

STATE OF MICHIGAN
COURT OF APPEALS

In re Application of CONSUMERS ENERGY
COMPANY to Increase Rates.

UNPUBLISHED
April 24, 2014

MICHIGAN COMMUNITY ACTION AGENCY
ASSOCIATION,

Appellant,

v

No. 312332

MPSC

MICHIGAN PUBLIC SERVICE COMMISSION,

LC No. 00-016794

Appellee,

and

CONSUMERS ENERGY COMPANY,

Petitioner-Appellee.

Before: WILDER, P.J., and FITZGERALD and MARKEY, JJ.

PER CURIAM.

Intervenor Michigan Community Action Agency Association (MCAAA) appeals as of right from an order of the Michigan Public Service Commission (PSC) authorizing Consumers Energy Company (Consumers) to “implement rates that increase its annual electric revenues by \$118,475,000.” MCAAA objects to the ratemaking treatment afforded expenses related to an aborted clean coal plant. It also objects to the PSC’s refusal to address in this rate case the settlement of a partial breach of contract case involving the federal government’s failure to timely accept spent nuclear fuel and high-level radioactive waste (SNF) for disposal. We affirm.

I. CLEAN COAL PLANT

On April 6, 2006, former Governor Jennifer M. Granholm issued Executive Order 2006-02 directing the Chairman of the PSC to provide an electric energy plan — the 21st Century Electric Energy Plan — for the State of Michigan. The plan was submitted to the governor on January 31, 2007, and recommended, among other things, that a new baseload power plant be

constructed no later than 2015 and, since build time would be at least six years, that action be taken immediately. In response, Consumers applied for approval of a Balanced Energy Initiative in Case No. U-15290 that included a proposal for a new 830 MW clean coal generating facility. During the planning process, the recession grew, which resulted in a reduced demand for electricity. Moreover, excess generating capacity and low spot market electric pricing became commonplace. Natural gas prices dropped, remained low, and were expected to remain low due to an increase in the availability of shale gas through hydraulic fracturing. This lowered the cost advantage of coal. Thus, Consumers deferred further planning of the new coal plant in May 2010. On December 2, 2011, during the projected test year at issue in this case, Consumers announced that it had abandoned the project.

In its application for an increase in rates, Consumers requested that the PSC authorize amortization of the \$21.8 million of clean coal plant costs over a three-year period, with inclusion of the unamortized balance in rate base, which would allow for a return on its investment. It asserted that the expenses and ultimate decision to defer development of the clean coal plant were reasonable and prudent. At the hearing on the application, Consumers offered testimony establishing that the expenses incurred during the planning stage amounted to \$21,750,721. These included expenses for engineering, permitting, site studies, legal costs, certificate of necessity services, integrated resource planning, application fees and system studies, an Electric Power Research Institute membership and associated reports and studies, geologic well studies, and site design and soil testing.

William A. Peloquin, a certified public accountant who served as MCAAA's expert witness, opposed allowing Consumers any return on its investment since the clean coal plant never became used and useful. Further, he opined that allowing a return would require ratepayers to cover 100 percent of Consumers' mistakes when there should be some sharing of the write-off, even if the expense was prudent. Further, Peloquin thought the project should be amortized over 10 years. He noted that the costs deemed prudent of the Midland Nuclear Plant were written off over 10 years without any return on the unamortized amount. Further, he indicated that, using a 6.98 percent rate of return, Consumers would recover 73 percent of the present value of expenses with a 10-year amortization without a return on the unamortized amount. Peloquin also indicated that since the amortization was to be included in base rates rather than surcharged, and would continue until the next rate case, extending the amortization over 10 years would lessen the amount of any over collection.

The PSC held in pertinent part:

The Commission finds that the succession of decisions that resulted in both the planning and the cancellation of this baseload plant were reasonable and prudent. Moreover, the Commission is not persuaded by MCAAA's arguments analogizing this situation to the Midland cogeneration project. Ten years is simply too long to amortize this amount. Consumers is authorized to follow its proposed accounting procedures for the 36-month amortized recovery in rates, with the unamortized balance remaining in rate base. However, because the company makes clear that only two-thirds of the planned 830 MW of this plant would have been dedicated to ratepayers, and concedes that, had it been built, ratepayers would not have been responsible for the costs associated with the one-

third dedicated to other entities, the Commission finds that Consumers is authorized to recover two-thirds of the full amount, or \$14.45 million, for this cost category.

In *In re Application of Consumers Energy Company for Rate Increase*, 291 Mich App 106, 109-110; 804 NW2d 574 (2010) (some citations omitted), the applicable standard of review was set forth as follows:

The standard of review for PSC orders is narrow and well defined. Pursuant to MCL 462.25, all rates, fares, charges, classification and joint rates, regulations, practices, and services prescribed by the PSC are presumed, prima facie, to be lawful and reasonable. A party aggrieved by an order of the PSC has the burden of proving by clear and convincing evidence that the order is unlawful or unreasonable. MCL 462.26(8). To establish that a PSC order is unlawful, the appellant must show that the PSC failed to follow a statutory requirement or abused its discretion in the exercise of its judgment. A reviewing court gives due deference to the PSC's administrative expertise, and should not substitute its judgment for that of the PSC.

A final order of the PSC must be authorized by law and be supported by competent, material, and substantial evidence on the whole record. Const 1963, art 6, § 28. Whether the PSC exceeded the scope of its authority is a question of law that is reviewed de novo.

A PSC order will be deemed unreasonable if it is unsupported by evidence. *Attorney General v Public Serv Comm*, 206 Mich App 290, 294; 520 NW2d 636 (1994). The PSC's findings of fact are given deference since it is in the best position to evaluate the weight and credibility of evidence. *In re Complaint of Rovas*, 482 Mich 90, 101; 754 NW2d 259 (2008). Finally, in *In re Application of the Detroit Edison Company to Increase Rates*, 297 Mich App 377, 382-384; 823 NW2d 433 (2012), aff'd __ Mich __ (2013), the Court cited *Attorney General v Pub Serv Comm*, 206 Mich App 290, 296; 520 NW2d 636 (1994), for the proposition that MCL 462.26(8) "requires a reviewing court to determine only whether an order is unlawful or unreasonable, not whether it is arbitrary and capricious."¹

MCAAA implies that the coal plant expenditures were imprudent. It points to Peloquin's testimony that the decision to go forward was based on the 21st Century Energy Plan, which was submitted to the governor on January 31, 2007, since some decisions were made before this plan was in place. However, David B. Kehoe, a Consumers employee responsible for strategic planning, testified that there was also reliance on the Capacity Needs Forum, which was initiated in October of 2004. The timing of the 21st Century Energy Plan does not suggest any imprudence with respect to the expenditures. Moreover, the PSC's determination that the expenditures were prudent was supported by competent, material, and substantial evidence on

¹ To the extent MCAAA suggests that the PSC's decision should be reversed if it is arbitrary and capricious, this is only accurate to the extent that the decision is unlawful or unreasonable.

the whole record. Kehoe testified that the expenses were reasonable and prudent, and gave substantive reasons to support his conclusion. He noted that requests for proposals were used for expenses over \$10,000 and sole source process was used for lesser expenses, consultants performed work required by the 21st Century Electric Energy Plan and necessary for filing a certificate of necessity, and further planning was deferred when indicated. He further testified that the initial need for construction made the planning and initial work reasonable and prudent, and that the change in circumstances made the deferment and cancellation reasonable and prudent. He disagreed that Consumers should have deferred earlier given awareness in 2008 and 2009 that excess generating capacity and low spot market electric prices were commonplace across the country; he said it could not have been known at that time how long the economic conditions would last or how long a full economic recovery would take, and that it would not have been prudent to turn the activities on and then turn them off “without a fair amount of consideration as to what the long-term view of the need for that plant is.” “Substantial evidence exists for a decision of the PSC if it is supported by opinion testimony offered by a single qualified expert witness with a rational basis for the expert’s views, whether or not other experts disagree.” *Midland Cogeneration Venture Ltd Partnership v Pub Serv Comm*, 199 Mich App 286, 315; 501 NW2d 573 (1993).

MCAAA also argues that the ratemaking treatment of the coal plant costs was not supported by competent, material, and substantial evidence on the whole record. It points to Peloquin’s testimony in support of the proposition that costs should be amortized over 10 years instead of three years, that the unamortized portion should not be carried in base rate, and that there should be a sharing of expenditures between ratepayers and Consumers or its shareholders.

In the present case, the ratemaking treatment approved by the PSC was supported by the testimony of Kenneth C. Jones, Consumers’ assistant controller, and Erin Rolling, a Consumers senior rate analyst. In focusing on Peloquin’s opinions, MCAAA ignores this testimony, which constituted substantial evidence. See *Midland Cogeneration Venture Ltd Partnership*, 199 Mich App at 315. Jones explained that a three-year recovery period was being proposed because one year would result in too large an increase in rates and he wanted to minimize electric customer base rate impact and provide a practical period for recovery in order to minimize uncertainty, recognition and measurement costs, and financial reporting costs. He explained that three years was preferable to ten years because stretching the time period out provides less certainty of recovery. Similarly, Rolling noted that the majority of the expenditures were incurred during a three-year period, that a timely recovery would help Consumers attract capital for future expenditures and would help it do so at a lower cost if investors were not concerned about recovery or the timing of recovery, that by spreading the costs over three years the annual impact on a typical residential customer would be approximately \$1.77 a year or \$0.15 per month, and that a three-year amortization would more closely match customers paying the amortization expense with customers at the time the expenses were incurred. Further, Rolling proposed that the unamortized costs be included in rate base during the amortization period because “Consumers Energy invested corporate capital in the Clean Coal Plant for the benefit of its customers and should receive a return on those funds until they are recovered from customers. . . . Including the unamortized balance in rate base during the amortization period helps assure that the Company and its investors are not harmed by the decisions to defer and ultimately cancel development of the coal-fueled plant based upon changed conditions that occurred.” This testimony supports the PSC’s determination that, except for the third of the

expenditures deducted since a third of the plant would not have been dedicated to ratepayers, not sharing rates between ratepayers and Consumers Energy or its shareholders was warranted. Again, these were costs that were deemed to have been prudently incurred. It was not unlawful or unreasonable to ensure that Consumers Energy and its shareholders would be compensated for such costs. Moreover, a three-year amortization and including the unamortized portion in base rate were clearly supported by competent, material, and substantial evidence on the whole record.

MCAAA further argues that there was a break from precedent, without explanation or rationale, since the costs of this cancelled plant were not treated the same as the costs of cancelled plants that are not deemed “used and useful” in providing services to customers. It primarily refers to the treatment of the Midland Nuclear Plant.

The Midland Nuclear Plant was fraught with difficulties and was 85 percent complete when it was cancelled. Consumers claimed it had invested \$4.2 billion but ultimately sought to recover \$2.1 billion in rates. See *Ass’n of Businesses Advocating Tariff Equity v Pub Serv Comm*, 208 Mich App 248, 251-153; 527 NW2d 533 (1994) (*ABATE*). A large portion was disallowed because the PSC, applying the “prudent investment” test, found that some of the expenditures were imprudent. *Id.* at 254-257. Specifically, it found that costs after July 2, 1980, were incurred in an imprudent attempt to complete the project. *Id.* at 265-266.

[U]nder the prudent investment test a utility is compensated for prudent investments at their actual cost when made, regardless of whether the investments proved to be necessary or beneficial in hindsight. [*Id.* at 257.]

Stated differently, “rates may be based on the prudent cost of doing business, even if that cost includes unsuccessful investments.” *Id.* at 262. This Court found that the PSC’s use of the prudent investment test was not unlawful or unreasonable, noting that “the PSC is not bound by any particular method or formula in exercising its legislative function to determine just and reasonable rates” *id.* at 258, and that “[i]n determining rates, the PSC may rely on its expertise and is not required to apply a particular method or process” so long as the result is just and reasonable. *Id.* at 266. It held that “the PSC may look at all relevant factors in exercising its broad discretion to determine a just and reasonable rate,” rejecting the notion that the PSC was required to apply the “used and useful” test under which “rates must be based on a utility’s cost of providing service and . . . a plant that is not used and useful is never part of the cost of providing service.” *Id.* at 258-260. Finally, the Court stated:

The ratemaking process involves a balancing of investor and consumer interests. The PSC permitted Consumers to recover costs it had incurred before acting imprudently and the recovery was spread over a ten-year period without interest. Given that the plant was intended to meet reasonably predicted energy demands of the public, the PSC reasonably balanced the interest of investors and the consuming public. [*Id.* at 267 (citation omitted).]

MCAAA points out that with the Midland Nuclear Plant, prudent costs were recovered over 10 years, there was nothing carried in base rate during that time, and ratepayers and shareholders shared the losses. Preliminarily, MCAAA cites no authority for the proposition that

the PSC is precedentially bound by its own decisions. However, *ABATE*, 208 Mich App at 258, reiterates that “the PSC is not bound by any particular method or formula in exercising its legislative function to determine just and reasonable rates.” The question is whether the rates were just and reasonable in this case, not whether the same formula used to set rates in a different case might also be applied here. Moreover, *ABATE* indicates that the PSC properly looked at the prudent investment test and did not need to consider whether the clean coal plant became “used and useful.” Finally, even if precedent were to be considered in deciding whether the ratemaking in this case was unlawful or unreasonable, the distinctions between the clean coal plant and the Midland Nuclear Plant justify distinct treatment. The current case involves \$14.45 million of recovered costs that were to be amortized whereas the amount at issue with the Midland Nuclear Plant was \$346 million. See 208 Mich App at 250. The greater amount provided a stronger rationale for amortizing it over a longer period. Moreover, *ABATE* suggests that Consumers was saddled with the *imprudent* expenditures associated with the Midland Nuclear Plant; it does not appear that prudent expenditures were shared between shareholders and ratepayers. Finally, although *ABATE* mentions that the unamortized costs were not carried in base rate with the Midland Nuclear Plant, the opinion does not address this as an issue. However, given Rolling’s testimony that Consumers invested corporate capital and should have a return on those funds until recovered, and her observation that including the unamortized balance in rate base during the amortization period helps insure that no harm follows from a prudent decision, it cannot be said that the PSC’s decision was unlawful or unreasonable.

II. SPENT NUCLEAR FUEL ISSUES

Consumers owned and operated the Big Rock Point Nuclear Generating Plant, which was retired in 1997, and the Palisades Nuclear Generating, which it sold in 2007. Under the Nuclear Waste Policy Act, 42 USC 10101 *et seq.*, and standard contracts entered into pursuant to the Act, the United States Department of Energy (DOE) was and is responsible for disposing of SNF from these plants. Consumers was required to pay for the disposal; it had a one-time \$163 million obligation for disposal of pre-1983 SNF (the DOE liability) that it elected to pay at the time of disposal rather than immediately. So far, the DOE has failed to timely accept and dispose of the SNF. Given damages arising from the delay, such as the costs of building facilities for on-site storage of SNF, Consumers sued the federal government for partial breach of the standard contract.

While the lawsuit against the federal government was pending, Consumers initiated Case No. U-16191 with a petition to increase rates. In that case, Consumers wanted to extinguish the DOE liability by paying it outright. Initially, the PSC held that, instead, Consumers had to establish an external trust for payment of the pre-1983 liability. On rehearing, the PSC held that the order requiring the trust did not preclude a settlement of the lawsuit that would involve the DOE liability, and directed Consumers to file a new application to address disposition of the proceeds if the settlement was successful. Following a settlement on July 11, 2011 that included payment of the DOE liability, Consumers filed a petition in Case No. U-16191, requesting rescission of the external trust requirement, and initiated a new case, Case No. U-016861, for review of the settlement and approval of a \$23.3 million refund to ratepayers. On December 6, 2012, the PSC issued an order in both Case Nos. U-16191 and U-16861, extinguishing the trust obligation and approving the application relative to the refund.

In the present case, Peloquin asserted that payment of the DOE liability as part of the settlement was imprudent. He therefore recommended that the \$163 million be refunded to ratepayers over a 10-year period. Ronald C. Callen, a consultant and technical adviser who also served as an MCAAA expert, similarly concluded that Consumers' actions were imprudent. Callen took issue not only with the \$163 million payment to the DOE, but also with \$260 million in annual fees paid to the DOE for post-1983 SNF disposal until the sale of Consumers' nuclear facilities in 2007. He similarly recommended that there be a downward rate adjustment over 10 years so as to refund the contract fees or, alternatively, that a trust be created for these funds.

The PSC denied the rate reduction, concluding that the issues of SNF fees and the DOE liability were not relevant to the present rate case. It noted that Consumers was not seeking to recover any SNF expenses and did not expect to incur any SNF expenses during the test year. Further, it noted that the issues MCAAA was raising would be addressed in Case No. U-16861. MCAAA argues that the propriety of the settlement should be addressed in this case as well because during the test year Consumers paid the DOE liability with ratepayer-supplied funds, thereby failing to preserve and pursue its remedies against the DOE, and because the MCAAA was seeking a remedy to carry out pre-existing PSC orders. As noted above, a PSC order will be upheld unless it is unlawful or unreasonable. *In re Application of Consumers Energy Company for Rate Increase*, 291 Mich App at 109-110. At the time the PSC issued its final order in this case on June 7, 2012, Consumers had already filed its July 14, 2011, petition seeking an order rescinding the directive that Consumers establish and fund the trust for the DOE liability in Case No. U-16191, Consumers had filed its September 9, 2011 application for approval of refunds relative to the DOE litigation settlement in Case No. U-16861, and a hearing had been held on April 10, 2012. Since both matters were pending at the time the order was issued in this case, and Consumers was not seeking any rates based on any costs associated with SNF funds in this ratemaking case, it was not unlawful or unreasonable for the PSC to decide to address these issues in Case Nos. U-16191 and U-16861.

Affirmed.

/s/ Kurtis T. Wilder
/s/ E. Thomas Fitzgerald
/s/ Jane E. Markey