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February 26, 2015

Ms. Mary Jo Kunkle
Executive Secretary
Michigan Public Service Commission
7109 W. Saginaw Highway
P.O. Box 30221
Lansing, Michigan 48909

Re: MPSC Case No. U-17689

Dear Ms. Kunkle:

Attached for paperless electronic filing in the above referenced matter, please find the Initial Brief and Proof of Service on behalf of Energy Michigan, Inc.

Thank you for your assistance in this matter.

Sincerely yours,

Laura A. Chappelle

c: ALJ
Parties

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STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter on the Commission's own motion)
to commence a proceeding to implement the)
provisions of Public Act 169 of 2014, MCL 460.11(3))
et. seq., with regard to **DTE ELECTRIC COMPANY.**)

Case No. U-17689

INITIAL BRIEF OF ENERGY MICHIGAN, INC.

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I. Introduction

This Initial Brief is filed on behalf of Energy Michigan, Inc. ("Energy Michigan") by its attorneys, Varnum. Failure to address any issues or positions raised by other parties should not be taken as agreement with those issues or positions.

II. Argument

A. The Company's proposal to re-allocate uncollectibles is unreasonable, unfairly burdens customers, including commercial and industrial electric choice customers, and should be rejected.

1. The Commission should deny DTE's proposal to change the allocation method for uncollectibles.

DTE Electric Company ("DTE or DTE Company") is proposing to deviate from its current method of allocating Uncollectible Accounts Expense ("UAE") to rate classes, as recently approved by the Commission in Case No. U-16472, in favor of a new allocation based upon an unreasonable premise that will result in unfair and unjust rate impacts upon most customers.

In Case No. U-16472, DTE allocated UAEs based on the overall cost to serve each of its different rate classes. Under this allocation method, UAEs were treated as a company-wide overhead, independent of the electric use of individual rate classes.

In this proceeding, however, DTE is seeking a change in the current method of allocating UAEs, which results in a greater amount of uncollectibles expenses assigned to the residential and small commercial classes of customers. DTE witness Mr. Don M. Stanczak testified:

"The Company is proposing to directly assign costs associated with uncollectible expense. In the past, DTE Electric has allocated these costs to rate classes based on a cost of service percentage basis. A more appropriate assignment of uncollectible expense is to allocate these costs to the customer classes that cause them. As further described by Witness Heiser, the company is proposing to allocate uncollectible expense based on net write-offs by class." 2 Tr. 138.

As Energy Michigan's expert witness, Alexander J. Zakem, and other party witnesses have explained, DTE is confusing an overhead cost with cost causation. As Mr. Zakem explained,

"[There should be] no change in [the] allocation method. The utility must recover uncollectible expenses. Uncollectibles are a company-wide overhead, independent of the electric use of rate classes. Thus the uncollectibles should be allocated in a general and equitable way to all rate classes to be paid by all customers. The current method of allocating uncollectibles to rate classes does this. DTE has not provided any reason to change." 3 Tr. 399.

"(C)ustomers cause uncollectibles, not customer classes – that is, the amount of uncollectibles of a class is not determined by the electric use characteristics of the class. Contrary to the principle of cost causation, DTE's proposal puts the burden of compensation for uncollectibles on the customers in the class who *do not cause uncollectibles at all*, but rather pay their bills." 3 Tr. 398. Emphasis in original.

Energy Michigan agrees with the Staff position that "there is no cause-and-effect relationship between a class and the UAEs for customers traced to that class." 2 Tr. 310. As the Staff has stated, ". . . [T]he Company's UAEs are not a specific cost of serving a given class but

a general cost of performing business as a utility. As such, they should be allocated based upon an overall allocation scheme." 2 Tr. 311.

For all of these reasons, Energy Michigan agrees with Staff that the allocation of the UAEs should be based on the overall cost of service using the allocator computed in Case No. U-16472. 2 Tr. 311.

2. In order to account for a fair allocation of costs, uncollectibles should be separated into a distribution portion and a power supply portion within the class to which they are allocated.

As Mr. Zakem has stated, "if a customer does not pay a bill, that bill includes *both* distribution *and* power supply charges. As a result, total uncollectibles include compensation to the utility for both distribution and power supply costs." 3 Tr. 390. "Because uncollectibles include both distribution and power supply charges, uncollectibles should be separated in a reasonable way into a distribution portion and a power supply portion. The distribution portion should be included in distribution rates, and the power supply portion should be included in power supply rates." 3 Tr. 391.

Including all uncollectibles only in distribution rates is an incorrect and unfair allocation of costs to customers. DTE offers two separate types of services – distribution service and power supply service. The costs for these services should be kept separate. If a customer does not pay the distribution component of a bill, then the utility is short of compensation for its distribution service, and therefore the "uncollectible" portion of the distribution component is a distribution expense. Likewise for power supply. If a customer does not pay the power supply component of a bill, then the utility is short of compensation for its power supply service, and therefore the "uncollectible" portion of the power supply component is a power supply expense. Power supply expenses should not be collected by distribution charges. However, DTE's current rate design puts power supply expenses into distribution charges.

Customers on electric choice, in particular, who only take distribution service from DTE, are unfairly compensating DTE for DTE's power supply customers who do not pay their power supply charges. As Mr. Zakem explained, proper separation of distribution and power supply costs is one of the main reasons for doing a careful cost of service study. 3 Tr. 392. Energy Michigan's proposal that DTE should separate uncollectible expenses into distribution and power supply – and charge for each in its respective rate components – provides a simple remedy for DTE's deficient cost of service methodology and rated design.

The Commission approved a fair allocation of uncollectible costs between distribution and power supply services in Consumers Energy's last general rate case (U-17087), when it approved the allocation for the E-1 rate to various rate classes, and then separated within each rate class a distribution portion and a power supply portion. Energy Michigan proposes a similar method for the DTE uncollectibles at issue in this case, as shown in Exhibit EM-3 (AJZ-3).

B. DTE's proposed 4 CP 100-0-0 Production Cost Allocation Methodology deviates from long-standing Commission precedent, and does not meet the statutory requirement for affordable and competitive electric rates for all customer classes.

DTE states that in order to more appropriately align cost allocation with cost causation, the production cost allocation should be based on a 100% demand 4 CP allocation (4 CP 100-0-0). The Company cites several reasons for the deviation from the current allocation of 12 CP 50-25-25, including 1) the completion of rate deskewing, 2) the anticipated generation resource shortfall in Midcontinent Independent System Operator ("MISO") Zone 7 (the lower peninsula of Michigan) which could occur as early as 2016, and 3) existing and proposed environmental regulations relative to coal-fired power plants. 2 Tr. 128. DTE alleges that "the proposed 100%

demand allocator more appropriately aligns cost allocation with cost causation" and that "if a portion of capacity costs are allocated based on energy use, then high-load factor customers do not fully benefit from the value that their high-load factor consumption brings to the system." 2 Tr. 135.

As DTE notes, the proposed 4 CP 100-0-0 allocation methodology will result in significant increases to both residential and commercial rates, while providing significant decreases in primary rates:

". . . moving from the current 12 CP 50-25-25 method of allocation for production to a 4 CP 100-0-0 causes residential to increase by \$53.9 million, commercial secondary to increase by \$8.7 million, C&I primary to decrease by \$59.2 million, and lighting to decrease by \$3.4 million." 2 Tr. 241.

Energy Michigan asserts that DTE's justifications for moving to a 4 CP 100-0-0 allocation methodology are unsupported, based upon faulty logic, deviate from long-standing Commission precedent, and will violate the law's requirement that energy cost of service energy rates must "support affordable and competitive electric rates for all customer classes." MCL 460(11)(3)(b).

First, DTE's reason for introducing a dramatically different production allocation methodology – one in which no accounting is made for energy – is unsubstantiated, particularly as it relies on MISO's expected "shortfall" of capacity in 2016. As Mr. Zakem clarified:

". . . MISO is not *anticipating, expecting, or predicting* a shortage or surplus (of capacity) but rather simply *calculating* how much additional capacity is needed. MISO refers to its calculated number as a "shortfall," not "shortage." "Shortfall" is the difference between two precisely defined numbers. "Shortage" implies there is not enough to go around.

MISO's actual expectations are different – it expects that the "shortfalls" it reports to NERC *will change*. The MISO June 5 Report . . . which shows only the North/Central region with a 2.3 GW shortfall, states:

This slide shows a **preliminary forecast** of a 10-year period, as is required for the NERC Long Term Reliability Assessment. MISO fully expects that **these figures will change significantly as future capacity plans are solidified** in the future by load serving entities and state commissions."¹

As Mr. Zakem noted, a MISO official clarified that addressing the shortfall does not necessarily require the construction of new generation in Michigan over the next couple years, when she stated that, "[I]n the short run, **the notion that Michigan has to build 3,000 MW of capacity is not the impression I want to leave you with.**"²

There are several other reasons why the "shortfall" DTE emphasizes will not result in a capacity shortage, including the fact that when the South MISO region is taken into account, there will actually be a 0.2 MW *surplus* of capacity in 2016, not shortfall, as further explained by Mr. Zakem. 3 Tr. 403-406.

Finally, based upon DTE's regulatory filings with this Commission, its own capacity resource plan envisions neither a shortage of capacity, nor that capacity costs will be unreasonably higher. Specifically, according to the Company's 2015 PSCR plan, DTE plans to purchase approximately 900 MW of additional capacity on an annual basis for the 5-year period of 2015-2019 at a moderately low projected price of \$27.00 per kW-year.³

DTE's 100% demand allocator is also based upon faulty logic and, importantly, by ignoring the energy value of expensive generation, deviates from sound, reasonable Commission

¹ 3 Tr. 401-402, emphasis in original, citing *MISO June 5 Report*, p. 16. Emphasis in original. <https://www.misoenergy.org/Library/MeetingMaterials/Pages/SAWG.aspx> See, 2014, meeting 20140710, meeting materials.

² 3 Tr. 402, citing MW Daily, October 22, 2014. Emphasis added. Citing Claire Moeller, MISO Executive Vice President of Transmission and Technology, during the October 22, 2014, meeting of the MISO System Planning Committee. <http://www.platts.com/latest-news/electric-power/louisville-kentucky/lower-michigan-electric-power-capacity-deficit-21437818>

³ DTE 2015 PSCR filing, Case No. U-17680, Exhibit A-12, line 15, column h.

rate-making policy that has been exercised for close to 40 years. Rather than "more appropriately aligning cost allocation with cost causation," DTE's 100% demand allocator penalizes other customer groups to the benefit of only one, which would be allowed to receive the value of low-cost energy production essentially for "free" – meaning that the value of the ability of a generating plant to produce low-cost energy is not recognized in the allocation of the costs of the plant.

One would be hard-pressed to view a production asset as not providing both energy and capacity. Of course, they provide both. And in general, an investment in a higher-cost generating plant is offset by its ability to produce low-cost energy. The Commission has recognized this in the past by including an energy component in the allocation of production costs. Commission Staff has succinctly stated the unfairness of DTE's proposal for a 100-0-0 allocation, i.e., no recognition at all of the value of low-cost energy, as follows:

" . . . Mr. Stanczak argues that under the 50-25-25 method, if a customer class increases its energy usage without increasing system demand . . . this class would see an increase in the allocation of capacity related costs". (Stanczak Direct, p. 7, lines 5 - 8). Under Mr. Stanczak's 100% demand allocation proposal, if a customer class increased its energy usage without increasing demand, it would see no increase in the allocation of production related costs. The customer class would receive increased service from production assets, but the class would not receive any increase in allocated production costs. In effect, with regard to production assets, this increase in service is cost-free. This is a violation of cost of service principles." 3 Tr. 306. Emphasis added.

Energy Michigan agrees with Staff that failing to account for the value of the costs of energy in the production allocator would be a significant departure from the Commission's long-standing rate-making policy stretching back at least 38 years and would violate cost of service principles. 2 Tr. 306. The fact that the Company has failed to substantiate this significant deviation from reasonable rate-making policy should lead the Commission to reject this proposed new allocation.

Finally, the Commission should reject the proposed 100% demand allocation due to the fact that it would violate the requirement that cost of service rates be "affordable" and "competitive" for all customer classes. MCL 460.11(3)(b). Under the statute, the Commission must:

"Explore different methods for allocation of production, transmission, distribution, and customer-related costs and overall rate design, based on cost of service, that support affordable and competitive electric rates for all customer classes."

While it is evident that one of the goals of this proceeding is to attempt to lower costs for one class of customers, this cannot be accomplished by imposing significant rate increases upon the other classes of customers in ways that violate Michigan statutory law and long established Commission rate making policy.

For all of these reasons, DTE's proposed 100% demand allocator should be rejected. Energy Michigan would instead support the Staff's proposed 75-0-25 allocation methodology.

III. Conclusion

WHEREFORE, Energy Michigan respectfully requests that the Commission:

- A. Reject DTE's proposal to change the present method of allocating uncollectibles to rate classes;
- B. Require DTE to separate the allocation of uncollectibles into a distribution and power supply portion;
- C. Reject DTE's proposal to change the production allocation methodology to 100% demand allocation; and
- D. Adopt Staff's proposal to change the production allocation methodology to 75-0-25.

Respectfully submitted,

Varnum LLP
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February 26, 2015

By: _____

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DTE Electric Company.)
_____)

Case No. U-17689

PROOF OF SERVICE

STATE OF MICHIGAN)
) ss.
COUNTY OF INGHAM)

Kimberly Champagne, the undersigned, being first duly sworn, deposes and says that she is a Legal Secretary at Varnum LLP and that on the 26th day of February, 2015, she served an electronic copy of an Initial Brief on behalf of Energy Michigan, Inc., upon those individuals listed on the attached Service List via email at their last known addresses.

Kimberly Champagne

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