STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the Matter of the Application of The Detroit Edison Company for certain determinations pursuant to Sections 32(c) and (d) of the Public Utility Holding Company Act of 1935 and for accounting Approval for the transfer of certain assets	)))))))	Case No. U-12266

RESPONSE OF THE DETROIT EDISON COMPANY TO PETITIONS TO INTERVENE AND REQUESTS FOR HEARING FILED BY ENERGY MICHIGAN, INC., THE ASSOCIATION OF BUSINESSES ADVOCATING TARIFF EQUITY, AND ATTORNEY GENERAL JENNIFER M. GRANHOLM

THE DETROIT EDISON COMPANY ("Edison" or "Company") by its attorneys submits this Response to the Requests for Hearing and Petitions to Intervene filed by Energy Michigan, Inc., The Association of Businesses Advocating Tariff Equity, ("ABATE") and Attorney General Jennifer M. Granholm ("Attorney General") in this docket.

I. INTRODUCTION

The three parties filing Petitions to Intervene in this captioned proceeding make similar arguments. The parties have fundamentally misconstrued the nature of Edison's filing and what is being asked of the Commission. Edison through its affiliate, DTE River Rouge No. 1 LLC, is proposing to refurbish and restart a generating unit (River Rouge Unit No. I) that is 43 years old and has not been used in any fashion by Edison to serve its retail customers for two decades. Edison is not asking in this Application for permission to purchase Rouge 1's capacity and energy, and Edison has not asked the Commission, in this case, to approve any such sale to Edison. Rather, Rouge 1 capacity and energy will be made available to competitive retail marketers in Michigan in 2000 and 2001 to meet the capacity needs of Michigan customers. This is a pro-competitive proposal which increases the amount of competitive capacity available in Michigan. Moreover, Edison's ratepayers will in no way bear the cost of bringing this newly-available Rouge I capacity to the retail market.

The points raised by the three intervenors are largely extraneous to the question Edison has placed before the Commission: whether, consistent with Section 32(c) of the Public Utility Holding Company Act of 1935 ("PUHCA"), it will benefit consumers, be in the public interest and not violate state law for Edison to transfer Rouge 1 to DTE River Rouge and allow it to be an "eligible facility" for Exempt Wholesale Generator purposes. Although the points raised by intervenors are irrelevant to the question being asked of the Commission in this proceeding, Edison addresses intervenors' points below. Even after these extraneous arguments are considered, the fact is, Michigan is short on in-state generation capacity. Edison has proposed a means to bring new generating capacity to the Michigan market in a timely manner without risk, and with clear benefit to ratepayers.

II. DISCUSSION

A. Transfer of the River Rouge Unit No. 1

All responding parties have argued that the transfer price for the River Rouge Unit No. 1 ("Rouge 1") power plant may be too low. Both ABATE and Energy Michigan suggest that the only proper way to value Rouge 1 is through independent appraisal or auction of the plant.

Support for the Rouge 1 transfer price is set forth in the Affidavit of David B. Harwood attached to the Company's Application. The affidavit explains that the age and condition of the Rouge 1 plant and the fact that it shares common facilities with Rouge Units 2 and 3, supports a transfer price of two times book value, which represents a price that is greater than the average transfer price for currently operating fossil plants. Mr. Harwood based his assessment on an analysis of comparable sales of fossil units taking into consideration the age, condition and specific physical configuration of Rouge 1. Given that Rouge 1 is a 43 year old unit that has been inoperable for two decades, has pieces of key operating equipment missing, and shares common facilities with other units, there can be no serious question that the valuation process used by Mr. Harwood is prima facie reasonable and can be relied on by the Commission for making its findings in this Application.

Nevertheless, Edison acknowledges that there are a number of valuation methodologies that could be used to value fossil-fired power plants, and that differing transfer prices can be calculated depending on the valuation approach used. Furthermore, electric utility restructuring legislation recently introduced in the Michigan Senate specifies a number of alternative methodologies for valuing power plant assets. Based on the uncertainty over which method is appropriate, Edison will agree, as a condition of Commission approval of its Application, to undertake revaluation of Rouge 1 in the future if legislation is passed that directs the use of valuation methods that are different than the method used here by Edison. However, any future revaluation must be subject to a reasonable valuation cap in recognition of the substantial economic risk faced by Edison's affiliate, to renovate, convert and restart the plant and that without a cap, would be subjected to additional economic risks and uncertainty.

In response to a related issue raised by ABATE, Edison agrees that in this instance it would be reasonable to credit the gain above book value realized by Edison from the transfer of Rouge 1 against existing stranded costs.

Edison categorically rejects any suggestion by Energy Michigan that Rouge 1 should be auctioned to a third party. First, there is no justification for a forced divestiture of Rouge 1 other than Energy Michigan's self-serving desire to obtain generation for its members. Second, Edison has not sought approval from the Michigan Public Service Commission to sell its plant and the Commission lacks the requisite authority to order the Company to sell the plant against its will. (See Consumers Power Co., v MPSC, 460 Mich 148; 596 NW2d 126 (1999)). Third, a forced sale of Rouge 1 is simply bad public policy. There is no guarantee that if the Rouge plant was sold to a third party its capacity would stay in Michigan to serve the Michigan retail access market. Further, the sale of Rouge 1 capacity to an independent third party does nothing to assist Edison in meeting its obligation to serve native load in the Summer of 2000 and to provide retailers in Michigan with access to an immediate new source of generation.

B. Rate Basing Versus Exempt Wholesale Generating Status

Both Energy Michigan and the Attorney General suggest that the appropriate course of action is for Edison to bear the cost of renovating and restarting Rouge 1 and to return the plant as a rate base unit, instead of seeking status as an Exempt Wholesale Generator. Edison believes that a decision to restart Rouge 1 as a rate base unit is not sound public policy and flies in the face of the Commission's public determinations that retail access and electric choice for Michigan customers should come sooner rather than later. The national trend is that States are enacting electric utility restructuring legislation that is transitioning the industry to deregulation. The very recent introduction of legislation in the Michigan Senate confirms that trend. Either under the Commission's electric choice orders or under some future legislative enactment, electric choice will come to Michigan customers within the next several years. As a result, Edison will lose load to electric choice and strand generation assets.

Placing Rouge 1 into rate base at this time so that Edison can recover its investment over some thirty years as is the case under traditional ratemaking, is fundamentally inconsistent with the deregulation of generation. With the loss of retail access load there would be no guarantee that the Rouge 1 unit, even if it is found to be "used and useful" today, would remain "used and useful" in the future. In short, rate basing Rouge 1 only adds more risk that Edison will incur additional stranded costs in the future. Because of these financial risks to both Edison and its customers, Edison has relied on short term seasonal purchases, generally from firm out-of-state suppliers to serve its summer peak load.

Edison has concluded that it would face substantial economic risks if it undertakes the restart and conversion of Rouge 1 as a utility rate-based generation unit. At the same time, Edison recognizes the need for additional in-state generation capacity as well as the need to "jump start" the State's electric choice program.

Accordingly, Edison has proposed to transfer Rouge 1 to an unregulated affiliate so that the affiliate can restart Rouge 1. While the affiliate will assume all market, operational and residual value risks of Rouge 1, there will be a corresponding opportunity to earn market returns by charging competitive wholesale prices. The only way to accomplish this is though the grant of EWG status for River Rouge 1. The transfer of Rouge 1 to an unregulated affiliate as an Exempt Wholesale Generator is simply good public policy, which reflects both the national legislative trend as well as recently-introduced legislation in Michigan requiring that all utility generation be functionally separated from the requested utility and placed into an affiliate as a part of electric restructuring. The transfer of generating assets to utility affiliates is widely used in all states where electric deregulation legislation has been enacted and the concept is also embraced in recently-introduced Michigan legislation,

C. Affiliate Abuse

ABATE, and in particular, Energy Michigan, raise the issue that the transfer of Rouge 1 to an affiliate will interfere with the creation of an independent and openly competitive market for generation. ABATE and Energy Michigan raise an extraneous issue that is not before the Commission in this case and which the Commission need not address in order to make the requisite determinations under PUHCA. Nonetheless, although this issue is outside the scope of what is being asked of the Commission in this case, Edison must respond to the alleged potential "affiliate abuse" issues raised by the parties.

1. Sellback of Capacity to Edison

As stated in the Company's Application, the power generated by Rouge 1 will be offered to marketers serving retail access load in Michigan. It is possible, however, that any unused capacity could be sold back to Edison to serve native load as implied by Energy Michigan. There is nothing inherently wrong with this option from a regulatory standpoint. If Edison needs additional power, it will have to buy the power at market prices from suppliers likely located outside of Michigan. If, in fact, Edison decides that it needs excess Rouge power, and that power is available, consistent with Section 32(k) of PUHCA, it must obtain a determination from this Commission to purchase energy from its affiliate. But, as noted above, that is not an issue before the Commission in this proceeding. Edison has not requested that the Commission make the determinations in Section 32(k) of PUHCA necessary for DTE River Rouge to sell capacity to Edison.[1] When and if Edison decides to purchase capacity from DTE Rouge River, it will make the requisite filing with the Commission. In this proceeding, the issue is premature and certainly not before the Commission.

Further, the proposed transfer will not increase Edison's rates via the PSCR or otherwise. In this regard, however, Edison notes that Rouge 1 is inoperable and has not been used for two decades to meet the power needs of Edison's ratepayers. No operating costs of the unit are reflected in rates and ratepayers receive no current energy, capacity, or operating reserve value from River Rouge 1. Transfer of the unit (and refurbishment at shareholder expense) does not deprive ratepayers of any ongoing

[1] In this regard, Edison is perplexed by paragraph 5 of Energy Michigan's filing, which appears to quote from Edison's Application for Commission approval for such an affiliate sale. There is no such quote in Edison's Application. Energy Michigan's "quote" underscores that it misunderstood what Edison has requested of the Commission in this case.

rate benefits from the unit. Edison's ratepayers, rather, stand to benefit by selling an old unit for twice its book value, which (as discussed above) will reduce Edison's stranded costs, and by having another generating resource available to third party retailers in Michigan to meet their power needs.

In any event, it would be unwise and premature to summarily deny Edison the option of purchasing excess power from Rouge 1 given the fact that it has no reasonable way today to determine how much retail access load will be leaving its system by Summer 2000, or whether it will be required to provide standby generation support for such load. This is all the more true given, as explained above, that Edison must file for a Commission determination under Section 32(k) of PUHCA in order to purchase such capacity.

2. <u>Alleged Subsidization of DTE River Rouge No. 1, L.L.C. by Detroit Edison</u>

Energy Michigan alleges that since Rouge 1 will be sharing facilities with Edison, there is a strong possibility for a cross-subsidization and affiliate abuse if Edison is hired to operate and maintain Rouge 1. Should this occur, the Commission has sufficient power to audit Edison's books and records, which should guarantee that there will be no affiliate abuse or cross-subsidization. Moreover, it is incorrect that Edison will supply natural gas fuel for Rouge 1. River Rouge 1 will independently procure its own fuel.

D. <u>Exacerbation of Market Power</u>

The scenario alleged by Energy Michigan that the transfer of Rouge 1 to an affiliate can only increase Edison's market power is absolutely false and without any basis in fact. The simple fact of the matter is that nearly one hundred percent of Edison's generating capacity is sold under MPSC tariffs and, therefore, there is by definition, no way for Edison to exert any market power. Moreover, any argument that Edison could withhold capacity fails because Edison has an obligation to serve customers and the withholding of generation to affect market control would be antithetical to this obligation. Correspondingly, DTE River Rouge will be selling in an unregulated market and must generate output to recover its investment and stay in business. DTE River Rouge has already offered this capacity to Michigan marketers as demonstrated in the Affidavit of John C. Guillaumin, attached as Exhibit A. Ironically, it's the regulatory uncertainty over the transfer of Rouge 1 that poses the biggest threat to its marketability.

Finally, Energy Michigan makes an allegation that is irrelevant to the question before the Commission in this case. In Paragraph 13 of its petition, Energy Michigan alleges that Edison and/or its affiliates are conspiring to control transmission import capacity into Michigan in an effort to reap higher prices for Rouge 1 output. The status of import capacity into Michigan (which is set forth in the affidavit of Alexander J. Zakem, attached to this Response as Exhibit B) is not as Energy Michigan states.

Edison has determined that it will need 2,050 MW of purchase power to serve all its native load in southeastern Michigan for the Summer of 2000, given the uncertainty as to the amount of retail access load that will leave the Edison system prior to this summer. To date, Edison has purchased rights to 1,430 MW of ECAR transmission capacity to Michigan for the summer of 2000. It is untrue that Edison's affiliates have purchased any transmission capacity into Michigan for the Summer 2000.

Edison acknowledges that at certain times of the year transmission capacity into Michigan can be constrained; however, third party suppliers can still purchase transmission capacity to Michigan. Any supplier serving Michigan customers can purchase network transmission service equivalent in firmness to Edison's capacity which will enable the importation of power. The decision to restart Rouge 1 offers additional capacity in Michigan and lessens the need for transmission import capacity.

In addition, as explained in the Zakem affidavit, there is some 330 MW of capacity located and available in Michigan owned by entities unaffiliated with Edison that to date has not been sold to Edison and therefore, can be used to serve retail access load in direct competition with the output of Rouge 1. Therefore, it is irresponsible to allege, as Energy Michigan has, that the transfer of Rouge 1 to an affiliate and the sale of its output to serve the Michigan retail access market stands as an abuse of affiliate power.

E. Legal Support for Expedited Commission Approval

The Attorney General raises several legal objections to the expedited resolution of Edison's Application by the Commission. First, there is absolutely no requirement under the Michigan Administrative Procedures Act that a contested case proceeding be held in order to make the findings requested of the Commission in this proceeding. Second, the Attorney General's citation of an unpublished Court of Appeals opinion as grounds for a hearing in this case is equally misplaced. The fact remains that Edison's Application does not result in a rate increase to customers under MCL § 460.6a. Therefore, there is no requirement that the Commission hold a contested case hearing to make the findings requested in Edison's Application. (See Attorney General v MPSC, 206 Mich App 290; 520 NW2d 636 (1994). Attorney General v MPSC, 220 Mich

App 561; 560 NW2d 348 (1996); Attorney General v MPSC, 227 Mich App 148; 575 NW2d 302 (1997).

III. CONCLUSIONS

The arguments raised by intervenors demonstrate a fundamental misunderstanding of what Edison has requested of the Commission in this case. Edison proposes to make available a generating unit that has not been used for two decades. Capacity from Rouge 1 will be made available to third party retailers in the competitive marketplace. Edison is not requesting approval to purchase capacity from Rouge 1 and will not do so without obtaining the required determinations from the Commission under PUHCA to effectuate such sale. Edison's filing involves a highly specific set of facts. The broad arguments raised by intervenors are extraneous to the narrow question before the Commission.

The single common argument raised by the three parties seeking intervention in this case concerns the appropriate transfer price to be paid for the Rouge 1 generating facility. As noted above, that question is irrelevant to the findings required by the Commission to satisfy the PUHCA requirements in Section 32(c). Edison believes that it has presented a prima facie case supported by a credible affidavit for the transfer price. Nonetheless, Edison acknowledges that there may be other valuation methodologies to determine the price that could be paid for the Rouge 1 asset. Therefore, Edison agrees to undertake revaluation of the transfer price should legislation pending in the Michigan Legislature be enacted that directs the consideration of a different valuation method than used by Edison, subject to a reasonable cap to recognize the substantial economic risk DTE River Rouge bears to renovate and restart Rouge 1.

A second concern expressed by the parties (and again, one that has nothing to do with the PUHCA determinations requested of the Commission in this case), is the potential impact the transfer of Rouge 1 to an affiliate will have on the potential for cross-subsidization between Edison and its affiliate.. Edison believes that it has demonstrated that such concern is simply unjustified because sufficient regulatory tools are available to the Commission, including access to books and records, to monitor the relationship between Edison and its affiliate to prevent any affiliate abuse.

Third, Edison believes that it has demonstrated that the correct and more sound public policy decision in this case should be to promote transition to a full, competitive electric market by encouraging the transfer of Rouge 1 to an affiliate so that the output of the unit will be used to serve marketers participating in the retail access program in Michigan in 2000 and 2001.

The fact is, Michigan is capacity short. Edison has proposed a means to bring new generating capacity to the Michigan market through sales to third-party retailers. Michigan consumers will be better off with Rouge 1 capacity being made available through DTE River Rouge than without Rouge 1. It is crucial for the Commission to make the findings requested in Edison's application now, without further delay, to insure that the Rouge 1 capacity will be available to serve the Michigan market this summer.

In conclusion, Edison requests that the Commission make determinations pursuant to Sections 32(c) and (d)(2) of PUHCA that allowing Rouge 1 to be an "eligible facility" (1) will benefit consumers, (2) is in the public interest, and (3) does not violate state law. Further, Edison respectfully requests that the Commission grant the necessary accounting approval to transfer the Rouge 1 asset to DTE River Rouge No. 1, L.L.C. effective with an order issued in this case as described in its Application, and that such findings and authorization be made without the initiation of a protracted, time-consuming contested case proceeding.

WHEREFORE, The Detroit Edison Company respectfully requests that the Commission deny the requests for hearing and petitions to intervene filed on behalf of ABATE, Energy Michigan and Attorney General, Jennifer M. Granholm

Respectfully submitted,

THE DETROIT EDISON COMPANY

Bruce R. Maters
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BRUCE R. MATERS P28080
Attorney for Detroit Edison
2000 Second Avenue, 688 WCB
Detroit, MI 48226
313/235-7481

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