



201 N. Washington Square • Suite 910
Lansing, Michigan 48933
Telephone 517 / 482-6237 • www.varnumlaw.com

Timothy J. Lundgren

Direct: 616 / 336-6750
tjlundren@varnumlaw.com

September 19, 2016

Ms. Kavita Kale
Michigan Public Service Commission
7109 W. Saginaw Highway
P.O. Box 30221
Lansing, Michigan 48909

Re: MPSC Case No. U-18014

Dear Ms. Kale,

Attached for electronic filing in the above-referenced matter, please find the Initial Brief of Energy Michigan, Inc., as well as Proof of Service.

Thank you for your assistance in this matter.

Sincerely yours,

VARNUM

Timothy J. Lundgren

TJL/kc

c. ALJ
Parties

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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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-18014

INITIAL BRIEF

OF

ENERGY MICHIGAN, INC.

Tim Lundgren, P62807
Varnum, LLP
Counsel for Energy Michigan, Inc.
201 N. Washington Square, Suite 910
Lansing, MI 48933
(616) 336-6750

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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. The Commission Should Reject DTE' Revenue Decoupling Mechanism As Proposed.

As Mr. Zakem cited in his Direct Testimony, DTE acknowledges that its proposed revenue decoupling mechanism ("RDM") was a "provisionary" proposal for which there is "currently no statutory authority." 4 Tr. 1090. Energy Michigan therefore presumes that the Company, in accordance with its testimony, will "rescind its RDM proposal." *Id.* However, should legislation authorizing an RDM be passed before an Order is issued in this case, Energy Michigan is concerned that the RDM proposed here is subject to a number of faults, which Mr. Zakem outlines in his testimony. See, 6 Tr. 1699-1708. In summary, these are as follows:

- Conflict with DTE’s existing “Performance Incentive Mechanism” for Energy Optimization.
- DTE’s claim of reduction to risk and rate of return, but no such adjustment proposed in its filing.
- No mechanism to return additional and excess revenue that DTE claims is created by DTE’s proposed economic development activities.
- Erroneous application of the RDM surcharge to distribution sales, which results in Electric Choice customers subsidizing reduced power supply revenues.
- Erroneous definition of “non-fuel revenue,” which instead should be defined as revenue that varies by sales level less variable costs.
- Failure to remove monthly customer service charges from non-fuel revenue.
- Failure to address variable O&M charges, which are a reduction of costs if sales decline.

Further, should the Legislature pass a statute authorizing an RDM, the parties in this case will not have had an opportunity to examine DTE's proposed RDM in the context of that statutory approval to see if it accords with legal requirements. For this reason, DTE should be precluded from offering an RDM proposal until there is statutory approval for such a mechanism in place in advance. Energy Michigan would therefore ask that the Commission reject DTE's proposed RDM even if there is legislation passed allowing for the approval of such mechanisms before the issuance of a final Order in this case.

B. DTE's Proposed Economic Development Program Unfairly and Disproportionately Affects Electric Choice Customers and is a Tax on All Ratepayers

1. DTE's Proposed Economic Development Expenses Unfairly and Disproportionately Affect Electric Choice Customers

DTE asserts that the principle reason for it to undertake the proposed economic development expenses is that it will lead to load growth. DTE asserts that this will help to reduce rate pressure. 3 Tr. 234. However, as Mr. Zakem testifies, "[s]ales growth will primarily affect costs in the power supply portion of DTE's business." 6 Tr. 1715. Because electric choice customers do not take power supply, if the expenses of this effort are not first allocated between power supply and distribution and assigned to customers on that basis, then electric choice customers will be paying disproportionately for benefits that they do not enjoy. See, 6 Tr. 1715. They will, in short, be subsidizing the power costs of DTE's full-service customers.

2. DTE's Economic Development Program Amounts to a New Economic Development Tax on DTE's Ratepayers

As Mr. Zakem points out in his testimony, in seeking ratepayer support for its economic development program, DTE is behaving more like a state agency than a regulated electric utility. 6 Tr. 1716-1717. If DTE's shareholders believe that it would be advantageous for the company to invest in economic development in Michigan, then DTE is already able to invest *shareholder* dollars in such activities without needing to seek Commission approval. However, in order to invest *ratepayer* money in such activities, as DTE seeks to do here, DTE should show some direct benefit to those customers, or else the program violates Michigan's cost-causation principles of rate design.

Instead of showing direct ratepayer benefits from the proposed economic development program, DTE points to hypothetical and abstract benefits, such as increased load growth and

sales through the expansion of business in the state, increased number of jobs, improved local economies, and helping customers engage "in the work that utilities provide." 3 Tr. 234-235. When one considers that in the context of physical assets we require a utility to satisfy the principle of "used and useful," the speculative benefits of this program seem very hypothetical indeed. The risk that these benefits will not be produced by DTE's investment of funds should not be shouldered by the ratepayers, but the shareholders, as the shareholders will be the primary beneficiaries of increased business and load growth for DTE, not the ratepayers. Equally important, is the countervailing concern that ratepayer-funded programs such as this one will continue to drive up Michigan's rates, providing an increasing disincentive both to businesses within the state looking to expand, and to new business considering Michigan as a place for new investment.

C. DTE's Incentive Compensation Proposal Needs to Be Modified to Properly Reflect True Costs and Benefits for its Customers.

Energy Michigan recommends that if the Commission approves an incentive compensation mechanism, then it should require 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 is that it fails to tie the performance being rewarded under the program to benefits to customers. See, generally, 6 Tr. pp. 1718-1721. DTE Exhibit A-20, Schedule L5 shows that 62% 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. Five of the eight "operating excellence" measures that DTE provides on Exhibit A-20, Schedule L5, lines 46-59 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, 6 Tr. 1721. 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 37-44.

On rebuttal, DTE witness Lacey stated that he agrees with Energy Michigan that DTE's Exhibit A-20 does not separate and allocate the costs associated with the proposed incentive compensation mechanism into power supply and distribution, but he asserts that such a separation is accomplished in the cost of service and rate design: "While it is true that Exhibit A-20, Schedule L5 does not undertake a functional separation of the costs associated with incentive compensation, the cost of service and subsequent rate design do just that. . . . As 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." 3 Tr. 438-439. Unfortunately, those details of the cost of service study and rate design are not provided on the record in this case. Further, Mr. Lacey does not clarify *how* the incentive compensation expenses are functionalized, only that they are functionalized. Every expense is "functionalized" in the cost of service. Energy Michigan's position is that these expenses have to be functionalized *correctly*. How are the incentive payments for "operating earnings" and "operating earnings per share" functionalized? Do some of these dollars end up in the distribution charge? The record created by DTE – in its testimony and exhibits – does not answer those questions.

In its rebuttal testimony, DTE agrees with Energy Michigan that separation of incentive compensation costs by distribution and power supply is appropriate to ensure that costs are correctly allocated between power supply and distribution and testifies that it has done so in its rate design. Yet DTE needs more specificity, not some generic "functionalization" that is not in the case record. Regulation by the Commission drives accounting – accounting does not drive regulation.

For these reasons, if the Commission decides to approve the Incentive Compensation Program that DTE has proposed, it should also simply and clearly require DTE to structure the program such that only expenses directly a part of providing distribution service be included in distribution rates. Unspecified "functionalization" by DTE does not provide sufficient and precise evidence on the record to allocate fairly the costs of the Incentive Compensation Program to customer classes.

D. DTE's Proposed Change to the Metering Language in the Electric Choice Tariff Should Not Be Accepted Without Modification

As Mr. Zakem explains in his testimony, Energy Michigan does not object to the apparent intent of the change in the Retail Access Service Rider EC2 as proposed by DTE. What is of concern is the language that DTE has chosen to implement the change. 6 Tr. 1722-1724. The section of the tariff proposed for revision addresses when customers who are on electric choice and are expanding their load will be counted as increasing participation in electric choice.

Mr. Zakem's recommendations were as follows:

- 1) Make clear that the word "expand" is here being used with the same meaning as in the Commission's September 29, 2009 Order in Case N. U-15801. He accomplishes this by including the definition.
- 2) Allow both the customer and the company to have input in determining whether or not a metering situation at a customer's site is "impractical".
- 3) Change the DTE waiver language from "may" to "will" – if the installation of a meter is truly impractical, then DTE should not have the "sole discretion" to refuse a waiver, as DTE's language would allow.

Taken as a whole, Mr. Zakem's modifications preserve the intent of the DTE tariff revisions and keep the final decision of “impractical” metering in the hands of the Company. At the same time Mr. Zakem’s proposed modifications acknowledge that the utility does not have "sole discretion" to withhold a waiver unfairly even if the metering situation is impractical for the customer; they also allow the customer to have some voice in the process. Under Mr. Zakem’s proposed modifications, if the customer does not agree with the Company on whether the metering situation is practical or not, the customer will have a right to register a complaint

with the Commission, without the Company claiming that it has “sole discretion” under the tariff.

III. CONCLUSIONS AND PRAYER FOR RELIEF

WHEREFORE, Energy Michigan hereby respectfully requests that the Commission:

- A. Reject the Revenue Deficiency Mechanism proposed by DTE; and
- B. Reject recovery of costs for the Economic Development Program proposed by DTE from ratepayers; and
- C. Should it approve the Incentive Compensation Program that DTE has proposed, also require that DTE functionalize costs and design rates with respect to power supply and distribution costs in accordance with the Testimony of Mr. Zakem and the Rebuttal Testimony of Mr. Lacey, so as to satisfy cost of service principles; and
- D. Require that DTE modify its proposed changes to the electric choice tariff to comply with the changes outlined by Mr. Zakem so as to ensure customers a role in the decision making; and
- E. Provide such other and further relief as the Commission may find lawful and appropriate.

Respectfully submitted,

Varnum LLP
Attorneys for Energy Michigan, Inc.

September 19, 2016

By: _____

Laura A. Chappelle (P42052)
Timothy J. Lundgren (P62807)
The Victor Center
201 N. Washington Square, Ste. 910
Lansing, MI 48933
517/482-6237

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Case No. U-18014

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 19th day of September, 2016, she served a copy of the Initial Brief of Energy Michigan, Inc., as well as this Proof of Service, on the Persons identified on the attached service list via electronic mail.

Kimberly Champagne

SERVICE LIST
MPSC Case No. U-18014

Administrative Law Judge

Hon. Sharon Feldman
Administrative Law Judge
Michigan Public Service Comm.
7109 W. Saginaw Hwy., 3rd Floor
Lansing, MI 48917
feldmans@michigan.gov

Counsel for Attorney General

Bill Schuette

Michael Moody
Celeste R. Gill
John A. Janiszewski
525 W. Ottawa St., 6th Floor
Williams Bldg.
PO Box 30755
Lansing, MI 48909
moodym2@michigan.gov
gillc1@michigan.gov
JaniszewskiJ2@michigan.gov

Counsel for MPSC Staff

Lauren D. Donofrio
Amit T. Singh
Graham Filler
7109 W. Saginaw Hwy., 3rd Floor
Lansing, MI 48919
donofriol@michigan.gov
singha9@michigan.gov
fillerg@michigan.gov

**Counsel for Michigan Cable
Telecommunications Association**

David E. S. Marvin
Fraser, Trebilcock, Davis & Dunlap, P.C.
124 W. Allegan, Ste. 1000
Lansing, MI 48933
dmarvin@fraserlawfirm.com

Counsel for DTE Electric Company

Jon P. Christinidis
Richard P. Middleton
Michael J. Solo
David S. Maquera
Andrea Hayden
One Detroit Plaza, 688 WCB
Detroit, MI 48826
christinidisj@dteenergy.com
middletonr@dteenergy.com
solom@dteenergy.com
maquerad@dteenergy.com
andrea.hayden@dteenergy.com
mpscfilings@dteenergy.com

**Counsel for Association of Businesses
Advocating Tariff Equity**

Robert A.W. Strong
Clark Hill PLC
151 S. Old Woodward Ave., Ste. 200
Birmingham, MI 48009
rstrong@clarkhill.com

Sean P. Gallagher
Michael J. Pattwell
Clark Hill, PLC
212 E. Grand River Ave.
Lansing, MI 48906
sgallagher@clarkhill.com
mpattwell@clarkhill.com

James Dauphinais
Michael Gorman
Brubaker & Associates, Inc.
16690 Wingley Ridge Road, Suite 140
Chesterfield, MO 63017
jdauphinais@consultbai.com
mgorman@consultbai.com

Counsel for Michigan Environmental Council, Natural Resources Defense Council and Sierra Club

Christopher M. Bzdok
Tracy J. Andrews
Olson, Bzdok & Howard P.C.
420 East Front St.
Traverse City, MI 49686
chris@envlaw.com
tjandrews@ymail.com
karla@envlaw.com
kimberly@envlaw.com

Casey A. Roberts
Sierra Club
85 Second St., 2nd Floor
San Francisco, CA 94105
Casey.roberts@sierraclub.org

Shannon Fisk
Earthjustice
1617 John F. Kennedy Blvd., Suite 1130
Philadelphia, PA 19103
sfisk@earthjustice.org

Counsel for The Kroger Co.

Kurt J. Boehm
Jody Kyler Cohn
Boehm, Kurtz & Lowry
36 East Seventh St., Ste. 1510
Cincinnati, Ohio 45202
KBoehm@BKLawfirm.com
JKylerCohn@BKLawfirm.com

Anthony J. Szilagyi
Law Offices of Anthony J. Szilagyi, PLLC
110 South Clemens Ave.
Lansing, Michigan 48912
szilagylaw@sbcglobal.net

Kevin Higgins
Energy Strategies, LLC
Parkside Towers
215 South State Ste, Ste. 200
Salt Lake City, Utah 84111
khiggins@energystrat.com

Counsel for Utility Workers Local 223

John Canzano
Lilyan N. Talia
Mcknight, Mcclow, Canzano,
Smith & Radtke, P.C.
400 Galleria Officentre, Ste. 117
Southfield, MI 48034
jcanzano@michworkerlaw.com
ltalia@michworkerlaw.com

Counsel for Residential Customer Group

Brian W. Coyer
Don L. Keskey
Public Law Resource Center, PLLC
University Office Place
333 Albert Ave., Ste. 425
East Lansing, MI 48823
bwcoyer@publiclawresourcecenter.com
donkeskey@publiclawresourcecenter.com

Counsel for Detroit Public Schools

Michael G. Olivia
Leah J. Brooks
Loomis, Ewert, Parsley, Davis & Gotting, PC
124 W. Allegan St., Ste. 700
Lansing MI 48933
mgoliva@loomislaw.com
ljbrosks@loomislaw.com

Counsel for Wal-Mart Stores East, LP, and Sam's East, Inc.

Tyler D. Tennent
Dawda, Mann, Mulcahy & Sadler, PLC
39533 Woodward Ave., Ste. 200
Bloomfield Hills, MI 48304
ttennent@dmms.com

Rick D. Chamberlain
Behrens, Wheeler & Chamberlain
6 N.E. 63rd St., Ste. 400,
Oklahoma City, OK 73105
rdc.law@gmail.com

**Counsel for Municipal Street Lighting
Coalition**

Constance De Young Groh
John R Liskey Attorney At Law
921 N. Washington Ave
Lansing, MI 48906
cdgroh@liskeypllc.com