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M E M O R A N D U M

November 15, 2010

TO: **Utility Consumer Participation Board**
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FROM: Don L. Keskey 
Public Law Resource Center PLLC

RE: **Case report concerning; *In re Consumers Energy Company*, MPSC Case No. 16191;
MCAAA Grant UCRF-11-03.**

This memorandum provides the Board with an update regarding the above referenced case, and summarizes the results of the final order issued on November 4, 2010 by the Michigan Public Service Commission (MPSC or Commission) on some key issues in this case. This firm represented the Michigan Community Action Agency Association (MCAAA) in this matter.

The MCAAA, by above-signed counsel, intervened in this case, and presented extensive expert testimony¹ and briefing² relating to issues concerning spent nuclear fuel (SNF) contract fees collected in rates under the Nuclear Waste Policy Act of 1982 (NWP) and the Standard Contract between nuclear utilities (including Consumers Energy Company, or CECO) and the U.S. Department of Energy (DOE). The purpose of MCAAA's presentation was to uphold and further implement rate remedies that the MPSC adopted in CECO's most recent previous electric rate orders (dated November 2, 2009 and January 25, 2010) in U-15645.³ These issues included removal of the accumulated DOE Liability from rate base and from the cost of capital, and removal of annual interest for the DOE Liability in Operation and Maintenance (O&M) expense, and recommendations for the establishment of an MPSC regulated trust to receive the \$163 million in accumulated SNF fees related to pre-1983 nuclear generation that CECO collected from ratepayers but did not deposit into the federal Nuclear Waste Fund (NWF) (which funds

¹ Testimony of Ronald C. Callen and CPA William Peloquin.

² Initial brief dated August 26, 2010, comprising 52 pages; reply brief of September 16, 2010, comprising 12 pages.

³ These orders are the subject of previous memos sent by this firm to the Board; the above-signed counsel represented the Michigan Environmental Counsel (MEC) and the Public Interest Research Group in Michigan (PIRGIM) in U-15645, wherein extensive expert testimony and briefing was presented that led to the adoption by the MPSC of the rate remedies referenced in this memo; in that case and in several previous cases, the MEC/PIRGIM (represented by above-signed counsel) were the sole parties to initiate and advocate these remedies. The MCAAA (represented by above-signed counsel) also advocated these remedies in CECO's gas cases (such as U-15606 and U-15986) wherein CECO attempted to allocate some SNF related costs in gas rates.

comprise what is termed the "DOE Liability"). MCAAA also continued its opposition to the inclusion in rates of the annual costs of a Bank Letter of Credit (LOC) related to CECO's "DOE Liability."⁴ While the annual costs of this Letter of Credit have escalated rapidly to over \$4 million per year, the "guarantee" provided by the bank is illusory because the condition precedent for the Bank's obligation is essentially wholly theoretical given the federal government's long-term or indefinite breach in performing SNF disposal.

In this case, the Staff also filed expert evidence on the SNF issues, and briefed some of the issues. As noted, MCAAA presented extensive expert testimony and briefing on these issues. The only other party participating on the issue was MEC, which filed no expert testimony on the issues, but supported the proposed rate remedies in briefing.

The Commission's November 4, 2010 order in this case, referring to its previous order issued November 2, 2009 in CECO's previous rate case, U-15645, reaffirmed its precedent in that case to remove the DOE Liability from rate base and the cost of capital, stating (pgs 3-4):

A utility's rate base consists of the capital invested in used and useful plant, less accumulated depreciation, plus the utility's working capital requirements. In previous rate cases, Consumers' rate base also included liability to the U.S. Department of Energy (DOE) for pre-1983 disposal of spent nuclear fuel (SNF). In the November 2 order, the Commission determined that DOE liability should be removed from rate base and the company's capital structure. The Commission further directed the company to provide a proposal to establish a trust for its pre-1983 DOE liability in its next rate case, or in a new docket, by January 4, 2011. In this case, the Staff and Consumers removed \$44,286,000 DOE liability from rate base. According to the Staff, the methods used differed but the resulting adjustment was the same. Issues regarding the DOE liability trust fund are discussed *infra*.

The Commission's November 4, 2010 order, page 41, also reaffirmed its precedent in its January 25, 2010 rehearing order in U-15645 (issued in response to this firm's Motion for Rehearing filed on behalf of MEC/PIRGIM) to exclude incremental annual interest cost related to the DOE Liability from O&M expenses, stating (p 41):

Consumers included DOE liability interest costs of \$2,093,000 in its projected O&M expenses. The Staff disagreed with the inclusion because it is inconsistent with the Commission's order in Case No. U-15645, where the Commission directed the company to establish a trust fund for DOE liability finding that the

⁴ This LOC was required by Entergy Nuclear Palisades when it acquired CECO's Palisades Nuclear Plant, and the SNF storage sites at both Palisades and at the decommissioned Big Rock Nuclear Plant; the LOC was required to provide Entergy assurance that, if CECO became obligated to pay the "DOE Liability" to the DOE (an event that would be required only if DOE was ready to commence accepting for disposal the subject SNF generated by CECO), that the Bank would pay the DOE Liability obligation if CECO was no longer able to. The above-signed counsel, and the above named expert witnesses (and also the MPSC Staff) opposed any Bank Letter of Credit costs in U-14992 (sale, transfer of Palisades and Big Rock plants or SNF sites), and in CECO's subsequent electric rate cases, U-15245 and U-15645, a position which the MPSC adopted in those previous cases.

trust earnings will provide for recovery of this expense. In its reply brief, MCAAA agreed with the Staff's position. As discussed further below, the Commission finds that establishment of an external trust is the most reasonable and prudent course of action. The trust earnings are expected to be sufficient to provide recovery for the DOE liability interest expense. Therefore, the Commission finds that Consumers' DOE liability interest costs of \$2,093,000 should be removed from O&M expenses.

With respect to the DOE Liability Trust fund, the Commission's November 4, 2010 order in this case required the implementation of the trust within six (6) months of the order. This portion of the order states:

A. Department of Energy Liability Trust Fund

In the November 2 order, the Commission determined that it was necessary to segregate pre-1983 DOE liability into a trust fund because of the uncertainty surrounding future payment of the funds and because the liability has grown quite large. The Commission directed Consumers to present a proposal to establish a trust for pre-1983 DOE liability in the company's next rate case or by January 3, 2011. The proposal was to include a recommendation for the period during which the accrued funds will be deposited into the trust and recommended guidelines for prudent management of the funds.

Although Consumers questions whether establishing a trust at this time is in the best interest of the company or its customers, Consumers accepted the Staff's recommendations to remove the DOE liability and letter of credit fees from the capital structure calculations in this case, it included replacement long-term debt in the capital structure calculations, and it provided a proposal for establishing a trust.

Consumers asserts that creating an external trust is the most expensive and risky approach from a customer standpoint. Consumers stated that it would be preferable to simply pay the DOE liability and extinguish the obligation. Under either option, the only incremental cost to customers would be the cost of debt which is issued to replace funds previously available from use of the DOE liability.

If the Commission decides to establish a trust, Consumers recommends structuring it similar to an escrow account that would: 1) preserve the principal and interest deposited into the trust; 2) minimize risk; and 3) use an investment strategy that closely matches the DOE interest charges that Consumers is assessed (i.e., the 13-week Treasury bill rate) on its obligation to the DOE.

Consumers asserts that its trust fund proposal is reasonably and rationally related to fulfillment of the company's obligation under the Nuclear Waste Policy Act of 1982 for the pre-1983 DOE liability. Consumers adds that investing funds in 13-week Treasury bills is a prudent investment strategy.

According to Consumers, the investment strategies proposed by other parties are too risky and costly for Consumers and its customers. Consumers stated that any trust structure that restricts the company's ability to pay the DOE

liability at any time is detrimental to Consumers and its customers. In addition, Consumers believes that the investment strategies proposed by the Staff and MCAAA complicate trust management and increase expenses. Consumers added that if the Commission mandates the trust fund structure and funding strategies advocated by the other parties, it would infringe upon the company's management prerogatives.

The Staff agreed with Consumers on certain aspects of the company's proposal, e.g., that the trust should be an external trust, managed by an experienced trust management firm, and fully funded at the initiation of the trust. However, the Staff disagreed with Consumers' proposal to limit the investment strategy of the trust and to curtail any distribution of proceeds from the trust until the DOE liability was paid off. The Staff believes that the primary purpose for establishing the trust is to ensure that funds are available in the future to cover DOE liability obligations.

According to the Staff, it is unlikely that DOE will be able to address the disposal of SNF for at least ten years. Therefore, the Staff recommended that the trust invest in primarily risk-free instruments with prudent investments in equity securities with an investment grade credit rating. The Staff asserted that its proposed strategy would provide the opportunity for the trust to earn well above the amount required for DOE liability expense and that this investment strategy is similar to the investment guidelines set forth in the Indiana Michigan Power Company's D.C. Cook Power plant's nuclear decommissioning trust.

Specifically, the Staff recommended that no more than 35% of trust funds should be invested in equity investments, with the bulk remaining in fixed-income instruments. In addition, the Staff recommended that the Commission establish a 3-year review cycle that includes: 1) an evaluation of the trust fund's performance and investment profile; 2) a 3-year forecast of investment objectives, balances and expenses; 3) an update of the accrued DOE liability; 4) a 3-year forecast of DOE liability accruals; and 4) updates on the DOE's plan for SNF disposal. The Staff suggested that the Commission should require Consumers to establish the trust fund within six months following an order in this case and direct the company to file a letter in this docket confirming the establishment of the trust.

The MCAAA concurred with the Staff's recommendations regarding the guidelines for the trust and added that it did not understand why Consumers should pay the DOE after the DOE's breach of the Standard Contract. The MCAAA opined that paying the DOE liability will reward the federal government for its default and could create more legal issues for Consumers if it must seek restitution for SNF funds paid up to now.

The MCAAA urged that the establishment of a trust should not be delayed or reconsidered because of questions relating to Consumers' Court of Claims case or its current settlement discussions with the DOE. In addition, MCAAA stated that the Commission should establish an ancillary process to consider the details of the trust implementation, including selection of a trustee, the provision for a request for proposals, consideration of trust costs among alternative trustees, and concerning all aspects of the trust governance and provisions of the trust.

MEC supports the Staff and the MCAAA's positions regarding the issue of the DOE liability trust. MEC adds that the Commission should not permit Consumers to use the DOE liability funds to obtain a settlement in its case against the federal government that is beneficial to the company's shareholders at the expense of the company's ratepayers.

In response, Consumers contends that the trust fund structure and investment strategy proposals by the Staff, MEC, and MCAAA should be rejected because they are not consistent with the purpose for which funds were recovered in rates. In particular, Consumers disputes the recommendation to manage the DOE liability trust investments in the same way investments for nuclear plant decommissioning trusts are managed. Consumers points out that:

(i) decommissioning trusts were established voluntarily by utilities for deposit of future funds, (ii) amounts needed for decommissioning were uncertain since no major nuclear plant had ever been decommissioned, (iii) trusts were to be funded through charging a provision for nuclear decommissioning in future rates, (iv) nuclear decommissioning trust fund investments sought to make positive returns that could reduce future nuclear decommissioning surcharge collections from customers, (v) the sole purpose was to provide funds for decommissioning, and (vi) there was no payment option that would eliminate or extinguish the liability for decommissioning.

Consumers' reply brief, p. 47.

In contrast to decommissioning trusts, Consumers contends that the principal amount of the DOE liability obligation is known, the accrued interest is known, the exact method of determining future interest is known, no future recovery from customers for purposes of the DOE liability expense is contemplated, and the DOE liability can be extinguished at any time.

The Commission agrees with the Staff, MCAAA, and MEC that Consumers' proposal to pay the DOE liability and extinguish the obligation at this time would be imprudent. As discussed by MCAAA, the federal government has defaulted on the Standard Contract, and it is unlikely that SNF will be collected by the federal government in the foreseeable future. The Commission finds that Consumers' proposal to pay the DOE liability will reward the federal government for its default on its contractual obligation and could create legal problems for Consumers in its enforcement of the statutory and contractual agreement with the federal government. Furthermore, Consumers' proposal to extinguish the DOE liability puts ratepayers at significant risk because Consumers will be using ratepayer funds to pay the federal government for a service that it may never receive.

Likewise, the Commission has already determined that the amount of money accrued, approximately \$163 million, is significant enough that maintaining the status quo is unreasonable and the creation of an external trust is now warranted. Therefore, the Commission reiterates that establishment of an

external trust, as directed in the November 2, order is the most reasonable and prudent course of action.

The Commission further finds Consumers' investment strategy to be too limited in light of the extensive timeline that appears to be involved. As the MEC and the MCAAA point out, the federal SNF disposal program is in a desperate a situation and may never perform SNF disposal. As has been widely reported, the appropriation for the SNF disposal program has been cut drastically and virtually all efforts at developing Yucca Mountain are stalled. The DOE may thus be forced to begin the SNF disposal program from scratch, which means many more years before any SNF is disposed of by the federal government.

The Commission finds that the Staff's proposal is reasonable and prudent and adopts the Staff's proposed trust structure and investment guidelines. The Staff's investment structure takes an appropriate long-term view and better balances the opportunity for some return on investment at a limited amount of risk. The Commission therefore finds that the Staff's proposal reasonably ensures that there will be sufficient funds in the future to cover any DOE liability, the funds are safe from comingling with Consumers' corporate funds, and ratepayers' funds are being properly invested to cover all future DOE liability expenses.

The Commission therefore directs Consumers to establish and fund an external trust for DOE liability within six months of the date of this order, in accordance with the Staff's proposed investment guidelines. The Commission further directs the company to file a letter in this docket attesting to the establishment of the trust. Annually thereafter, Consumers shall file a summary report in this docket reporting the current trust investment mix and annual trust performance. A more complete review shall be performed every three years, in accordance with the Staff's recommendation.

The ordering paragraphs of the Commission's order includes paragraph E, on page 81, which states:

E. Within six months of the date of this order, in accordance with the Commission Staff's proposed investment guidelines, Consumers Energy Company shall establish an independent trust for pre-1983 Department of Energy liability funds. The Commission further directs Consumers Energy Company to file a letter in this docket attesting to the establishment of the trust. Annually thereafter, Consumers Energy Company shall file a summary report in this docket reporting the current trust investment mix and annual trust performance.

(End of Quotes).

The extensive evidence and briefing submitted by MCAAA in this case has assisted in cementing the precedent gained in CECO's previous electric case, U-15645, on these issues, and has greatly strengthened the evidentiary record on these issues for purposes of any potential challenge to these rate remedies in a state or federal case, or future MPSC case. The rate remedies adopted by the Commission on the DOE Liability issues in MPSC Case Nos. U-15645 and this case (U-16191) has served to protect ratepayers from being improperly charged for the

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DOE Liability in rates (rate base, cost of capital, O&M costs, Letter of Credit Costs) and also preserves the total amount of the DOE Liability in an external trust to ensure that the funds are available in the event any obligation to pay the NWF arises in the future or if the funds are needed to address the disposal of SNF that is presently stored at present or former nuclear plant sites located in Michigan.

Please advise me if you have any questions regarding this case.

DLK/cd

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