



THE VICTOR CENTER, 201 N. WASHINGTON SQUARE, STE. 810
LANSING, MICHIGAN 48933

TELEPHONE 517 / 482-6237 • FAX 517 / 482-6937 • WWW.VARNUMLAW.COM

ERIC J. SCHNEIDEWIND

MAIL ejschneidewind@varnumlaw.com

October 4, 2002

Ms. Dorothy Wideman
Michigan Public Service Commission
6545 Mercantile Way
P.O. Box 30221
Lansing, MI 48909

Re: Case No. U-13286

Dear Ms. Wideman:

Enclosed for filing in the above captioned matter please find the original and four copies of Energy Michigan's Reply Brief. Also enclosed is the original Proof of Service indicating service on counsel.

Please date stamp one copy of the above entitled document for my records and return it in the self-addressed stamped envelope provided.

Thank you for your assistance in this matter.

Very truly yours,

VARNUM, RIDDERING, SCHMIDT & HOWLETTLLP

Eric J. Schneidewind

EJS/mrr

cc: ALJ
parties

STATE OF MICHIGAN
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of the Application of)	
THE DETROIT EDISON COMPANY)	Case No. U-13286
to unbundle its retail electric rates.)	
_____)	

REPLY BRIEF OF ENERGY MICHIGAN, INC

Energy Michigan, Inc. (Energy Michigan) by its attorneys, Varnum, Riddering, Schmidt & Howlett LLP submits its Reply Brief to the Michigan Public Service Commission (Commission).

I. INTRODUCTION AND SUMMARY OF POSITION

A. Introduction: the Promise of Unbundling and the Mischief That May Result from this Case

1. The promise of unbundling

In theory, rate unbundling is supposed to eliminate discrimination between the price of utility service offerings to retail sales customers and the price of those same components of utility service that are used by Electric Choice customers. Also, a proper unbundling format should isolate and identify the generation component of utility retail service so that customers may compare that price with the competitive price they are quoted for the same service by Alternate Electric Suppliers. If done properly, unbundling can facilitate competition.

An example illustrates the potential benefits of unbundling: if retail electric service costs 6

¢ /kWh and it is determined that transmission costs .5 ¢, distribution 1.5 ¢ and generation is 4 ¢, discrimination against Electric Choice customers can be prevented if all Electric Choice customers are allowed to purchase transmission and distribution at the same .5 ¢ and 1.5 ¢ rate that is paid by retail sales customers. Also, if utility generation service to this customer is identified as costing 4 ¢ /kWh, it should be relatively easy for the customer to compare generation prices offered by alternate suppliers with the 4 ¢ utility price, thus facilitating competition.

Unfortunately, neither of these benefits of unbundling can be achieved in this case or in the current regulatory framework. When PA 141 was passed June 5, 2000, the transmission and distribution services used by Electric Choice customers were priced at different (mostly higher) levels than similar distribution and transmission service components used by retail sales customers. The rate freeze mandated by PA 141 § 10d(1) effectively locks in all Edison rate offerings to retail sales and Electric Choice customers at least through December 31, 2003. Given this situation, for example, if Electric Choice customers are paying 1.7 ¢ for retail distribution and retail sales customers are paying 1.4 ¢ for much the same service, it does little or no good to unbundle the bundled sale rates into sub-components such as distribution and generation service. This is because Electric Choice customers are still mandated to pay the same 1.7 ¢ price for the sum of these services and sales customers will still pay the same 1.4 ¢. In this sense, the rate freeze prevents the non-discrimination benefits of unbundling.

The rate comparison benefits are prevented because isolation of the generation component of retail service depends on taking a total price of retail service (6 ¢) and subtracting the transmission or distribution component of 2 ¢. If Electric Choice customers pay more or less than 2 ¢ for transmission or distribution, the amount that they can afford to pay for generation is more or less than the 4 ¢ paid by retail customers. Thus, the PA 141 rate freeze prevents meaningful price comparisons. For these reasons, the promise of unbundling, if it is to be achieved, must occur after January 1, 2004 and in any event will not be realized by any product forthcoming from this case.

2. The mischief that may result from this case

Detroit Edison's unbundling filing is a very typical utility response to competition. The classic utility approach to unbundling is to reshuffle the costs of retail service so as to greatly maximize the transmission and distribution rates which all customers will pay when unbundling is finally implemented (probably after January 1, 2004) and to minimize the generation component as much as possible. An example illustrates this tactic: if the total price of retail service is 6 ¢ and traditional cost of service methods indicate that transmission and distribution are .5 ¢ plus 1.5 ¢ for a total of 2 ¢, and generation is 4 ¢, the so-called "price to beat" that a competitor must match is 4 ¢. However, if the utility is able to manipulate cost data so as to raise the transmission and distribution component by 1 ¢ while lowering generation by 1 ¢, then it can charge 3 ¢ of transmission and distribution costs to all customers. Thus, the Electric Choice customer must pay a utility 3 ¢ for transmission and distribution instead of 2 ¢. The impact of this change is that the Electric Choice customer now can only afford to pay 3 ¢ to a competitor for generation rather than 4 ¢ in order to beat the fully bundled utility retail rate. If competitors cannot offer generation at less than 3 ¢ they will go out of business and competition will end.

As will be seen below, the Edison filing is full of techniques and tactics which tend to overstate the cost of transmission and distribution and understate the cost of generation. Edison also tosses in previously rejected adjustments to generation costs such as "rate skewing" which, if adopted, would also minimize generation costs and handicap competitors.

It is for these reasons that the Law Judge and the Commission must be extraordinarily careful about approving the details of this filing: to do so would prejudice future competition and potentially lock the Commission into a set of data which results in anti-competitive rate structures.

B. Summary of Position

For the reasons outlined in the Introduction and the defects in the Edison presentation which are detailed below, Energy Michigan strongly recommends that the Law Judge and the Commission adopt the position of ABATE and the Attorney General that this case be treated as an advisory filing only and not be used to set precedent. The requested treatment is fully consistent with the Commission's disposition of the Consumers Energy unbundling filing in Case U-12970 which contained many of the same flaws and harmful precedents advocated by Detroit Edison .

II. REPLY TO DETROIT EDISON:

THE DETROIT EDISON UNBUNDLING FILING IS SO FLAWED
THAT IT CANNOT BE ADOPTED OTHER THAN ON AN ADVISORY
BASIS AND SHOULD BE USED AS PRECEDENT FOR FUTURE RATE CASES

Detroit Edison has proposed that the Commission adopt its unbundling proposal. *Edison Brief, p. 16.*

Following are just a few of the specific flaws in the filing and reasons that the Detroit Edison filing should not be adopted.

A. The Detroit Edison Filing Uses Inappropriate Cost of Service Studies and Data to Unbundle Rates

In Case U-12970, the Commission stated, "It follows that the unbundling of existing rates should be consistent with the methodology used to set the rates. Even if a more recent cost of service could provide some arguable insight...using an updated study for unbundling analysis would be meaningless in the absence of a mechanism to set rates to recover those costs. The price signals being sent were Consumers services are its existing rates. It is not necessary to devise unbundled prices on some other basis". *U-12970, May 16, 2002, page 16, 2002.*

Detroit Edison Exhibit A-3 2000 (Revenue by Function) was used by Mr. Heiser to analyze and allocate Edison's costs to generation, transmission and distribution functions. However, year 2000 Detroit Edison revenues are understated by approximately \$58 million due to a failure to report special contract revenue and large customer contract discounts at full tariff rates. *See Detroit Edison SMC Annual Report To The Commission, James Musial, December 21, 2002.* An attempt to set rates on the basis of discounted special contract revenue without demonstrating that use of the discounted revenue is justified by cost of service studies specific to the special contract class fails to meet the burden of proof placed on Detroit Edison in Case U-10646. In that case, the Commission specifically stated that any attempt to set rates using discounted SMC revenue would require Edison to bear a burden of proof that the impact of its actions did not have a detrimental effect on competition. Edison has not made the required proofs in this case. *U-10646, March 23, 1995, p. 21.*

B. The Methodology Used by Detroit Edison to Determine (and Greatly Underestimate) Generation Costs Leads to Biased and Inaccurate Results

Edison witness Heiser allocated costs by first allocating costs to transmission and distribution then anything left over would be determined to be allocated to generation. *Musial, 2 TR 37.* This so-called residual method of allocating costs can lead to significant distortions if the assumptions to allocate costs differ from the assumptions used to set the initial rates in the general rate case.

For example, in his presentation, Edison witness Heiser states that he used a cost of capital structure that reflected 1999 debt and equity weightings instead of the 1994 values used in Case U-10102 when the rates were initially determined. *2 TR 73.* Thus the costs of transmission and distribution were different than the 1994 cost study. Naturally the left over "residual" cost of generation was different as well. This type of deviation can and does produce rate distortions which artificially minimize generation costs. The best possible evidence of the distortions produced by Mr. Heiser's "residual" method of allocating costs to generation can be seen in the capacity charge estimated by Edison for Rate D-1.1. Edison witness Musial admitted that the Edison residual allocation methodology resulted in a capacity of -1.60981 ¢/kWh. Of course, a negative charge for electric

service flies in the face of common sense as well as sound rate methodology. 2 *TR* 42. That the Edison residual allocation methodology yielded such a result is the best reason why Edison's attempt to minimize generation costs should be treated with extreme skepticism by the Commission and the Law Judge.

C. All Securitization Reductions Were Used to Reduce the Generation Component of Edison's Rate

Edison witness Musial admits that on one hand securitization reductions have been used to reduce all components (transmission, distribution, generation, etc.) of current Edison retail rates but that in his unbundling proposal these reductions are reflected exclusively in the generation component of the rates. 2 *TR* 32. This result is another method to minimize generation costs to the detriment of future competitors.

D. Edison's Unbundled Rates Include Adjustments for "Rate Skewing" Which Were Rejected By the Commission and Are Currently Under Appeal

Each Detroit Edison tariff which is the subject of the unbundling sheets in Exhibit A-1 contains a heading "Unbundling Calculation" and a sub-heading "Percent Distribution Skew Adjustment". Mr. Musial explains that this adjustment was necessary to remove the effects of so-called rate-skewing which, in Edison's belief, has caused the generation component for some rates to be understated and for other rates to be overstated. 2 *TR* 36-37. Edison used much the same argument in Case U-12639 to urge differential transition charges based on this "skewing" adjustment which would charge some customers more and some less to eliminate the alleged effects of the improper cost allocations contained in Edison rates. The Commission rejected Edison's argument about inclusion of rate skewing adjustments in the absence of a full general rate case that confirmed or adopted this position. *U-12639, December 20, 2001, p. 30-31. Edison has appealed the Commission's refusal to adopt the unproved "rate skewing" allegations of Edison. Detroit Edison v MPSC, Court of Appeals Case 241991.* The Commission should not now adopt the Edison allegations of rate skewing contained in Exhibit A-1 before this matter is fully litigated in the courts or is proven in a

general rate case.

IV. THE EDISON REQUEST FOR A TRANSMISSION SURCHARGE
SHOULD BE REJECTED AS A VIOLATION OF THE PA 141
RATE FREEZE

Detroit Edison proposes to implement a mechanism to raise and lower transmission service charges. *Edison Brief, p. 4.*

PA 141 § 10d(1) effectively freezes all Detroit Edison rates through December 31, 2003. Despite the proposal of Edison witness Musial to implement a cost adjustment mechanism to raise or lower transmission charges, Edison has not made the case that such charges are excluded from the scope of PA 141, § 10d(1). *2 TR 43.* Specifically, Detroit Edison has experienced many changes in cost during the PA 141 rate freeze. Some costs such as interest rates and certain fuel components have undoubtedly decreased during the freeze. Other costs have increased. However, the freeze does not allow Detroit Edison to pass along the cost of increases to its customers, either retail or Electric Choice during the rate freeze period. Also, Edison admits that the FERC has not yet implemented jurisdiction over the transmission component of retail rates. *Edison Brief, p. 10.* Until FERC acts, preemption has not and cannot occur.

Moreover, Section 10d(3) of PA 141 does offer Detroit Edison the opportunity to request accrual and deferral of any costs mandated by federal or state action. If Edison believes that these transmission costs are mandated by federal action, Section 10d(3) provides an avenue to recover these costs in a time frame when they will be applicable to all retail and Electric Choice customers rather than falling exclusively on Electric Choice customers. Edison witness Musial has admitted as much in his direct testimony where he states, “In the absence of Commission authority to recover increased transmission related costs during the rate freeze period, the Company will defer these costs for future recovery pursuant to 2000 PA 141.” *2 TR 43.*

V. CONCLUSION AND PRAYER FOR RELIEF

The Detroit Edison unbundling filing in this matter is unsound from a methodological standpoint as detailed above and, in any event, cannot be used to eliminate discrimination or facilitate rate comparisons because of the impact of the PA 141 rate freeze. For these reasons, the Commission and the Law Judge should:

- A. Adopt the position enunciated by the Commission in Case U-12970 that the unbundling filings of Consumers made during the PA 141 rate freeze should be used only for guidance but not to create any precedent for subsequent rate proceedings; and
- B. As explained in IV. above, the Detroit Edison proposal to assess a transmission charge is a violation of the PA 141 rate freeze and cannot be adopted. Energy Michigan agrees with the ABATE proposal that this matter should be considered, if at all, in a separate proceeding to consider any costs related to such increases subsequent to the expiration of the rate freeze currently in place.

Respectfully submitted,

VARNUM, RIDDERING, SCHMIDT & HOWLETT LLP
Attorneys for Energy Michigan, Inc.

October 4, 2002

By: Eric J. Schneidewind
Eric J. Schneidewind (P20037)
The Victor Center, Suite 810
201 N. Washington Square
Lansing, Michigan 48933
(517) 482-6237

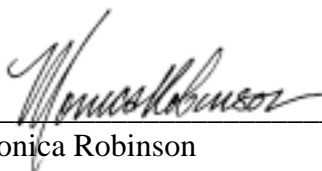
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Case No. U-13286


PROOF OF SERVICE

Monica Robinson, duly sworn deposes and says that on this 4th day of October, 2002 she served Detroit Edison a copy of Energy Michigan, Inc.'s Reply Brief upon those individuals listed on the attached service list by e-mail and regular mail at their last known addresses.



Monica Robinson

Subscribed to and sworn before me
this 4th day of October, 2002.


Eric J. Schneidewind, Notary Public
Eaton County, Michigan
Acting in Ingham County, Michigan
My Commission Expires: April 24, 2006

SERVICE LIST- U-13286

Honorable Barbara Stump
Administrative Law Judge
Michigan Public Service Commission
6546 Mercantile Way, Suite 14
Lansing, MI 48911

Bruce Maters
Jon Christinidis
Detroit Edison
2000 Second Avenue, 688 WCB
Detroit, MI 48226

Donald Erickson
Assistant Attorney General
6520 Mercantile Way, Suite 2
P.O. Box 30736
Lansing, MI 48909

Patricia S. Barone
Assistant Attorney General
Public Service Commission
6545 Mercantile Way #15
Lansing, MI 48911

Larry Bailey
MPSC Staff
6545 Mercantile Way
P.O. Box 30221
Lansing, MI 48909-7721

ABATE
Bob Strong
255 S. Woodward Avenue, 3rd Fl
Birmingham, MI 48009

National Energy Marketers Association
Jennifer Frye
Dickinson Wright, PLLC
215 S. Washington Square, Suite 200
Lansing, MI 48933

Energy America, LLC
Jerome L. Fine
784 W. Lake Lansing Road
East Lansing, MI 48823

Michigan Electric & Gas Association
Sherri Wellman
Loomis, Ewart, Parsley, Davis & Gotting
232 S. Capitol, Suite 1000
Lansing, MI 48933