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July 28, 2015

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

Re: MPSC Case No. U-17767

Dear Ms. Kunkle:

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

Thank you for your assistance in this matter.

Sincerely yours,

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c. ALJ
Parties

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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of DTE ELECTRIC COMPANY for authority to increase its rates, amend its rate schedules and rules governing the distribution and supply of electric energy, and for miscellaneous accounting authority. _____	)))))))	Case No. U-17767

INITIAL BRIEF

OF

ENERGY MICHIGAN, INC.

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INITIAL BRIEF OF ENERGY MICHIGAN, INC.

I. INTRODUCTION

This Initial Brief is filed on behalf of Energy Michigan, Inc. ("Energy Michigan") by its attorneys, Varnum LLP. 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. DTE's Incentive Compensation Proposal Needs to Be Modified to Properly Reflect True Costs and Benefits for its Customers.

While Energy Michigan does not take a position as to whether or not the Commission should allow DTE Electric ("DTE") to implement an Incentive Compensation Program, yet if it does, then Energy Michigan recommends that the Commission make several modifications to the program proposed by DTE. These suggested revisions will better align the proposed program with true cost of service, in accordance with MCL 460.11(1).

As Energy Michigan's witness, Mr. Alexander J. Zakem, pointed out in his Direct Testimony, there are two main deficiencies in DTE's program, the first of which is that it fails to

tie the performance being rewarded under the program to benefits to customers. See, generally, 8 Tr. pp. 1891-1892. DTE Exhibit A-20, Schedule L5 shows that 62.8% of the incentive payout is tied to financial goals that benefit shareholders and not customers. It is only equitable that if there is to be a shared benefit based on these goals, that share should come from the increased shareholder earnings and not from customer rates. It is not reasonable to ask DTE's customers to pay increased rates to reward the Company for increasing revenue for its shareholders, when that revenue increase has come from the customers themselves.

The second main deficiency in DTE's proposed Incentive Compensation Program relates to a failure to separate distribution service benefits from power supply service benefits. Four of the five "operating excellence" measures that DTE provides on Exhibit A-20, Schedule L5, lines 36-46 relate directly to power plants. As Mr. Zakem discusses, Retail Open Access ("ROA") customers of DTE, who take only distribution service and not power supply, do not receive, nor should they receive, the benefits that are associated with improvements in power supply reliability or reductions in plant expenses. These customers are already paying another supplier and the Midcontinent Independent System Operator ("MISO") for these services. See, 8 Tr. 1892. Therefore, the Commission should require that, in accordance with the cost-of-service principle of assigning costs to the customers that receive the benefits, ROA customers should be charged only for those incentive program costs that benefit distribution-only customers, and not for those that benefit power supply customers. The appropriate costs for distribution only customers are shown on Exhibit A-20, Schedule L5, lines 37-38.

On rebuttal, DTE has stated that it agrees with Energy Michigan that its Exhibit A-20 does not separate, and allocate, the costs associated with the proposed incentive compensation mechanism into power supply and distribution. 6 Tr. 914. However, DTE witness Mr. Heiser

goes on to note that these costs are separated in the cost of service allocation: "[a]s a result, costs functionalized as production-related are included solely in production rates and costs functionalized as distribution-related are included solely in distribution rates." 6 Tr. 914. Thus, in its rebuttal testimony, DTE agrees with Energy Michigan that Exhibit A-20 does not separate incentive compensation costs by distribution and power supply, but that functionalization is appropriate to ensure that costs are correctly allocated between power supply and distribution. DTE also agrees with Energy Michigan that Exhibit A-20, Schedule L5, lines 40-46, relating to power supply, should be put solely into power supply rates and in its rebuttal testimony states that it has done so.

For these reasons, if the Commission decides to approve the Incentive Compensation Program that DTE has proposed, it should also require DTE to structure the program, to the extent that it does not already conform, in accordance with the changes outlined by Mr. Zakem in his Direct Testimony so as to ensure that it correctly reflects true cost of service principles.

B. In Order to Eliminate ROA Customer Subsidization of Power Supply Customers, Uncollectibles Should be Separated Into a Distribution Portion and a Power Supply Portion Within the Class to Which They are Allocated.

DTE currently includes all uncollectibles in the distribution portion of its rates. See, Exhibit A-13, Schedule F1.5, page 1 of 14, line 4. However, uncollectibles include both distribution and power supply costs, and so should be separated into a distribution portion and a power supply portion when the costs are allocated to customers. As Mr. Zakem explained,

> 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. … Distribution customers should pay a fair share of uncollectibles in

> their distribution rates, and power supply customers should pay a fair share of uncollectibles in their power supply rates.

8 Tr. 1894. Including all uncollectibles only in distribution rates is an incorrect and unfair allocation of costs to customers and flies in the face of cost of service principles. DTE offers two separate types of services – distribution service and power supply service. The costs for these services must be kept separate in order to prevent distribution customers from subsidizing power supply customers. 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. The same reasoning applies for power supply service. 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. It is illogical and arbitrary that a power supply charge is transformed into a distribution charge by a customer's failure to pay. Nor does a full service customer's failure to pay make distribution-only customers suddenly responsible for the costs imposed on the system for the power supply of that customer.

The end result of the current practice is that customers on electric choice who only take distribution service from DTE are unfairly subsidizing DTE' power supply customers by paying power supply costs for those who do not pay their bills. Electric choice customers who only take distribution service from DTE should only have to pay for the uncollectible expense properly attributed to the distribution service that they receive. If implemented in this manner, then the appropriate costs are assigned to the appropriate customer classes and cost of service principles are satisfied.

There should be no concern that separating distribution and power supply costs would impose any significant burdens on the Company, as Mr. Zakem has provided in Exhibit EM-2 a table showing how to separate the uncollectibles into distribution and power supply components and how to include the components into the rate design targets for the major rate classes based on DTE's proposed allocation of uncollectibles. If the Commission requires that DTE continue its current allocation method for uncollectibles, Mr. Zakem provided Exhibit EM-3, which illustrates how the separation is to be accomplished. Mr. Zakem discusses how these separations are to be accomplished in additional detail in his testimony. 8 Tr. 1897-1900.

C. DTE's Proposed Change in its Line Extension Standard Allowance Table is Problematic.

DTE's Exhibit A-15, Schedule G-1, page 7 of 113, revised the prices in the Line Extension Standard Allowance Table. Under the current table, the allowance to distribution-only customers (*i.e.*, those with "no full service contract") is different from the allowance to "full service contract" customers. Under this approach, as Mr. Zakem explains, "two customers may receive the same type of distribution service and same benefit from extension of distribution facilities, but end up paying different amounts. 8 Tr. 1933.

DTE appears to agree. In his rebuttal testimony, DTE witness Mr. Timothy A. Bloch states that the allowances for full service customers are based on the average incremental margin of full service customers, while the average incremental margin of Retail Access customers is "much smaller." 4 Tr. 579. Since full service and Retail Access customers pay the same distribution charges, the only explanation for Mr. Bloch's testimony is that the line extension allowance for full service customers takes into account the "incremental margin" based on power supply service, while the allowance for Retail Access customers is based only on "incremental

margin" for distribution service. Mr. Bloch addresses *how* the line extension allowances are different for full service customers and Retail Access customers, but he does not address *why*.

Mr. Zakem goes on to explain:

> Revenue from power supply service should not be used as a rationale for charging less for new distribution facilities. Power supply and distribution are separate services, and they should be priced by cost of service and charged for separately, without subsidy from one to the other and without discrimination among customers.

8 Tr. 1933-1934.

Line extension is a distribution service. Therefore, the Commission should specify that line extension allowances be based only on distribution revenues and/or distribution "incremental margins" and require that DTE modify the captions on its line extension Table in C6.2(4)(a) by replacing the word "Full" with "Distribution," as discussed above and in Mr. Zakem's testimony. 8 Tr. 1933-1934.

D. The Discount for the D8 Interruptible Rate Should Be Set to the Value of Interruptible Capacity.

Energy Michigan explained that interruptible service can qualify as a "load modifying resource" and so can be used to satisfy MISO capacity requirements. 8 Tr. 1931. DTE appears to agree. In his rebuttal testimony, DTE witness Mr. Bloch notes that if interruptible customers return to firm service, it will increase the Company's capacity requirements. 4 Tr. 578.

The question at hand for the Commission is: what is the additional cost of the increased capacity requirements – MISO's requirements for planning resources? The additional cost is exactly the same as the additional savings to other customers due to the reduction of capacity requirements created by the D8 rate.

Energy Michigan has proposed that the discount for the D8 interruptible rate should reflect the value of the MISO capacity for which interruptibility substitutes. 8 Tr. 1931. The value of MISO capacity is being saved, and that is the value that other customers should pay for in the form of a discount given to the D8 rate.

DTE's objective for the D8 rate is not clear. DTE claims that setting the D8 discount to the value of the capacity saved is "too low" to incentivize customers to the D8 rate, that customers would likely return to firm service because "the economic benefit is too low." 4 Tr. 577. What DTE is actually implying is that if customers return to firm service, DTE can go out and buy capacity for *less* than the current discount it is offering to customers to provide the same capacity via an interruptible rate. This does not make economic sense.

With a visible capacity price in MISO, the capacity value of an interruptible rate is now simple to quantify. A discount for an interruptible rate should be based on visible and specific economic value, as that is the only way to make the discount equitable, without subsidy, for both the customers on the rate and the customers not on the rate.

Energy Michigan recommends that the Commission order DTE to set the discount for the D8 interruptible rate based on the value of capacity in the MISO market, as proposed by witness Mr. Zakem in his Direct Testimony. See, 8 Tr. 1932-1933.

III. CONCLUSION

WHEREFORE, Energy Michigan respectfully requests that the Commission:

A. Should it approve the Incentive Compensation Program that DTE has proposed, it also require DTE to modify the program in accordance with the changes outlined by Mr. Zakem in his Direct Testimony so as to ensure that it better reflects true cost of service principles; and

B. Require DTE to separate the allocation of uncollectibles into a distribution and power supply portion and apply those costs to the appropriate customer classes in accordance with the approach outlined in Mr. Zakem's testimony and exhibits; and

C. Require that DTE modify the captions on its line extension table in C6.2(4)(a) by replacing the word "Full" with "Distribution," as discussed above and in Mr. Zakem's testimony; and

D. Require that DTE set the discount for the D8 interruptible rate at the value of capacity in the MISO region, as discussed above and in Mr. Zakem's testimony.

Respectfully submitted,

Varnum LLP
Attorneys for Energy Michigan, Inc.

July 28, 2015

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In the matter of the application of DTE ELECTRIC COMPANY for authority to increase its rates, amend its rate schedules and rules governing the distribution and supply of electric energy, and for miscellaneous accounting authority.	))))))))	**Case No. U-17767**

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 28th day of July, 2015, she served a copy of the Initial Brief on behalf of Energy Michigan, Inc. in the above-referenced case upon those individuals listed on the attached Service List via email at their last known addresses.

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