STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of	)	
THE DETROIT EDISON COMPANY	)	
to implement the Commission's stranded	)	
cost recovery procedures and for approval	)	Case U-13350
of net stranded cost recovery charges.	)	
______________________________________	)	

REPLY BRIEF OF ENERGY MICHIGAN, INC.

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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of THE DETROIT EDISON COMPANY to implement the Commission's stranded cost recovery procedures and for approval of net stranded cost recovery charges.	))))))	Case U-13350

REPLY BRIEF OF ENERGY MICHIGAN, INC.

I. INTRODUCTION AND SUMMARY OF POSITION

A. Introduction

This Reply Brief of Energy Michigan, Inc. (Energy Michigan) is filed in response to Briefs of the Detroit Edison Company (Edison or Detroit Edison) and the Michigan Public Service Commission Staff (MPSC Staff or Staff). Failure to respond to arguments or opinions of any parties to this matter should not be taken as agreement with those positions or arguments.

B. Summary of Position

Reply to Edison

1. Edison proposals to "eliminate" regulatory lag and use projected cases should be rejected.

These Edison proposals suffer from a fatal defect. The Edison projection of Production Fixed Costs (PFC) revenue requirements for years 2000 through 2003 actually increase $24 million even though projected retail sales decline more than 10%. This one "assumption" creates $24 million of new stranded costs in year 2003. Also, the year 2000 PFC revenue

requirements contain inappropriately allocated estimated costs. The year 2000 revenues which are the basis for PFC revenue assumptions through 2003 deliberately ignore huge surplus recoveries of energy charges in years after 2000 as well as revenues from sales to Ford Rouge and imputed revenues from special contract customers. Edison's projected case method and proposals to eliminate regulatory lag would lock in these flawed assumptions for years to come.

2. Edison proposals to eliminate securitization offset and rate equalization reductions should be rejected.

Detroit Edison Witness Padgett stated that where Detroit Edison demonstrates stranded costs (PFC Revenue Requirements exceed PFC Revenue) for non-securitized assets, there is no basis to continue the securitization and tax charge offset. Just as clearly, where Detroit Edison shows a huge excess of PFC revenue over PFC revenue requirements, there should be a zero transition charge regarding non-securitized assets and full offset of securitization charges to Electric Choice customers. If the 2001 PFC revenue excess is not used to offset securitization charges, it is tantamount to agreeing that Edison needs to collect securitization charges from EC customers even though its PFC revenues were more than adequate to cover PFC revenue requirements for both securitized and non-securitized production facilities. This position makes no sense in fact or law.

Put another way, if it can be shown that the excess recovery of stranded costs is more than sufficient to provide the EC offset at projected levels of EC sales, this demonstrates that Edison will receive enough revenue in that year to recover the cost of both securitized and non-securitized assets even if Edison receives no transition charge or securitization charge revenue from EC customers.

Use of excess PFC revenue (stranded benefits) to offset securitization charges does not take transition charges below zero. Rather, it brings total PFC securitized and non-securitized charges to zero because Edison PFC revenue is sufficient to pay those costs without

collecting securitization charges from EC customers.

3. Four Edison "refinements" to the stranded cost recovery process should be rejected.

Edison has proposed four "refinements" to the process of determining stranded costs.

Collectively, these "refinements" would result in approval of a deeply flawed unbundling study which was found by Energy Michigan to be literally unuseable because of its numerous errors. Edison's proposal to lock in an assumption that each kWh of sales brings in the same 1.25 ¢ per kWh of fixed cost in years 20001-2003, ignores huge revenues from third party sales and sales to the Ford Rouge complex while understating special contract sales revenues. The "refinements" also assume that Edison's total Production Fixed Costs revenue requirement increases $24 million from 2000-2003 despite sales which are estimated to decline more than 10%!!

This host of errors and unreasonable assumptions makes the Edison proposal to fix PFC revenue at 1.25 ¢ /kWh inaccurate and unusable. Edison's proposal to limit stranded cost mitigation for third party sales to the pro-rata EC portion of Edison's total sales is a modification of the MPSC methodology which, not coincidentally, would illogically deprive EC customers of hundreds of millions of dollars of mitigation through 2003.

4. Edison's proposed estimate of 2000 and 2001 net stranded costs should be rejected.

The Edison calculation of stranded costs for 2000 and 2001 is based on understated revenues, impermissible reallocations of costs, obviously inaccurate assumptions (e.g., see Exhibit A-4, line 1 which uses increased total PFC revenue requirements from 2000 to 2003 while simultaneously projecting an actual retail sales decline of over 10%) as well as impermissible revisions of assumptions regarding capital structure and rate of return which have never been approved by the Commission.

Note that Edison's proposed transition charges for non-securitized assets would be in addition to a .49 ¢ /kWh securitization charge for securitized assets. Thus, EC customers would pay charges for securitized assets (.49 ¢/Wh) and non-securitized assets (1.28 ¢/kWh) to produce a total liability of 1.77 ¢/kWh.

Reply to Staff Position

Energy Michigan opposes portions of the Staff position which deny carry forward of stranded benefits to cover future stranded costs and points out a calculation error regarding the availability of excess securitization savings to offset stranded costs.

II. DETAILED REPLY TO DETROIT EDISON

A. Detroit Edison's Four "Refinements" to the Stranded Cost Recovery Process Should Be Rejected

1. Use of the Heiser 2000 unbundling study.

a. Edison position.

Edison requests that the Commission approve use of the functional plant splits and revenue requirement for PFC contained in the 2000 unbundling study presented by Witness Heiser. Edison claims that the previous cost of service study presented in U-10102 is out of date and not representative of Edison's cost structure. Edison Brief, p. 7.

b. Energy Michigan reply.

It is critical that the Commission reject Mr. Heiser's cost study. It is no secret that approval of this study could determine the outcome of future Edison unbundling

presentations and thus, as will be more fully discussed below, approval of the Heiser study has the potential to lock in disastrously incorrect data and conclusions.

The study presented by Mr. Heiser is deeply flawed. Energy Michigan Witness Polich testified that the study improperly added items to Production Fixed Costs which are normally recovered as variable costs or are recovered with surcharges including nuclear decommissioning costs, MPSC assessment fees and Washington D.C. franchise fees. Tr 278. The Heiser study also improperly used an unapproved rate of return and improperly allocated revenues which would offset PFC expenses including fuel cost revenue, O&M revenue and adjustments for special contract revenues. Tr 281-82. These errors are more fully discussed in the Energy Michigan Initial Brief at pages 9-16.

For the foregoing reasons, the Heiser study should be rejected as unfit for any use whatsoever.

2. Use of fixed cents per kWh to estimate PFC revenues through 2003.

a. Edison position.

Edison proposes that their calculation of PFC revenues available during the year 2000 be converted into a cents per kWh number by dividing total year 2000 revenue by total tariff sales. The result is 1.25 ¢ /kWh. Thereafter, for years 2001-2003 when comparing PFC revenue requirements with PFC revenue, the PFC revenue would be calculated by multiplying actual retail sales by the 1.25 ¢ /kWh year 2000 revenue estimate rather than reviewing actual revenue and allocating that revenue to Production Fixed Costs. Edison Brief, p. 8-9. In effect, this method is proposed as a substitute for the Staff proposal which calculated a percentage of overall revenue that is attributable to Production Fixed Costs in a test year and used that percentage allocation in the future.

b. Energy Michigan reply.

By using year 2000 data as a basis for revenue assumptions through 2003, Edison avoids use of 2001 actual data which shows huge third party sales revenues of over $192 million including revenue of over $143 million from the unwinding of power options and calls whose cost was paid by Edison customers through the Detroit Edison frozen PSCR factor. See Exhibit A-1. Also, the Edison 2000 revenue estimate excludes over $31 million of revenue from sales to the Ford Rouge complex and discounts revenue from special contract customers by over $56 million. Energy Michigan Initial Brief, p. 6-7 (third party sales), p. 15-17 (SMC); and 17-18 (Ford Rouge). Thus, if the Edison 1.25 ¢ /kWh estimate of PFC revenues is used for years 2001-2003, over $100 million of PFC revenue per year would be ignored. The Edison cents per kWh factor should be rejected as both inaccurate and subject to abuse.

3. Edison's attempt to artificially limit the third party sales credit should be rejected.

a. Edison position.

Edison proposes that the amount of third party sales revenue which is used to reduce stranded costs be calculated by determining the percentage of EC sales to total sales and applying that percent to the net third party sales revenue. Edison Brief, p. 9-18. Edison supports this position by claiming that:

i. third party margins do not relate to the total Electric Choice load;

ii. that some of the sales were not sales of generation;

iii. that in calculating the third party revenue, the costs associated with the sales should be incremental costs rather than average costs;

iv. that $12 million of PSCR credits were not taken into account; and finally,

v. that crediting 100% of third party sales margin to offset stranded costs is an unlawful taking of Detroit Edison property or unfairly deprives retail customers of the benefits of these third party sales. Edison Brief, p. 10-18.

b. Energy Michigan reply.

Following is the Energy Michigan response to each of the Edison arguments:

i. Relationship of third party sales to EC sales.

The Commission adopted the Staff proposal for calculating stranded costs in Case U-12639. This methodology compared historical PFC revenue requirements with historical PFC revenues available to pay those costs. Included in the revenue available to pay PFC revenue requirements were the net revenues from third party sales. U-12639, December 20, 2001, p. 4. As will be noted below, the Commission allowed the utilities to subtract variable costs of such sales from overall third party sales revenues and stated a willingness to consider in those subtractions the credit given to PSCR customers. Id, p. 17-18. The net stranded costs calculation method was adopted by the Commission pursuant to its extremely broad authority in PA 141 § 10a(10)(c). This legal authority allows utilization of "...any method the Commission considers appropriate". In comparing fixed PFC revenue requirements with PFC revenue, it is highly appropriate to consider fixed cost revenue to Edison from sales of power which was excess to the needs of the Edison. Energy Michigan Initial Brief, p. 18-19.

ii. Use of revenue from hedges and calls.

First and foremost, the Commission should understand that hundreds of millions of dollars of hedges and calls were purchased for the year 2000 and every year beyond with customers funds that are still being collected through the frozen PSCR clause. See Case U-11800. When Detroit Edison sold unneeded hedge instruments in 2000 and 2001, it obtained over $34 million of revenue in 2000 and over $143 million in 2001. Exhibit A-1. Edison had no additional costs in making these sales above levels contained in net power purchase costs used in Exhibit A-1 because customer funds in Edison rates had already been used to purchase the hedges and calls. Exhibit I-53, p. 1. Thus the revenues from the hedge sales described in A-1 were pure profit.

Energy Michigan Witness Polich proposed that third party sales revenue should be used to offset stranded costs based on a four part test where satisfaction of any one of the four criteria would result in use of the revenues. In the case of the Edison sale of hedges and calls, Edison met three of the Polich tests in that 1) customer funds were used to purchase the resources later disposed of at a profit (not Edison funds), 2) the power was procured to serve retail customers and 3) a portion of the power sold to third parties was made available as a result of reduced load created by customers leaving for open access. 3 Tr 283.

Given the current rate freeze, Detroit Edison will not reduce its retail rates to return this excess revenue to retail customers. Under these circumstances it would be particularly inappropriate for Edison to charge stranded costs to EC customers at the same time it is enjoying hundreds of millions of dollars of windfall profits or excess revenue financed by retail customers not Edison stockholders.

iii. Calculation of the cost to make third party sales.

Edison Position

In its initial Application, Edison Witness Byron calculated net revenue from third party sales by subtracting the cost of such sales which was largely fuel and purchase power expense calculated at average Detroit Edison costs. On rebuttal, Mr. Byron changed his position and advocated that Edison's cost of making third party sales be based on incremental fuel and power costs. Edison also claims that certain revenue from sales to wholesale for resale customers and revenues from buy/sell retail transactions with Ontario Power should be excluded from calculation of third party sales receipts. Edison Brief, p. 13-14.

Energy Michigan Reply

The analysis of Edison third party sales revenue presented in the Energy Michigan Initial Brief did in fact accept Mr. Byron's criticism regarding exclusion of sales to wholesale customers and removed that revenue. Energy Michigan Initial Brief, p. 21. Mr. Byron's objections to inclusion of revenue from hedge sales are addressed in (ii.) above. While Mr. Byron opposed use of revenue from resale transactions with Canada (OPG) on the grounds that these sales were not "freed up" by Electric Choice, the sales did occur, the revenue was received and under the Staff methodology adopted by the Commission the revenue should be recognized.

As to use of incremental cost to calculate the cost of third party sales, it is incredible that Mr. Byron's rebuttal advocating that position literally attacks his direct testimony which advocated use of average values. As noted in the Energy Michigan Initial Brief, this inconsistency fatally damages Mr.

Byron's position. Energy Michigan Initial Brief, p. 20-21. Besides a lack of credibility, Mr. Byron's position is illogical. Why should it be assumed that third party sales are always made at incremental cost rather than average cost? Use of incremental cost is simply a method of allocating artificially high costs to a certain category of sales in order to reduce revenue and thus reduce offsets to stranded costs. Finally, Mr. Byron did not support his testimony with evidence demonstrating that incremental costs were in fact incurred for just these sales or with any evidence demonstrating why incremental costs are more accurate. 3 Tr 282.

iv. PSCR credit.

Edison Position

Edison claims that it is inappropriate to credit 100% of net third party sales margins to Electric Choice customers because part of that margin is already being credited to PSCR customers. Edison Brief, p. 17.

Energy Michigan Position

Both the Energy Michigan and MPSC Staff cases used third party sales margins net of the credits given to PSCR customers. Exhibit I-36, line 3 and 12 and Exhibit S-43, line 6 referencing Exhibit JHB-1 (Exhibit A) which gives that same credit at line 7. Thus, the position advocated by both Energy Michigan and Staff does avoid crediting the same revenues twice by subtracting the credit from third party sales margins already given to PSCR customers.

v. Edison's use of the Falletich "adjustment" to reduce offsets to less than $1 million.

Edison Position

Edison claims that net third party sales benefits should be allocated to Electric Choice in the same percentage as Electric Choice sales bear to total system sales. This formula results in Electric Choice receiving approximately $1 million of third party power sale credits for 2000 through 2001 (Exhibit A-4, revised) instead of the more than $50 million proposed by Staff and Energy Michigan. Edison Brief, p. 15-16.

Energy Michigan Reply

As with the Energy Michigan position at i. above, two arguments defeat the Edison position. First, Energy Michigan and Staff among others have relied upon the Commission decision reached in Case U-12639 to apply all third party margins as a reduction of stranded costs. U-12639, December 20, 2001, p. 10. Second, (also noted above), this case has no direct or indirect bearing on sales customers. While third party sales margins are used to offset Detroit Edison stranded costs claims, it is not true that if those offsets were not made, Edison would then allocate the sales margins to the benefit of retail sales customers. With the PA 141 rate freeze Sec. 10d(1), Edison has declined to lower rates and is not likely to do so in this case. Thus, there is no benefit or detriment to sales customers from using third party sales to offset stranded costs. Also, the calculation of stranded costs or benefits would be separate from retail sales issues in any event.

4. Edison's proposed "limitation" on Electric Choice stranded costs obligations.

a. Edison position.

Edison Witness Falletich proposed that stranded costs chargeable to Electric Choice

customers be the lesser of the total PFC revenue deficiency or the PFC deficiency attributable to Electric Choice customers. Also, under Mr. Falletich's proposal, there will never be any stranded benefits. Edison Brief, p. 18-20. Mr. Falletich sums up by concluding that under his methodology a stranded cost of $66 million through 2002 would be covered by excess securitization savings but stranded costs of $83 million in 2003 would have to be covered through a combination of securitization savings and a 1.28 ¢ /kWh transition charge. Exhibit A-6, Edison Brief, p. 19-20.

Following are the major flaws in the Falletich proposal:

> 1) Mr. Falletich's proposal does not discuss the fact that in addition to the proposed transition charge in 2003, he would add a securitization charge of .49 ¢. The total charge to EC customers would be 1.77 ¢ /kWh, not 1.28 ¢.
>
> 2) Mr. Falletich's fundamental concept of calculating stranded costs is fatally and obviously flawed. A review of Exhibit A-4 demonstrates this fact.
>
> We have discussed at Section II.A.2 above that Mr. Falletich's estimate of revenues available to pay fixed costs have been understated due to use of flawed cost studies, improper allocation of revenues, exclusion of substantial revenues.
>
> The calculation of the fixed cost revenue requirement at line 1 is equally flawed. An examination of the revenue requirement proposed by Mr. Falletich shows that it is $627 million in 2000 but increases to $651 million from 2001 through 2003. Yet, during that same time, Exhibit A-5 estimates that bundled retail tariff sales will decline from 49,000 Gwh to roughly 44,000 Gwh. In other words, by simply assuming that PFC revenue requirements will increase but that sales and thus revenues available at 1.25 ¢ /kWh will decline over 10%, the gap between Production Fixed Costs

revenue requirements and revenue available is incorrectly assumed to expand from $3 million in 2000 to over $88 million in 2003. See Exhibit A-4, line 9.

3) Since Mr. Falletich ignores third party sales revenues and other major sources of income and will not allow transition charges larger than zero, the result of his methodology is that stranded costs customers would always pay .49 ¢ /kWh for securitized assets regardless of the stranded costs or benefits determined by his methodology. This result flies in the face of reason, the record evidence and statutory requirements that the Commission's rate reflect net stranded. PA 141, § 10a(10).

B. Edison Proposals to Eliminate Regulatory Lag and Make Stranded Cost Unavoidable.

1. Edison position.

Edison claims that the Commission's use of actual reported historical data to determine stranded costs prevents Edison from fully recovering its costs because Choice customers can return to tariff service and avoid payment of deferred net stranded costs and second, those deferred costs will never be recovered from Electric Choice customers. Edison Brief, p. 20. Edison claims that the way to eliminate this problem is to impose a 2003 transition charge based upon Edison's estimate of 2003 stranded costs (see Exhibit A-4) and to make stranded cost charges non-avoidable by assessing customers who return to retail sales service from Electric Choice for a full amount of so-called non-recoverable stranded costs attributable to that customer. Edison Brief, p. 23; Padgett Testimony, 3 Tr 219.

2. Energy Michigan reply.

Section II, A (4) of this Reply Brief has discussed the flaws in Mr. Falletich's projected stranded costs methodology. A calculation methodology which assumes increased fixed

costs revenue requirements while predicting a reduction in retail sales of more than 10% is ridiculous on its face. See Exhibit A-4. The other flaws in the assignment of costs and exclusions of revenues are additional reasons to reject the Edison projected case methodology. Those flaws are discussed in the Energy Michigan Initial Brief at pages 9-21.

Energy Michigan Witness Polich opposed Mr. Padgett's proposal for retroactive recovery of stranded costs on the grounds that it appeared to be a form of prohibited retroactive rate making for the benefit of Detroit Edison. Mr. Polich also stated that the Padgett proposal would clearly chill the market for Electric Choice and for that reason would have an anti-competitive impact. Finally, the proposal is one sided because it fails to include provisions which would credit returning Electric Choice customers for the benefits generated for Edison by reducing expensive power purchases. 3 Tr 285.

The Padgett position is retroactive rate making because it requires that EC customers who have paid lawful surcharges under one rate, be exposed to collection of an as yet unknown future liability which would be calculated and collected after they have switched rates. Michigan Bell Telephone Co. v PSC, 315 Mich 533, 24 NW 2d 200 (1946).

Moreover, Edison's position in this case is fundamentally inconsistent because it objects to the carry forward of stranded benefits but is demanding the retroactive imposition of stranded costs. Once again, Edison is trying to have it both ways.

The Padgett proposal is fundamentally unfair because it is based on the concept that an under recovery of stranded costs should never be tolerated even if it means retroactively billing a customer for such costs after they return to sales service. But Mr. Padgett has also opposed the totally prospective carry forward mechanism which allows current excess stranded cost recovery to be used to offset future stranded costs. As will be seen in C. below, it is Mr. Padgett's position that transition charges should never go below zero (e.g. use stranded benefits to offset securitization or to create a carry forward) even if there are huge stranded benefits. Padgett, 3 Tr 222.

Edison consistently maintains that stranded costs must be recovered and stranded benefits must be ignored. This position is an illogical and inconsistent framework in which Electric Choice customers can never win and Edison can never lose.

C. Edison's Proposal to Create a Floor of Zero for Transition Charges.

1. Edison position.

Edison proposes that where there are stranded benefits (PFC revenue exceeds PFC revenue requirements) the transition charge must be no less than zero. Mr. Padgett claims that carry forward of those sufficiencies <u>for a period beyond the Act 141 rate freeze for full requirements customers would be retroactive rate making and carry forward of stranded benefits during the rate freeze would be a prohibited rate reduction</u>. Edison cites several Michigan court cases in support of this position. Edison Brief, p. 24-25.

2. Energy Michigan reply.

a. The zero floor.

Mr. Padgett failed to point out that when Edison uses "zero" it really means .49 ¢ /kWh. This is because it is Edison's position that where PFC revenue exceeds PFC revenue requirements, the charge for non-securitized assets should be zero but Edison should still be allowed to continue to charge the .49 ¢ /kWh for securitized assets with no offset. See Edison Brief, p. 26-29.

This position is totally illogical. During a given year, Detroit Edison's PFC revenue requirements include the costs of securitized assets and non-securitized assets. Edison has taken the position that if there is a PFC revenue deficiency, it means that a transition charge must be imposed and there is not enough money to pay securitization costs which also must be assessed. Edison Brief, p. 28, 3 Tr 207-08.

If this is true, then the converse should be true as well: if there is an excess of PFC revenue, it means that PFC revenue was sufficient to pay non-securitized costs and it can be determined if these excess funds are sufficient to cover the short fall from securitization charges which were not collected from EC customers due to the 2001 offset. If non-securitized PFC revenue requirements are $1.1 billion and 2001 EC offsets for securitization charges cost $5 million, then PFC revenues of $1.3 billion leave Edison with a $.15 billion more money than was required to pay unsecuritized PFC revenue requirements and the cost of EC securitization offsets. Under these circumstances, there should be zero transition charges and a full offset of EC securitization charges. For extra safety it can be determined if the excess is sufficient to pay all or part of the cost of securitized assets during the year in which the transition charge will be applied. See Energy Michigan Initial Brief, Attachment A and Exhibit I-32, lines 26-29.

This fact can be determined, as was done by Mr. Polich in Exhibit I-32, by calculating the PFC revenue sufficiency and subtracting from that sufficiency the Electric Choice sales volume multiplied by the appropriate securitization charge. If the PFC revenue sufficiency covers this estimate of the cost of securitization offsets then there should be no question of using stranded benefits to pay for a full offset of securitization charges as well as a zero transition charge. This framework is described in Mr. Polich's Testimony at 3 Tr 284-85 and the Energy Michigan Initial Brief, p. 26-28.

Mr. Polich did not propose a negative transition charge in the sense that stranded benefits would be used to provide large refunds to customers. Rather, stranded benefits would be used to pay cost of both securitized and non-securitized assets and any balance would be carried forward to accomplish the same purpose in future years. Id.

b. The carry forward of stranded benefits is not retroactive rate making.

Edison appears to be confused regarding the definition of retroactive rate making and the applicability of a leading Michigan case cited in their Brief at page 25. Michigan Bell Telephone Co v Michigan Public Service Commission, 315 Mich 533, 25 NW 2d 200 (1946) provides the classic definition of retroactive rate making. In that case, the MPSC had calculated and authorized rates for Michigan Bell Telephone Company during 1944 but on December 28, 1944 as a result of a new hearing ordered Bell to reduce its gross revenues for the entire year in an amount of $3.5 million and make refunds in that amount to its Michigan subscribers. P. 535. The court found that the Commission could not order a company to refund amounts previously collected under a lawfully established rate. Id.

The MPSC / Staff method of calculating and collecting stranded costs prospectively establishes a transition charge each year by considering actual recorded data from the most recently available test year (approximately two years before the collection year) then determining the actual extent of over or under collections and implementing a charge which is designed to enable the utility to prospectively recover under collections. In Order U-12639, the Commission indicated its willingness to consider carry forward of over collections as an alternative to an immediate rate reduction which would accompany a finding of surplus of PFC revenue to PFC revenue requirements. U-12639, December 20, 2001, p. 22. The Commission did determine it would not award rate reductions based on a finding of stranded benefits.

Because the MPSC method uses past data to develop and implement known future charges, it is not retroactive and indeed it is based on literally the same historic test years concept that has been used for scores of years. Unlike Michigan Bell, the Staff methodology establishes a known future rate which is not subject to change. It is well established Michigan law that selection of an appropriate test year is within the broad rate making power of the Commission. Consumers Power v PSC, 181 Mich App 261, 448 NW 2d 806 (1989). Also see the broad grant of authority regarding netting methodology granted in PA 141 § 10a(10)(c).

The Energy Michigan carry forward proposal is also both known and prospective in its application. An example will illustrate this fact. Assume that Detroit Edison is found to have $50 million of stranded benefits (PFC revenue exceeds PFC revenue requirements by $50 million). Assume also that 2003 EC sales are estimated to be 6.5 million Mwh and the securitization charge offset would be .49 ¢ /kWh or a total of $31.85 million. Under the framework proposed by Witness Polich (Exhibit I-32, lines 26-29) $31.85 million would be subtracted from the $50 million stranded benefits leaving a balance of $28.15 million. The Commission would then determine that the known $28.15 million remaining stranded benefits would be <u>prospectively</u> applied in 2004 or thereafter as a credit against stranded costs found in the 2002 test year and collected in 2004. This example illustrates that the Commission would be exercising its lawful powers to use historic data for the purpose of calculating known future rates and, in this instance, future credits.

If Edison contends that this practice is retroactive rate making, then it must also believe that the Commission has no authority whatsoever to collect unrecovered stranded costs from a test year (such as the year 2000) prior to the year under consideration in this case which was supposed to be 2001. Edison was not heard to oppose the Commission's decision to allow one more review of year 2000 data and potential collection of year 2000 stranded costs even though the case regarding that matter has been closed. Instead, Edison apparently approved of the Commission's decision to revisit year 2000 and collect any found deficiencies in the year 2003 instead of 2002.

The Energy Michigan proposal is quite distinct from the retroactive rate making concept advocated by Mr. Padgett in which a lawful transition charge would be collected from EC customers and then at some future date in some future case the Commission would determine that customers no longer taking service under the EC rate should have paid a certain amount of transition charges and that those transition

charges should be collected from EC customers who had long since switched to another rate. This is retroactive rate making and does not comply with the standard set forth in the Michigan Bell case discussed above.

D. Forward Looking Transition Charge for 2003

1. Edison position.

Edison requests implementation of a 1.28 ¢ transition charge (in addition to a .49 ¢/kWh securitization charge!) based on Edison's projected stranded costs for 2003. Edison claims that use of a projected 2003 test year will more closely align occurrence of net stranded costs with the period where resulting charges will be in effect. Edison Brief. p. 25-26.

2. Energy Michigan reply.

The Energy Michigan Reply at II.B. demonstrates the technical flaws in the methods that Edison used to estimate the 2003 charge. See Exhibit A-4. The PFC revenue requirement was assumed to increase $24 million from 2000 to 2003 even though revenues from sales were assumed to decline more than 10%, flawed cost studies were the basis of PFC revenue requirements and PFC revenues improperly exclude large third party sales and discount contract revenues to mention a few of the problems. Edison's "forward looking" transition charge is a graphic illustration of the dark side of projected rate making. Use of the projected format gives parties an incentive to indulge in forms of gamesmanship and manipulation which result in a set of projections totally divorced from reality.

E. Edison's Proposal to Eliminate Securitization Offsets and Rate Reduction Equalization Credits

1. Edison position.

Edison claims that the securitization offsets and rate reduction credits are subsidies to Electric Choice which should be eliminated because Choice customers receive greater benefits than full service customers. Edison Brief, p. 27. Edison also claims that since it incurred stranded costs in 2001, it is not receiving enough money from customers to pay the cost of non-securitized assets much less to continue securitization offset which also reduces income. Id, p. 28.

Finally, Edison says that equalization credits reducing the total charge paid to Edison below zero violates the restriction of 10d(5) that reductions be produced as opposed to the customer paying less than nothing. Brief, p. 28-29. Finally, Edison says that when Electric Choice customers receive greater benefits than full service customers a reallocation prohibited by 10d(5) takes place.

2. Energy Michigan reply.

i. Offsets

Let's turn around the quote supporting the Edison position. Edison says that where a PFC revenue deficiency occurs, transition charges must be above zero and there is no basis to offset securitization charges. 3 Tr 207-08. If this is the case, the reverse must be true. If there is a large stranded benefit there can be no transition charge since adequate PFC revenue is being received to pay the cost of non-securitized assets and there should be securitization charge offsets if the PFC revenue excess is sufficient to pay or offset the cost of securitization charges which would be collected from EC customers for securitized assets. In this exercise, the transition charge never goes below zero but revenues excess to the level required to pay the PFC revenue requirements of non-securitized assets are used to pay (offset) the cost of securitized assets which is billable to EC customers.

Energy Michigan Witness Polich performed this exercise in Exhibit I-32, lines 26-28

and Attachment A, lines 26-29 to the Energy Michigan Initial Brief. In that Exhibit, he found that Edison had revenues in excess of the level required to pay non-securitized costs (a stranded benefit) then determined that EC customers were estimated to use approximately 10,000 Mwh of service from 2002 to 2003 and would normally be liable for securitization charges of roughly $49 million. Id. Mr. Polich subtracted the required $49 million cost of securitization offsets from his calculation of stranded benefits and a positive balance resulted. <u>This exercise demonstrated that based upon a review of 2001 actual costs with minimal levels of EC participation, the stranded benefit produced would be sufficient to cover the PFC revenue requirements of Edison's non-securitized assets and to cover the cost of securitization offset or non-collection of all securitization charges from the amount of EC sales projected for 2002-2003. Exhibit I-32, lines 26-29.</u>

The fundamental concept here is that where Edison's PFC revenues are sufficient to pay all PFC revenue requirements of non-securitized assets <u>and</u> the cost of securitization charges which are offset for EC sales there should be a full offset of securitization charges for those EC volumes. If a balance is left over it should be carried forward to pay future transition charges or offsets. This position is far more logical than Edison's interpretation which could result in a finding of large stranded benefits which produced a zero transition charge but continuing collection of the .49 ¢ /kWh securitization charge even though the revenue was not needed to make Edison whole.

ii. Rate equalization.

The Commission has already found that Section 10d(5) gives it the flexibility to use excess securitization benefits to produce rate reductions or reduce the level of any charges (such as securitization or transition charges) authorized by the Commission to recover an electric utility's stranded costs. In Order U-12639, page 25-26 the Commission found that this result achieved the policy goal that ROA and full service

customers would be treated on an equal basis. The equalization adjustment also prevents use of charges and credits in a way that reallocates cost responsibility between the different customer classes which was in effect prior to PA 141. Id. This result is achieved because the rate equalization credits ensure that all customer classes have the same 5% reduction as a result of securitization.

Edison's claims that securitization assets and rate equalization credits have been illegally used to reduce Electric Choice rates below "a point beyond where there is anything to reduce." Edison Brief, p. 28. Edison claims that this result is a taking and a reallocation, both prohibited by law. Edison then cites numerous cases which find that a taking of utility property is prohibited under Michigan law.

PA 141 § 10d(5) does in fact give the Commission the right to use excess securitization savings to "further rate reductions or to reduce the level of any charges authorized by the Commission to recover a utility's stranded costs."

In the implementation of securitization, Edison gave all customers classes a 5% reduction. To the extent that one class did not receive this reduction a prohibited reallocation of cost responsibility would have occurred.

Also, Edison apparently assumes but does not prove that some large very high voltage customers received an EC equalization adjustment which exceeded the rate paid by those customers for distribution service from Edison. Edison claims that this result goes beyond the concept of "reduction" permitted by statute. Yet, Edison does not acknowledge that the same reduction would occur for very large high voltage retail sales customers or that the result is an improper use of securitization savings. Edison is being illogical and inconsistent.

The use of excess securitization savings to produce these reductions is not a "taking" from Edison because no funds are taken away from Edison. The excess

securitization funds do not belong to Edison. PA 141 provides that the excess savings must be used for rate reductions, funding of the LIEE or for the further reductions described in Sec. 10d(5). Sec. 10d(5) does not provide that these savings be allocated to Edison. The Commission has lawfully exercised its broad authority under the statute to determine that excess savings would be used for EC reductions as described above.

F. Edison's Critique of Energy Michigan Position

The following is a reply to Edison's critique of the Energy Michigan position in its Brief. P. 31-35.

1. Carry forward.

Edison claims that the ABATE and Energy Michigan carry forward constitute unlawful retroactive rate making. The Energy Michigan discussion in II.C. above covers this issue.

2. Treatment of special contract revenue.

Edison objects to Energy Michigan's imputation of full tariff revenue for special contract sales claiming "there is no evidence in the record that the customers associated with these contracts will choose to remain Detroit Edison full service tariff customers in a post-Act 141 environment". Edison also claims that their witnesses explained the significant benefits provided by special contracts to Electric Choice customers in the form of lower stranded costs. Edison Brief, p. 32.

The argument for imputation of tariff rates to special contract revenues is covered in the Energy Michigan Initial Brief at pages 15-17. Note that Edison did not respond to Mr. Polich's Testimony that failure to impute SMC revenue at tariff rates would result in higher stranded costs which in turn would damage competition. 3 TR 281. Also, the Commission specifically confirmed the damage which would be caused to Choice customers by failure

to impute special contract revenues at tariff rates and adopted a similar adjustment offered by Energy Michigan. U-13380, December 20, 2002, p. 11-13.

3. The right of Electric Choice customers to stranded benefits.

Edison opposes what it claims to be Energy Michigan's position that EC customers are entitled to stranded benefits on an equal basis to Edison's statutory right to recover stranded costs. Edison Brief, p. 32-33.

Edison mischaracterizes the Energy Michigan position. It is Energy Michigan's position that where stranded benefits are found, Edison's net unsecuritized PFC revenue requirements have been covered and, if the balance of excess revenue (stranded benefits) is sufficient to cover the likely cost of securitization offsets to EC customers in 2003, an offset to those securitization charges can be maintained <u>while still allowing Edison full recovery of securitized costs</u>. Thus, excess PFC revenue (stranded benefits) can justify a zero transition charge and waiver of securitization charges.

As to rate reductions, the legislature created a category of securitization savings called "excess securitization savings" which are generated each year and calculated by Detroit Edison. To the extent that this pot of money is available, <u>it has not come out of the pocket of Detroit Edison</u>. PA 141 specifically grants authority to the Commission to determine how these funds will be spent. Sec. 10d(5). The Commission in exercise of that authority determined that 100% of those funds would be used to lower transition charges for Electric Choice customers. U-12478, November 2, 2000, p. 25. The reductions granted put Electric Choice customers in the same position monetarily as Edison's own retail customers who receive a 5% rate reduction. See Energy Michigan Initial Brief, p. 31. Thus the result is both lawful and does not create a preference for Electric Choice customers. Rather it puts them on an equal footing with all other Edison customers.

4. Edison claims that the transition charges cannot go below zero. Edison Brief. p. 34.

See 3. above for Energy Michigan reply.

5. Edison opposes Energy Michigan's position against a "forward looking" transition charges. Edison Brief. p. 34.

See Energy Michigan Reply in II.D. above.

6. Class specific transition charges.

Edison takes issue with the Energy Michigan opposition to class specific transition charges. Edison denies that the charges are anti-competitive or that they reallocate costs. Edison Brief, p. 34-35.

It is telling that Detroit Edison offers absolutely no evidence to support its conclusion that class specific transition charges do not reallocate costs or otherwise violate PA 141. Energy Michigan Witness Polich testified that class specific transition charges as proposed by Edison <u>are</u> anti-competitive because they increase charges to customers most likely to participate in competition. He testified that class specific charges appeared to reallocate existing revenue requirements in violation of PA 141, § 10d(5) and may also violate the rate freeze in Sec. 10d(1). 3 Tr 284.

In Case U-12639, the Commission rejected very similar class specific transition charge proposals from Detroit Edison (equalization transition charge adjustment) and Consumers Energy (removal of skewing adjustment). The Commission cited its belief that PA 141 § 10d(5) does not permit the proposed adjustment since class specific charges likely reallocate cost responsibility among the different classes from levels in effect prior to PA 141. The Commission also found the adjustments to be anti-competitive because they increase rates to customers classes most likely to consider ROA service. This finding was not refuted by Edison in this case. Also, the adjustments may violate the statutory rate freeze since they increase rates for commercial and industrial secondary customers in a way that is not related

to recovery of stranded costs. Case U-12639, December 31, 2001, p. 31.

III. REPLY TO MPSC STAFF

A. Failure to Carry Forward Year 2000 Benefits

1. Staff position.

The MPSC Staff found that Edison PFC revenue requirements exceeded PFC costs by $53,101,000 in the year 2000. Staff also found that PFC costs exceeded PFC revenues (stranded costs) by $10,012,000 in the year 2001. Staff used these numbers to calculate a transition charge of zero for the year 2000 and a transition charge of $0.0018/kWh in the year 2001. Exhibit S-43, revised and Exhibit S-44.. Thus, even though on a net basis, stranded benefits exceeded stranded costs by more than $40 million from 2000 to 2001, Staff proposes that EC customers pay transition charges due to Staff's refusal to carry forward stranded benefits.

2. Energy Michigan reply.

Staff's position results in a one way street where Detroit Edison will keep unlimited amounts of stranded benefits and will collect stranded costs from its customers whenever such costs occur. This position is likely to be particularly damaging when recovery of deferred Clean Air Act costs commences. When the Commission decided to remove Clean Air Act costs from this case, it did not adopt a mechanism to shift forward the current revenues being received from customers to pay those costs to a time frame when the costs would be recovered. Thus, during the rate freeze and to the extent that Clean Air Act cost amounts exceed the amount of costs above depreciation which could have been deferred, Edison will be collecting customer monies which are excess to its new (reduced) revenue requirement. Under the rate freeze, Edison will keep this excess revenue but present the deferred Clean Air Act costs for recovery without any offset. If Edison attempts to recover the deferred

Clean Air Act costs by means of securitization, Electric Choice customers may be forced to pay such costs despite the fact that the cost could have been fully or partially offset by adequate revenue prior to 2004.

The Commission has adequate records in this case to determine the revenue available to Detroit Edison each year prior to 2004 and the revenue requirement cost of the Clean Air Act investments which are being deferred. The Commission could make a finding that the cost of deferred Clean Air Act investments could have been covered by current revenues and that this finding would be used to reduce the liability of Electric Choice customers for future collection of Clean Air Act costs.

In any event, the Staff recommendation demonstrates the inequity which can occur when very large excesses of PFC revenue are determined for one year but that excess is not carried forward to cover a much smaller deficiency in a succeeding year.

B. Inaccurate Calculation of Section 10d(5) Credit

1. Staff position.

In Exhibit S-45, revised, the Staff proposed a net transition charge of $0.0045/kWh based upon securitization charges of $0.0049, a transition charge of $0.0018 and a excess securitization reduction of $0.00222.

2. Energy Michigan reply.

Energy Michigan believes that the Staff calculation of the excess securitization reduction is incorrect. It appears that Staff used the Detroit Edison estimate of ROA load in the year 2003 of 6,500,000 Mwh. See S-44, line 7. If 6,500,000 Mwh are multiplied by the Staff's securitization reduction calculated in S-45 ($0.00222) the result is a cost of $14,430,000. Yet, Exhibit A-24, <u>revised</u> shows an excess savings securitization reserve of $38.369 million

to provide reductions. Also, that Exhibit A-24 is based on the assumption that $24 million of excess savings will be used to pay pre-securitization residential rate reductions which were disapproved by the Commission in U-12478. Thus the total pool of available excess securitization savings is in excess of $62 million rather than the $14 million used by Staff. The actual excess savings available would more than pay for securitization offsets and equalization rate reductions.

IV. PRAYER FOR RELIEF

Based on the evidence and argument presented in this case, Energy Michigan requests that the Commission:

1. Reject the proposals of Detroit Edison to collect any stranded costs attributable to years 2000 and 2001;

2. Reject Edison's proposals for elimination of regulatory lag and implementation of forward looking transition charges of any kind;

3. Reject Edison's proposals to implement a floor of zero for transition charges and other so-called refinements of the net stranded costs recovery procedure;

4. Adopt the Energy Michigan proposal for standard rate case filing requirements;

5. Adopt the Energy Michigan finding that Detroit Edison will experience over $480 million of stranded benefits even with continuation of current offsets and credits; and

6. Find that stranded benefits proposed in #6 should be used to reduce 2003 transition charges to zero to offset 2003 securitization charges for all EC customers and the balance should be carried forward to reduce future charges while continuing the practice of using excess securitization savings to continue rate equalization reductions.

Respectfully submitted,

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January 23, 2003

By: ______________________________

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STATE OF MICHIGAN

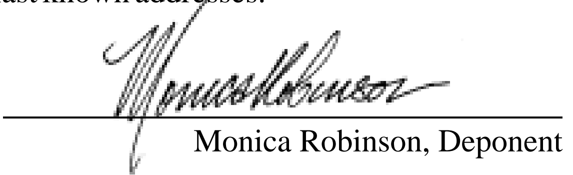
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

****

In the matter of the application of) THE DETROIT EDISON COMPANY) to implement the Commission's stranded) cost recovery procedures and for approval) of net stranded cost recovery charges.) ______________________________________)	Case U-13350

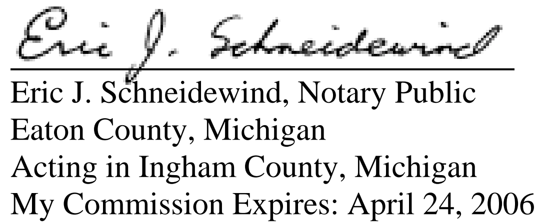
PROOF OF SERVICE

Monica Robinson, duly sworn, deposes and says that on this 23rd day of January 2003 she served a copy of Energy Michigan, Inc.'s Reply Brief upon those individuals names on the attached service list by regular mail and e-mail at their last known addresses.



Monica Robinson, Deponent

Subscribed and sworn to before me
this 23rd day of January, 2003



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