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ASSOCIATION OF BUSINESSES ADVOCATING TARIFF EQUITY

Senate Bill 271 ("SB 271") and Senate Bill 273 ("SB 273") as approved by the Senate on October 26, 2023 includes certain modifications to existing law that provide significant benefits to utilities and their investors at the expense of ratepayers while stripping away the Michigan Public Service Commission's ("Commission") discretion to consider record evidence in determining just and reasonable rates. ABATE believes SB 271 misses the mark for several reasons.

1) SB 271: The utilities should only be able to collect ACTUAL COST from their customers. The law allowing utilities to collect projected costs from Michigan residents, small businesses and large, energy intensive industries has cost customers millions of dollars. (detail below)
2) SB 271 Section 47 (1): This law bypasses the regulatory rate case process to determine what is a reasonable profit (return on equity "ROE") for the utility to make regarding investments in renewable generation AT THE TIME THE UTILITY ACTUALLY MAKES THE INVESTMENT and locks in an ROE/profit for the utility as soon as they file a renewable plan and BEFORE they have even made an investment. As an example: In both Consumers Energy and DTE's most recent electric rate cases, the MPSC approved a 9.9% ROE for all other capital investments made by the utility. Which, by the way, is also still above the national average for electric utility ROE's. But this law requires the MPSC to allow the utilities to earn a 10.7% ROE on the renewable energy investments which results in unnecessary higher electricity rates. There is no need for special cost allocation treatment for renewable generation.
3) There was a last minute change to SB 271 Section 28 (8) that added another financial incentive to the utilities associated with renewable and clean power purchase agreements.
   - This bill language is discriminatory! The bill requires that ALL electric providers must meet the renewable portfolio standard and the clean energy standard but only provides a financial incentive to the utilities to enter power purchase agreements.
   - There is no requirement that the utilities enter into power purchase agreements for renewable power or clean power. This is an optional choice for the utilities. Therefore the law should not mandate that the utilities receive a financial incentive.
   - MCL 460 Section 6t already requires that, "the commission shall consider and may authorize a financial incentive for that utility that does not exceed the utility's weighted average cost of capital."
4) This bill language mandates that the highest possible weighted average cost of capital be used which will drive up electricity rates to customers! The bill proposes to use pre-tax WACC on a permanent capital basis (i.e. it only considers the capital provided by long-term debt, common equity, and preferred stock). In Michigan, the ratemaking WACC includes investment tax credits, short-term debt, and accumulated deferred income taxes ("ADIT"). ADIT typically makes up a significant portion of the ratemaking capital structure and is included at a 0% cost rate. SB 271 Section 101 (5) Again, this bill language is discriminatory! The bill requires that utilities and alternative electric

suppliers must meet the energy storage requirement but only provides a financial incentive to the utilities to enter storage purchase agreements. There is no requirement that the utilities enter into storage purchase agreements. This is an optional choice for the utilities. Therefore the law should not mandate that the utilities receive a financial incentive. (more detail below)

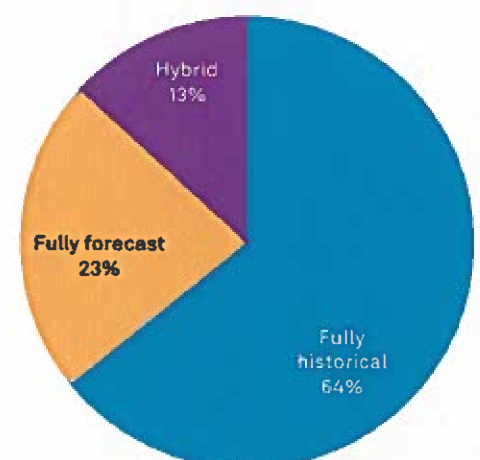
SB 273 also unnecessarily increases rates for customers…

5) The 2008 energy bill created an energy efficiency program requiring the utilities to collect money from all customers and then use that money to fund projects that reduce energy usage by customers. Using electricity more efficiently is certainly a good thing. However, the law also then authorized the utilities to collect millions of dollars of profit as an "incentive" for running this energy efficiency program. As shown on a recent utility investor presentation slide, they proudly identify collecting over $50 MILLION Dollars per year in incentive from customers. SB 273 now INCREASES THE FINANCIAL INCENTIVE even more! So customers are paying the utility for all the cost of the energy efficiency programs and then also have to pay increased rates to provide the utility a profit for simply managing the program. At a minimum the financial incentive should have been REDUCED not increased!

Use Actual Cost in Setting Utility Rates

The State of Michigan guarantees the incumbent investor-owned utilities a captive customer base and the opportunity to both recover their costs and earn an authorized rate of return on their expenses. When a utility seeks a rate increase, it files an application with the Michigan Public Service Commission (MPSC). In that application, the utility lists all its costs and revenues over a 12-month period to support its contention that an increase on customer rates is necessary. That 12-month window is called the "test period" or the "test year." The determination of the test year is critical in terms of setting rates. For over 60 years utilities used an historical test year, based on ***actual costs and revenues,*** and only adjusted for known and measurable changes. The 2008 energy policy allowed utilities in Michigan the option to propose a future test year based on ***projected / estimated*** costs and revenues. Since then, every utility has premised its rate increase requests on projected future costs. The subjective nature of projecting costs and revenues – and the obvious inability to accurately predict what future costs and revenues will be - has resulted in higher rates for customers. Even when the actual costs are lower than predicted, customers still pay the higher rates as if the costs were as high as the utility predicted. It is the utility shareholders – not the customers – which receives the benefit (i.e., the utility does not spend the projected money on operations, reliability or client service and gives the money to shareholders in increased dividends). As the law

Rate case test year



Data compiled as of Feb. 15, 2023.
Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.
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currently stands, there is a regulatory incentive for utilities to overestimate costs and utilities are taking advantage of this incentive to generate more profit for their investors. This is why the majority of state regulatory bodies still require the use of actual cost / historic test year!

Utilities claim that there is 'regulatory lag' in using actual cost from the historic test year which impacts their credit rating. That may have been true prior to 2008. But the 2008 energy legislation also required the MPSC to issue a decision regarding a utility rate case within 12 months and the 2016 energy legislation further reduced the rate-case timeline to 10 months. So, at present, there is very little 'regulatory lag' when the utilities have the ability to file a rate case every 11 months!

Data regarding utility rate cases comparing their projected revenue increase need versus their revenue need based on actual cost. Negative number in column (d) indicates they have earned more than needed to meet their authorized rate of return.

(a)	(b)	(c)	(d)	(e)
Utility	Case	Projected Revenue Need	Actual Revenue Need based on Historical Test Year	Utility Over-Projection of Revenue Need
CECo Electric	U-17990	$225,413,000	($13,967,000)	$239,380,000
	U-18322	$172,758,000	($26,118,000)	$198,876,000
	U-20134*	$57,900,000	($17,354,000)	$75,254,000
	U-20697	$244,357,000	($21,835,000)	$266,192,000
	U-20963	$225,102,000	($25,071,000)	$250,173,000
	U-21224*	$266,442,000	$83,384,000	$183,058,000
CECo Gas	U-18124	$90,500,000	($264,000)	$90,764,000
	U-18424*	$178,200,000	($35,283,000)	$213,483,000
	U-20322	$229,000,000	($33,458,000)	$262,458,000
	U-20650	$244,700,000	$89,900,000	$154,800,000
	U-21148*	$278,400,000	($29,000,000)	$307,400,000
	U-21308	$211,900,000	($17,700,000)	$229,600,000
DTE Electric	U-18014	$343,972,000	($33,404,000)	$377,376,000
	U-18255	$230,942,000	$50,009,000	$180,933,000
	U-20162	$328,440,000	$18,335,000	$310,105,000
	U-20561	$350,668,000	$111,501,000	$239,167,000
	U-20836	$388,222,000	($111,696,000)	$499,918,000
	U-21297	$618,536,000	($93,577,000)	$712,113,000
DTE Gas	U-16999*	$76,700,000	($6,551,000)	$83,251,000
	U-17999	$182,900,000	($560,000)	$183,460,000
	U-18999	$85,100,000	($61,829,000)	$146,929,000
	U-20642	$203,800,000	($29,100,000)	$232,900,000
	U-20940	$194,800,000	$11,900,000	$182,900,000
				$5,620,490,000

**Case Nos. U-16999, U-18424, U-20134 and U-21224 settled.*

- Utility rates need to be set to only recover the *actual cost* incurred!

Amend 1939 PA 3, MCL 460.6a(1)

16 schedules. The commission shall require notice to be given to all
17 interested parties within the service area to be affected, and all
18 interested parties ~~shall~~ **MUST** have a reasonable opportunity for a
19 full and complete hearing. ~~A utility may use projected costs and~~
20 ~~revenues for a future consecutive 12-month period in developing its~~
21 ~~requested rates and charges.~~ **THE COMMISSION SHALL USE A UTILITY'S**
22 **ACTUAL COST OF PROVIDING SERVICE DURING A HISTORICAL TEST YEAR**
23 **ADJUSTED ONLY FOR KNOWN AND MEASURABLE CHANGES IN ESTABLISHING THAT**
24 **UTILITY'S RATES AND CHARGES.** The commission shall notify the

Amend 1939 PA 3, MCL 460.6a(16) to add the following definitions:

"Historical test year" means the most recent prior 12 month period for which the utility has actual cost and revenue data."

"Known and measurable changes" means the following:

a) Costs and billing determinants can be normalized for the effects of volatile business conditions on the grounds that there is no reason to expect these conditions to be abnormal during the rate year.

b) Cost and output conditions in the historical test year may also be "annualized". Effects may be removed, for a full year, of conditions that occurred during part of the historical test year but are not expected to continue.

c) Impacts of conditions that occurred only during certain months of the historical test year and are expected to prevail in the near future may also be annualized.

d) Cost and output data may, additionally, be adjusted for imminent certain changes that have already occurred during the historical test year or will occur in the next 10 months.

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Utility Financial Incentive for Renewable and Clean Power PPAs

SB 271: (A) removes the Commission's discretion in determining just in reasonable rates; (B) requires that the utility's permanent capital structure including only long-term debt and common equity be used to provide a new financial incentive for renewable and clean energy Power Purchase Agreements (PPA's) rather than the utility's ratemaking capital structure; (C) requires customers to pay in rates the income taxes of the utility on top of an already-excessive incentive level by using the pre-tax weighted average cost of capital ("WACC")[1], and; (D) does not take into consideration the fact that electric utilities in Michigan do not need an incentive mechanism to support their current credit quality or access to capital, or the fact that utilities in Michigan are consistently authorized above-average return on equity ("ROE") levels. As it will be demonstrated later in this paper, the issues identified in (B) and (C) above would equate to approximately $3.0 million in enhanced profit above the currently allowed cap for every $100 million in annual PPA payments. The relevant concerning portion of the Draft is provided in Section (8).

Specifically in Section 28 (8), SB 271 provides that:

> If an electric provider whose rates are regulated by the commission enters into a purchase power agreement for renewable energy resources or a third-party contract for an energy storage system or clean energy system with an entity that is not an affiliate, the commission shall authorize an annual financial incentive for the electric provider. The financial incentive shall be calculated as the product of contract payments in that year multiplied by the electric provider's pre-tax weighted average cost of permanent capital comprised of long-term debt obligations and equity of the electric provider's total capital structure as determined by the commission's final order in the electric provider's most recent general rate case. (emphasis added)

A. SB 271 removes Commission Discretion in determining just and reasonable rates.

As provided for in Section 28 (8), SB 271 removes all discretion from the Commission in determining what a just and reasonable incentive might be, and as a result, just and reasonable rates. This is in stark contrast to Public Act 341 ("PA 341"). As stated in PA 341:

> For power purchase agreements that a utility enters into after the effective date of the amendatory act that added this section with an entity that is not affiliated with that utility, the commission shall consider and may authorize a financial incentive for that utility that does not exceed the utility's weighted average cost of capital.

PA 341 allows the Commission, but does not require it, to authorize an incentive. Any such incentive shall not exceed a utility's WACC. PA 341 gives the Commission discretion based on the unique facts and circumstances put into evidence to be considered, and that latitude should

[1] WACC and Rate of Return ("ROR") are used interchangeably throughout.

remain with the Commission. SB 271, as passed by the Senate, would require the Commission to authorize an annual financial incentive for the electric provider at the pre-tax WACC.

B. SB 271 unnecessarily increases costs by using the wrong capital structure to determine the incentive.

SB 271 specifies that "The financial incentive shall be calculated as the product of contract payments in that year multiplied by the electric provider's pre-tax weighted average cost of permanent capital [...]". This is in stark contrast to what is allowed under PA 341, which states that "a financial incentive for that utility that does not exceed the utility's weighted average cost of capital." This is a very important distinction that comes at a very high and unnecessary cost to ratepayers.

In Michigan, the WACC used to set rates for regulated utilities consists of more than just permanent capital (i.e. common equity, preferred stock, and long-term debt). In fact, the ratemaking capital structure used to set rates in Michigan consists of several other sources of capital including, but not limited to, short-term debt, accumulated deferred income taxes ("ADIT"), and investment tax credits ("ITC"). The most significant of these other capital sources is ADIT. In setting rates, the Commission recognizes ADIT as a source of zero-cost capital available to the utility as evidenced by its inclusion in a utility's capital structure when calculating the overall ROR that is then applied to rate base. Importantly, ADIT balances have been pre-funded in rates by ratepayers. SB 271 gives no recognition to this significant source of zero-cost long-term capital that has been funded in rates by ratepayers.

C. SB 271 unnecessarily increases costs for ratepayers by requiring ratepayers to fund utility income taxes in rates on an unnecessary and excessive incentive.

SB 271 provides that the incentive shall be the **pre-tax** WACC. This specification would require ratepayers fund $1.34 in rates for every $1.00 shareholder return on the excessive incentive for state and federal income tax purposes, regardless of the electric utility's income tax situation. This requirement is counter to what to date has been allowed by the Commission and would further enrich shareholders to the unnecessary detriment to ratepayers.

As will be demonstrated in the Table 1 below, Items (C) and (D) collectively increase the WACC and level of incentive allowed by nearly 50%, increasing rates by an additional $3.0 million in revenue requirement per $100 million in annual PPA payments.[2]

[2]These estimates are based on the WACC of 6.11% using the ratemaking capital structure and pre-tax WACC using the permanent capital structure proposed by Consumers Energy in its current rate case before the Commission, Case No. U-21389.

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Table 1: Illustrative Impact of SB 271 on the Allowed Incentive

Current Incentive Cap Allowed Under PA 341 (WACC)

Source of Capital	Weight	Cost	WACC
Long-Term Debt	39.96%	4.14%	1.66%
Preferred Stock	0.14%	4.50%	0.01%
Common Shareholder's Equity	42.58%	10.25%	4.36%
Short-Term Debt	1.08%	4.79%	0.05%
Deferred Income Taxes	15.79%	0.00%	0.00%
Investment Tax Credits			
Long-Term Debt (ITC)	0.21%	4.14%	0.01%
Preferred Stock (ITC)	0.00%	4.50%	0.00%
Common Equity (ITC)	0.23%	10.25%	0.02%
Total WACC			**6.11%**
Assumed Annual PPA Payment			**$100,000,000**
Current Allowed Incentive			**$6,111,171**

Required Incentive Provided for in SB 271 (Pre-Tax WACC on Permanent Capital)

Source of Capital	Weight	Cost	WACC	Income Tax Factor	Pre-Tax WACC
Long-Term Debt	48.33%	4.14%	2.00%	1	2.00%
Preferred Stock	0.17%	4.50%	0.01%	1.34	0.01%
Common Shareholder's Equity	51.50%	10.25%	5.28%	1.34	7.07%
Pre-Tax WACC w/ Permanent Capital (SB 271 Draft)					**9.08%**
Assumed Annual PPA Payment					**$100,000,000**
SB 271 Allowed Incentive					**$9,081,246**
Increase in Allowed Incentive ($)					**$2,970,075**
Increase in Allowed Incentive (%)					**48.6%**

All WACC components are provided in MPSC Case No. U-21389 Exhibit A-14 (MRB-1), Schedule D-1.

D. ***SB 271 overlooks the fact that electric utilities in Michigan do not need an incentive mechanism to support the current credit quality, access to capital, or the fact that utilities in Michigan are consistently authorized above-average ROE levels.***

Finally, the enhanced incentive is unnecessary as demonstrated by the ability of electric utilities in Michigan to access significant amounts of external capital while maintaining strong investment grade credit ratings. For example, Consumers Energy has grown its electric rate base by nearly 70% over the last 10 years from approximately $8.2 billion (U-17087) to $13.8 billion (U-21389). Consumers Energy's current credit rating from S&P is A- with a stable outlook, which is one notch higher than the typical investor-owned utility. Requiring the Commission to authorize such an excessive incentive is further taxing on the ratepayers given the longstanding issue of Michigan utilities being authorized ROEs that are 20-70 basis points above industry averages.

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The Voice of Energy Intensive Consumers in Michigan

Rod Williamson, Executive Director