

S T A T E O F M I C H I G A N

C O U R T O F A P P E A L S

MICHIGAN ENVIRONMENTAL COUNCIL,

Appellant,

v

CONSUMERS ENERGY COMPANY,

Petitioner-Appellee,

and

MICHIGAN PUBLIC SERVICE COMMISSION,
MICHIGAN POWER LIMITED PARTNERSHIP,
ADA COGENERATION LIMITED
PARTNERSHIP, and CADILLAC RENEWABLE
ENERGY, L.L.C.,

Appellees.

UNPUBLISHED

August 10, 2010

No. 287696

Public Service Commission

LC No. 00-014701

Before: M. J. KELLY, P.J., and MARKEY and OWENS, JJ.

PER CURIAM.

In this dispute over utility rates, appellant Michigan Environmental Council (MEC) appeals the Michigan Public Service Commission's (PSC) April 22, 2008, order allocating the proceeds from the sale and auction of petitioner-appellee Consumers Energy Company's sulfur dioxide allowances. The primary issue on appeal is whether the record evidence supported the PSC's decision regarding the proper allocation of the allowances. We conclude that the record evidence supported the PSC's allocation of the allowances and was otherwise lawful. For these reasons, we affirm.

I. BASIC FACTS AND PROCEDURAL HISTORY

A. THE PSC'S RATEMAKING AUTHORITY

The PSC has broad statutory authority to set just and reasonable rates for public utilities. See MCL 460.6(1). An electric utility can recover its power supply costs through either base rates¹ or a power supply cost recovery (PSCR) clause. A PSCR clause is

. . . a clause in the electric rates or rate schedule of a utility which permits the monthly adjustment of rates for power supply to allow the utility to recover the booked costs, including transportation costs, reclamation costs, and disposal and reprocessing costs, of fuel burned by the utility for electric generation and the booked costs of purchased and net interchanged power transactions by the utility incurred under reasonable and prudent policies and practices. [MCL 460.6j(1)(a).]

If a utility has adopted a PSCR clause, the PSC sets and reconciles the utility's rates on an annual basis. The utility presents a plan to acquire the power it needs to serve its customers prior to the beginning of its plan year. This plan must include the utility's expected sales and propose a PSCR factor.² The PSC then establishes the rates the utility is allowed to charge customers for the plan year. After the year concludes, the PSC conducts a reconciliation proceeding in which it considers the "reasonableness and prudence" of the utility's expenditures and the amounts collected by the utility to cover those expenditures. MCL 460.6j(12). If a utility recovered more than needed to cover its expenditures, the excess is refunded to ratepayers. If a utility did not recover enough to cover its expenditures, the utility is authorized to recover its expenses through increased rates. MCL 460.6j(14) and (15).

B. CASE NO. U-15001

In September 2006, Consumers filed an application seeking approval of a PSCR plan and monthly PSCR factors for the calendar year 2007. The PSC docketed the application as Case No. U-15001. MEC intervened in the case, and the PSC Staff also participated in the proceedings. The Administrative Law Judge (ALJ) held an evidentiary hearing on July 10 and 17, 2007.

Among the issues discussed at the hearing was the appropriate treatment of revenues from the sale and auction of Consumers' sulfur dioxide allowances. David Kehoe testified that he was Consumers' Director of Staff, Electric Generation. Kehoe stated that, beginning in 1990, federal law required utilities to start using allowances to control sulfur dioxide emissions. The Environmental Protection Agency issued the allowances, each of which allowed a utility to emit

¹ Base rates are established in a general rate case. MCL 460.6a(2)(b).

² A PSCR factor is "that element of the rates to be charged for electric service to reflect power supply costs incurred by an electric utility and made pursuant to a power supply cost recovery clause incorporated in the rates or rate schedule of an electric utility." MCL 460.6j(1)(b).

one ton of sulfur dioxide. A utility could bank, sell, or trade allowances that it did not need. The EPA issued allowances to utilities based on their sulfur emissions during the base years 1990 to 1992. Kehoe indicated that during the base years, Consumers burned a great deal of high sulfur coal, and so received more allowances from the EPA. Consumers gradually increased the amount of low sulfur coal that it burned and accumulated excess allowances because it continued to receive allowances based on its sulfur usage during the base years. Kehoe indicated that from 1998 to 2005, which was the period in which rates were frozen and capped,³ Consumers accumulated a surplus of 61,310 allowances.

In February 2006, Consumers sold 40,000 excess allowances (23,776 of which it accumulated during the frozen/capped rate period) for \$58,673,414. Consumers sought to allocate 50% of this revenue to its PSCR customers, and to retain the remaining portion. Consumers reasoned that it should be allowed to retain 50% of the revenue because during the frozen/capped rate period, it incurred higher operation and maintenance costs by burning low sulfur coal, but was not allowed to pass these costs on to its customers. Consumers intended to use the revenue it retained to invest in projects that enhanced its distribution capacity, as well as its generation reliability and its customer service.

Staff witness Ronald Ancona testified that 100% of the revenue from the sale of Consumers' excess allowances should be allocated to Consumers' customers, as should 100% of the revenue from the EPA's auctions of allowances on Consumers' behalf from 2004 to 2006.⁴ Ancona asserted that allocating all the revenue to Consumers' customers would insure that the customers received the full benefit of the sale and auctions.

MEC witness William Peloquin testified that 100% of the revenue from the sale of Consumers' excess allowances and the EPA's auctions of allowances should be allocated to Consumers' customers. Peloquin asserted that the sulfur dioxide expenses were PSCR costs; he also contended that Consumers did not act in a timely manner to switch to low sulfur coal and thereby reduce sulfur dioxide emissions.

C. CASE NO. U-14701-R

While Case No. U-15001 was still pending, Consumers filed an application seeking reconciliation of its PSCR revenues and expenditures for the 2006 calendar year. The PSC docketed the application as Case No. U-14701-R. MEC intervened in the case, and the Staff also participated in the proceedings. The parties also raised the issue of the proper allocation of the proceeds from Consumers' sale of allowances and the EPA's auction of allowances in this case.

³ 2000 PA 141 reduced rates and imposed caps on the rates that an electric utility such as Consumers could charge its customers. The rate caps expired on December 31, 2005. See MCL 460.10d.

⁴ These auctions generated \$3,459,830 in revenue for Consumers.

Consumers' witness Thomas Cox indicated that the company's original proposal to allocate one-half of the revenue from the sale of allowances to customers was reflected in the company's proposed PSCR rates. Cox opposed the allocation of revenue gained from the EPA's auctions to customers.

MEC witness Peloquin reiterated his contention that 100% of the proceeds from the sale of Consumers' allowances and the EPA's auction of allowances should be credited to Consumers' customers. Peloquin asserted that Consumers' commitment to burning low sulfur coal was late in developing, and that Consumers already recovered the costs associated with converting to low sulfur coal.

The Staff did not file direct testimony in Case No. U-14701-R regarding the allocation of revenue from allowances, but filed a brief recommending that 70% of the revenue from Consumers' sale of allowances be allocated to customers, and that Consumers be allowed to retain 30% of the revenue. The Staff brief noted that the record in Case No. U-15001 showed that Consumers took action to increase its use of low sulfur coal. By doing so, Consumers reduced its need for allowances. The Staff concluded that Consumers took cost-effective measures to comply with federal standards; and, on that basis, the Staff concluded that the sharing of proceeds from the sale of allowances, but not from the EPA's auction of allowances, was appropriate.

D. THE PSC'S DECISION

In an order entered on April 22, 2008, in Case No. U-15001, the PSC addressed the issues raised in Consumers' application for approval of a PSCR plan and monthly PSCR factors for the calendar year 2007. The PSC concluded that the issue of the distribution of proceeds from the sale of allowances should be addressed in the order issued in Case No. U-14701-R.⁵

In an order entered on the same day, in Case No. U-14701-R, the PSC addressed the issues raised in Consumers' application for reconciliation of its PSCR revenues and expenditures for the calendar year 2006. The PSC noted that, because the issue of the allocation of proceeds from the sale and auction of allowances was also raised in Case No. U-15001, the ALJ took official notice of the record from Case No. U-15001.

The PSC summarized the arguments made by the various parties concerning the allocation of the revenue from the sale of allowances and adopted the Staff's proposal that 70% of the revenue be allocated to Consumers' PSCR customers, and that Consumers be allowed to retain the remaining 30% of the revenue. The PSC noted that Consumers' coal burning plants were some of the oldest in the country, and that Consumers' switch to low sulfur coal resulted in cheaper fuel for customers, notwithstanding potentially increased operating costs, and a reduced need for allowances. The PSC reasoned that had Consumers not taken these steps, it likely would have used more allowances and had to purchase allowances at ratepayer expense. The

⁵ The remaining claims addressed in the PSC's order in Case No. U-15001 are not at issue on appeal.

PSC found that Consumers' investment in new equipment to burn low sulfur coal avoided the need to purchase higher priced fuel and more allowances.

The PSC also adopted the Staff's recommendation that 100% of the proceeds from the EPA's auction of allowances on Consumers' behalf should be allocated to ratepayers. The PSC reasoned that that revenue did not result from Consumers' decision to invest in new equipment; thus, ratepayers should get the full benefit of those revenues.

The PSC concluded that \$41,071,390 of the proceeds from the sale of the allowances should be allocated to ratepayers, while Consumers should retain the remaining \$17,602,024. Furthermore, the entire amount of the proceeds from the EPA auction, or \$3,459,830, should be allocated to the ratepayers.⁶

MEC moved for rehearing of the PSC's order in Case No. U-14701-R, but the PSC denied the motion on the ground that MEC's petition for rehearing merely stated the same arguments that were rejected in the original decision.

This appeal followed.

II. UNLAWFUL ORDER

A. STANDARDS OF REVIEW

On appeal, MEC argues that the PSC order was unlawful because it did not have a full and fair opportunity to contest the order and because the record evidence did not support the order. MEC also argues that the order constituted unlawful retroactive ratemaking.

The standard of review for PSC orders is narrow and well defined. *In re Consumers Energy Application*, 279 Mich App 180, 188; 756 NW2d 253 (2008). 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; *Attorney General v Pub Serv Comm*, 165 Mich App 230, 235; 418 NW2d 660 (1987). All rates, fares, charges, classification and joint rates, regulations, practices, and services prescribed by the PSC are presumed to be lawful and reasonable. See MCL 462.25. A party aggrieved by an order of the PSC has the burden of proving by clear and satisfactory 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 mandatory statute or abused its discretion in the exercise of its judgment. *In re MCI Telecom Complaint*, 460 Mich 396, 427; 596 NW2d 164 (1999). An order is unreasonable if it is not supported by the evidence. *In re Consumers Energy Application*, 279 Mich App at 188.

⁶ The PSC addressed other issues in the order that are not at issue on appeal.

This Court will defer to the PSC's administrative expertise and will not substitute its judgment for that of the PSC. *Attorney General v Pub Serv Comm No 2*, 237 Mich App 82, 88; 602 NW2d 225 (1999). This Court gives respectful consideration to the PSC's construction of a statute that the PSC is empowered to execute. If the language of a statute is vague or obscure, the PSC's construction serves as an aid to determining the legislative intent, and will be given weight if it does not conflict with the language of the statute or the purpose of the Legislature. However, the construction given to a statute by the PSC is not binding on this Court. *In re Complaint of Rovas Against SBC Mich*, 482 Mich 90, 103-109; 754 NW2d 259 (2008). Whether the PSC exceeded the scope of its authority is a question of law that this Court reviews de novo. *In re Complaint of Pelland Against Ameritech Mich*, 254 Mich App 675, 682; 658 NW2d 849 (2003).

B. COMPETENT, MATERIAL, AND SUBSTANTIAL EVIDENCE

The PSC conducted contested case hearings in Case No. U-15001, Consumers' application for approval of a PSCR plan and monthly PSCR factors for the calendar year 2007, and in Case No. U-14701-R, Consumers' application for reconciliation of its PSCR revenues and expenditures for the calendar year 2006. See MCL 460.6j(5) and MCL 460.6j(6).⁷ MEC intervened in both cases and participated in both hearings. In both proceedings, MEC opposed allocating to Consumers any percentage of the revenue from the sale of allowances. MEC had a full and fair opportunity to be heard in these proceedings. In Case No. U-15001, the Staff proposed allocating to Consumers' ratepayers 100% of the revenue from the sale of allowances. It is true that in Case No. U-14701-R, the Staff submitted a post-hearing brief in which it modified its argument and recommended allocating to Consumers' ratepayers 70% of the revenue and permitting Consumers to retain the remaining portion. MEC filed a reply brief in which it objected to the Staff's 70-30 proposal on both lack of notice and substantive grounds. The ALJ's Proposal for Decision recommended that the Staff's proposal be rejected; however, the PSC adopted the Staff's proposed allocation. MEC's assertion that it did not receive the notice required by MCL 460.6a is without merit. MEC had the opportunity to object to the Staff's revised proposed split of the revenue, and points to no argument regarding the proposed split that it was unable to raise for the PSC's consideration. The PSC took the position that had Consumers not taken proactive steps to reduce the cost of fuel for customers, including some steps taken when rates were capped and frozen, it was likely that Consumers would have been required to purchase additional allowances at a higher cost. The PSC concluded that, for that reason, it was equitable to allow Consumers to retain a portion of that revenue. The PSC could properly rely on the evidence put forth by Consumers rather than that presented by MEC. *Great Lakes Steel v Pub Serv Comm*, 130 Mich App 470, 481-482; 344 NW2d 321 (1983). The fact that MEC disagrees with the PSC's decision does not make the decision unlawful or unreasonable.

⁷ A "contested case" is defined as "a proceeding, including rate-making, price-fixing, and licensing, in which a determination of the legal rights, duties, or privileges of a named party is required by law to be made by an agency after an opportunity for an evidentiary hearing." MCL 24.203(3).

The basis for the PSC's decision is clearly set out in the April 22, 2008, order. MEC's argument that the PSC's decision is unlawful and unreasonable because it does not comply with Const 1963, art 6, § 28 and MCL 24.285 is without merit.

C. UNLAWFUL RETROACTIVE RATEMAKING

The PSC cannot make utility rates retroactive. *Detroit Edison Co v Pub Serv Comm*, 416 Mich 510, 523; 331 NW2d 159 (1982). Utility rates are set on the basis of estimates of costs. When the estimates prove inadequate, the previously set rates cannot be changed to correct the error. The only step the PSC can take is to prospectively revise rates in order to better estimate costs. *Id.* The bar against retroactive ratemaking applies only to rates charged by a utility under a lawful order. The PSC can mandate a refund of monies paid pursuant to rates set under an unlawful order. *In re MCI Telecom Complaint*, 255 Mich App 361, 366; 661 NW2d 611 (2003).

Here, the PSC did not engage in retroactive ratemaking. This is not a case in which Consumers' rates charged to customers proved to be inadequate. Rather, the revenue at issue resulted from the sale of excess allowances that had been allocated to Consumers. The expenses incurred by Consumers in years prior to 2006 were a factor in the PSC's decision to allow Consumers to retain 30% of the revenue, but that decision did not change Consumers' rates then in effect. Ratemaking simply was not an aspect of this issue. MEC has not shown by clear and satisfactory evidence that the PSC's order was unlawful or unreasonable in this regard. MCL 462.26(8).

The PSC's order is lawful and reasonable, and complies with the requirements of Const 1963, art 6, § 28, and MCL 24.285.

Affirmed.

/s/ Michael J. Kelly
/s/ Jane E. Markey
/s/ Donald S. Owens