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November 12, 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 to Exceptions. 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

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

ENERGY MICHIGAN, INC. REPLY TO EXCEPTIONS

Following are the Replies to Exceptions of Energy Michigan, Inc. (Energy Michigan) to the Proposal for Decision (PFD) issued October 18, 2002 by Administrative Law Judge (ALJ) Barbara Stump. Failure to reply to any other Exceptions should not be taken as agreement with those Exceptions.

I. Reply to National Energy Marketers Exception B:  
The PFD Failed to Require DTE's Unbundled Rates to Be  
Based On Fully Embedded Costs

Energy Michigan strongly supports the Exception of the National Energy Marketers (NEM) regarding the failure of the PFD to require Detroit Edison unbundled rates to be based on fully embedded costs. Energy Michigan agrees that explicit or implicit approval of the Detroit Edison unbundling filing and methodology would, as NEM says, "distort and impede the development of a competitive retail electric market and it should be rejected on that basis". *NEM Exceptions, p. 4.*

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 bundled sales and Electric Choice 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.

Following are just a few of the specific flaws in the filing and reasons supporting the conclusion of NEM that the Detroit Edison filing was not based on fully embedded costs:

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 for 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 \$56 million due to a failure to report special contract revenue and large customer contract discounts at full tariff rates. See *Detroit Edison SMC and LCC Annual Reports 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. 2 TR 42. Of course, a negative charge for electric service flies in the face of common sense as well as sound rate methodology. 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.

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.

### Conclusion

The Commission should address these concerns by specifically stating that the so-called “unbundling data” provided by Edison is for information purposes only and is not approved by the Commission nor is it to be included on customer bills. *See Exception #3 below*.

### II. Energy Michigan Agrees With the Exceptions of the Attorney General, ABATE and NEM That DTE’s Proposed Transmission System Charge Should Be Rejected

Energy Michigan agrees with the Exceptions of the Association of Businesses Advocating Tariff Equity (ABATE), the Attorney General (AG) and NEM that Edison’s proposed transmission service charge, as adopted by the PFD, should be rejected by the Commission. As more fully set out in Energy Michigan’s Exceptions in this matter, the transmission service charge should be rejected for the following reasons:

1. Modification of a transmission charge is a violation of the PA 141 § d(1) rate freeze if this matter is jurisdictional to the Michigan Public Service Commission (Commission).
2. If this matter is not jurisdictional to the Commission, the Commission has no authority to adopt or approve such a charge.
3. Energy Michigan agrees with the Attorney General that adoption of a transmission service charge along with the frozen retail rates would result in double collection of transmission costs. *AG Exceptions, p. 2*.

4. Energy Michigan agrees with the Attorney General that since FERC has not exercised jurisdiction at this point, it is premature to authorize Detroit Edison to include such a charge in their retail rates and in any event may be beyond the authority to do so. *AG Exceptions, p. 2.*

For the above reasons, the recommendation of the PFD that Detroit Edison's proposed transmission service charge be approved should be rejected by the Commission.

III. Energy Michigan Agrees With Detroit Edison Exception 1  
That Proposed Unbundled Charges Should Not Be Included on Bills to Customers

Detroit Edison objected to the findings in the PFD that Detroit Edison should include its proposed unbundled rates on customer bills. Edison excepted to that filing. *Edison Exceptions, p. 1-3.*

In Exception 1, Energy Michigan has detailed its objections to the methodology used by Detroit Edison to unbundle its retail charges. Given the flaws in the Edison methodology detailed by Energy Michigan in I. above, the information contained in the Edison unbundling is erroneous and would mislead customers regarding the true cost of various components of utility bundled service. Including this erroneous information on customer bills would simply heighten confusion and potentially result in Edison claims, such as those advanced by Consumers Energy in Case U-13380, that so-called rate skewing adjustments or artificially deflated estimates of the cost of generation have been approved by the Commission.

For these reasons, Energy Michigan strongly urges the Commission to avoid wide distribution of the Detroit Edison unbundling estimates and to accompany this action with a strong disclaimer regarding the cost of service conclusions contained in the Detroit Edison unbundling "information".

IV. Conclusion and Prayer for Relief

WHEREFORE, Energy Michigan respectfully requests that the Commission adopt these Exceptions

as more fully described above.

Respectfully submitted

VARNUM, RIDDERING, SCHMIDT & HOWLETTLLP  
Attorneys for Energy Michigan, Inc.

November 12, 2002

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STATE OF MICHIGAN  
BEFORE THE PUBLIC SERVICE COMMISSION

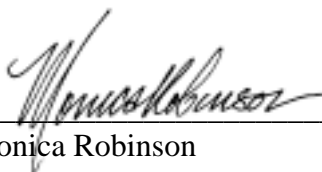
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Case No. U-13286

PROOF OF SERVICE

Monica Robinson, duly sworn deposes and says that on this 12th day of November 2002 she served a copy of Energy Michigan, Inc.'s Reply to Exceptions to Proposal for Decision upon those individuals on the attached service list by e-mail and regular mail at their last known addresses.

  
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Monica Robinson

Subscribed to and sworn before me  
this 12th day of November, 2002.

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

SERVICE LIST- U-13286

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