously approved valuation of $6.6 million is fair and reasonable.

There was no opposition to Detroit Edison’s request, and the ALJ recommended that the Commission affirm the valuation.

The Commission adopts that recommendation.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 106, as amended, MCL 460.551 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; 1969 PA 306, as

b. The Staff’s methodology for calculating net stranded costs should be adopted.

c. Neither Consumers nor Detroit Edison had stranded costs in 2000.

d. The stranded cost transition charges for Consumers and Detroit Edison are zero for 2002, and the offset for the securitization and tax charges and the rate reduction equalization should continue.

e. The net stranded benefits or costs for Consumers and Detroit Edison should be carried forward, and the utilities should be permitted to use deferred accounting for those amounts.

f. Implementation costs should continue to be deferred for later recovery.

g. Consumers’ ROSA and Detroit Edison’s ETCA should be rejected.

h. The $6.6 million valuation of the River Rouge Unit No. 1 Power Plant should be affirmed.

THEREFORE, IT IS ORDERED that:

A. The Commission Staff’s methodology for calculating net stranded costs is adopted.

B. The stranded cost transition charges for Consumers Energy Company and The Detroit Edison Company are zero for 2002, and the offset for the securitization and tax charges and the rate reduction equalization shall continue to be included in customers’ bills.

C. The net stranded benefits or costs calculated by the approved methodology for Consumers Energy Company and The Detroit Edison Company shall be carried forward. The utilities may use deferred accounting to recognize the timing difference in the determination and recovery of the stranded costs.

D. Consumers Energy Company and The Detroit Edison Company shall continue to defer recovery of implementation costs for future recovery.
E. Consumers Energy Company’s removal of skewing adjustment and The Detroit Edison Company’s equalization transition charge adjustment are rejected.

F. The $6.6 million valuation of The Detroit Edison Company’s River Rouge Unit No. 1 Power Plant is affirmed.

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

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

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ Laura Chappelle
Chairman, concurring in part in a separate opinion.

( S E A L)

/s/ David A. Svanda
Commissioner

/s/ Robert B. Nelson
Commissioner


/s/ Dorothy Wideman
Its Executive Secretary
E. Consumers Energy Company’s removal of skewing adjustment and The Detroit Edison Company’s equalization transition charge adjustment are rejected.

F. The $6.6 million valuation of The Detroit Edison Company’s River Rouge Unit No. 1 Power Plant is affirmed.

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

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

MICHIGAN PUBLIC SERVICE COMMISSION

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Chairman, concurring in part in a separate opinion.

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Commissioner

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Commissioner


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Its Executive Secretary
In the matter, on the Commission’s own motion, to implement the provisions of Section 10a(10) of 2000 PA 141.

Suggested Minute:

“Adopt and issue order dated December 20, 2001 establishing a methodology to calculate net stranded costs, and setting the transition charges for 2002 for Consumers Energy Company and The Detroit Edison Company, as set forth in the order.”