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October 12, 2001

Ms. Dorothy Wideman
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
Lansing, MI 48911

Dear Ms. Wideman:

Re: MPSC Case No. U-12892

I am enclosing for filing an original and 4 copies of the Attorney General's Initial Brief. I am also enclosing a proof of service. In addition, I am submitting a copy of this brief in PDF electronic format.

Sincerely,

Donald E. Erickson

Donald E. Erickson
Assistant Attorney General

c All Parties
sld/cases/U-12892

PROOF OF SERVICE - U-12892

The undersigned certifies that a copy of the Attorney General's Initial Brief was served upon the parties listed below by mailing the same to them at their respective addresses with first class postage fully prepaid thereon, or by State Interdepartmental mail as indicated, on the 12th day of October 2001

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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 recover implementation costs for the period ended December 31, 2000

MPSC No. U-12892

____/

Attorney General's Initial Brief

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October 12, 2001

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History and Background

On March 29, 2001, The Detroit Edison Company (DECo or the Company) filed an application in this case. The application requests the Michigan Public Service Commission (MPSC or Commission) to approve the prudence and recovery of $28 million in electric restructuring implementation costs incurred and booked during 2000.

The captioned case has its origins in electric industry restructuring cases previously decided by the Commission; therefore, portions of those decisions relating to implementation cost recovery and true-up mechanisms should be discussed and considered as a foundation for deciding the issues in the captioned case.

A. Previous Case Decisions

On January 8, 1996, Governor John Engler forwarded to the Commission recommendations from the Michigan Jobs Commission entitled "A Framework for Electric and Gas Utility Reform." That document advocated various changes to the electric industry in Michigan. After receiving that document, the MPSC conducted public hearings in Case No. U-11076, which the MPSC closed on June 5, 1997, without further action.

Meanwhile, on December 19, 1996, the Commission Staff (Staff) filed a document entitled "Staff Report on Electric Industry Restructuring." In response to that report, the MPSC issued an "Order and Notice of Public Hearings" dated December 20, 1996, in Case No. U-11290. Based upon discussions at public meetings during January 1997, the MPSC then issued an "Order Requesting Comments and Notice of Hearing" on February 5, 1997. The Commission ordered DECo and Consumers Power Company [now Consumers Energy Company

(CECo)] to make informational filings no later than March 7, 1997, and scheduled public hearings and additional written comments.

On June 5, 1997, the Commission issued an Opinion and Order in Case No. U-11290 signed by a 2-1 majority. The majority opinion concluded that a framework for a customer choice program outlined in the opinion is reasonable and should be adopted. Among other things, the opinion addressed so-called "stranded costs" which had been discussed in the Staff's Report as well as in the informational filings made by CECo and DECo. The Staff's Report had defined stranded costs either as costs incurred during the regulated era that will be above market prices or as costs necessary to facilitate the transition to competitive markets. The Staff Report described the following categories of cost as stranded costs:

1. Regulatory assets.
2. The net book costs of nuclear facilities.
3. The above-market capacity costs of purchase power agreements.
4. Employee related restructuring costs, which would not be incurred absent restructuring.
5. Other costs associated with restructuring, such as establishing an independent system operator, creating new billing software systems, new metering systems, etc.

Pages 7-14 of the June 5 Opinion and Order discuss stranded costs. Page 11 of the Opinion and Order concludes that the Staff Report provides a reasonable basis for determining stranded costs and that stranded cost recovery is an important element of electric restructuring because such recovery is needed to protect the interests those who wish to remain traditional sales customers of the serving utility as well as to protect utilities. But, page 11 concludes that stranded cost recovery needed to be clarified and supplemented with a true-up process. Page 12 said that the Commission is committed to ensuring that customers who choose to remain sales customers of the existing utility are not harmed by the change, discusses that some stranded costs are already included in existing sales rates, and says that it would not be equitable to increase rates for customers remaining on sales service to pay for costs associated with customers who choose direct access service. The majority also said that it would not be appropriate to disallow the recovery of costs prudently incurred by the utilities.

Pages 12-13 of the June 5 opinion conclude that imprudent costs will not be included in determining stranded costs. With regard to costs which a utility would not incur absent a direct access program, pages 12-13 conclude: (1) it would be inappropriate to disallow recovery of prudently incurred costs, (2) it would be inappropriate to require customers who do not wish to participate in direct access to bear these costs, and (3) such costs should be included in a transition charge if such costs are prudently incurred.

Page 14 of the June 5 opinion addresses concerns regarding estimates of the market price of power, the potential for stranded benefits, and the need to encourage utility mitigation measures. Then, page 14 states:

> The Commission concludes that an annual true-up mechanism is necessary to assure that electric restructuring is carried out in a manner that protects the public interest. With this order, the Commission directs Consumers and Detroit Edison to file proposals for establishing a true-up mechanism. The Commission envisions that such a mechanism would provide for annual adjustments up or down to stranded costs to reflect changes in the actual market price of power from a base point and other relevant factors. Proposals should incorporate a method of measuring the price of power actually paid by customers in the market, an appropriate base point, and a method for adjusting from that base point.

However, in the June 5 opinion, the Commission did not establish any stranded cost charge or mechanism.

On July 14, 1997, the Commission issued a multi-captioned Order and Notice of Hearing in Case Nos. U-11290, U-11449, U-11451, U-11452, U-11453, U-11454, and U-11456. Page 4 of that notice of hearing indicated that the Commission would consider issues related to a true-up mechanism in Case No. U-11454. A prehearing conference and evidentiary hearings were conducted, and briefs and reply briefs were submitted in Case No. U-11454. A 2-1 majority of the Commission in Case No. U-11454 issued an Opinion and Order on October 29, 1997.

Pages 5-9 of that Opinion and Order address issues concerning the MPSC's authority to impose recovery of stranded costs and conclude that doing so would not be unlawful. Pages 9-10 conclude that it is necessary for the true-up mechanism to include an adjustment for sales. Pages 10-11 conclude that it is necessary for the true-up mechanism to include an adjustment for transition cost bids. **Page 11 concludes that implementation costs related to restructuring should be reviewed in annual true-up proceedings.** Page 18 of the Opinion and Order approves an annual true-up mechanism as described in the order for CECo and DECo.

Various parties sought rehearing from the June 5 order as well as the October 29 orders, and on January 14, 1998, the Commission issued its "Rehearing on Restructuring." Pages 11-15 of that order address rehearing petitions related to stranded costs. Page 11 acknowledges that CECo had calculated total stranded costs of $2,107 million, that DECo had calculated stranded costs of $3,254 million, that the Commission's previous orders did not make any findings regarding the calculation of stranded costs and proposed charges for recovering those costs, and that the Commission had previously determined that those issues should be deferred to future true-up proceedings. But, page 12 of the order concludes that the Commission should make an initial estimate of stranded costs and related charges and confirms that customers who choose not to participate in open access will not be paying a stranded cost charge. Pages 13-14 of the order calculated $2,483 million in stranded costs and a transition charge of 1.25¢/kWh for DECo.

Pages 15-19 of the January 14 order address rehearing of the true-up mechanism. Page 16 concludes that CECo and DECo should file their true-up proposals by March 31 of each year for the preceding calendar year. Page 18 of the order states:

> Several parties requested clarification of the true-up methodology. Although the Commission believes that the October 29, 1997 order in Case No. U-11454 adequately describes the true-up mechanism, the following description should clarify the methodology in light of the additional decisions made in this order.
>
> 1. The Commission has estimated stranded costs based upon the sales volumes proposed by Consumers and Detroit Edison. To the extent that the actual volumes, either for open access customers or for those who remain full-service customers, vary from those used in the estimate, stranded costs will be recalculated using the actual volumes in place of the estimates.
>
> 2. The Commission has estimated stranded costs based upon a market price of 2.9¢/kWh in 1998, escalated thereafter at the same rate used by the utilities. To the extent that the actual market price varies from that used in the estimate, the stranded costs will be adjusted up or down by the product of multiplying the actual open access volumes for that year by the difference between the estimated market price and the actual market price.
>
> 3. During the years 1998 through 2001, if the bid amount differs from the actual stranded cost, based upon the actual sales volumes and actual market price for each year, then the difference will be added to or subtracted from the stranded cost amount, as appropriate.
>
> 4. If any costs are found to be imprudent in a rate or PSCR proceeding, an equivalent adjustment will be made in calculating stranded costs.
>
> 5. **If a utility incurs any implementation costs for restructuring, those costs should be reviewed for prudence in the annual true-up proceeding and stranded costs adjusted appropriately.**
>
> This methodology would apply if there is no securitization of assets associated with stranded costs. If securitization is authorized, then it will be necessary to develop an additional true-up mechanism to assure repayment of the principal and interest of the securitized assets. The stranded cost true-up described above would then have to be modified to work in conjunction with the securitization true-up to ensure that the total securitization and transition charges do not result in an over- or under-recovery of costs. (emphasis added)

The MPSC agreed to clarify its June 5, October 29, and January 14 orders, and in response to clarification motions the Commission issued its "Order" on February 11, 1998. With regard to the true-up mechanism, page 6 of the February 11 order states:

> The January 14 order provided a more detailed description of some but not all of the issues to be considered in the annual stranded cost true-up proceeding than was contained in the October 29 orders. ABATE's motion seeks clarification that the Commission's discussion of the stranded cost true-up proceeding in the January 14 order was not intended to restrict or eliminate issues that the Commission had previously found to be relevant in the October 29 orders, such as mitigation and netting. The Attorney General also seeks clarification regarding the issues that may be addressed in the true-up proceedings. Detroit Edison and Consumers also indicate that additional clarification is needed and, in its answer to the motions for clarification, Consumers proposes a formula that it says is consistent with the methodology set forth by the Commission.
>
> The Commission's discussion in the January 14 order was in response to requests for a more detailed description of the true-up methodology. **The discussion was not intended to restrict or eliminate any issues, such as mitigation, that the Commission had previously found to be relevant.** Rather, the intent was to provide additional details on specific issues to the extent that such details can be provided at this time. (emphasis added)

On March 8, 1999, the MPSC issued a multi-captioned Opinion and Order in Case Nos. U-11290, U-11449, U-11451. U-11452, U-11453, and U-11454. The March 8 order addresses implementation plans filed by CECo and DECo. Pages 27-29 of the order address CECo's and DECo's implementation cost recovery proposals for 1998. Page 28 notes that CECo and DECo were scheduled by previous orders to file their true-up proposals for 1998 by March 31, 1999, but concludes that a slightly modified proceeding for 1998 would be helpful because: (1) the true-up is needed to review the prudence of any implementation costs incurred by the utilities and (2) there are significant policy decisions which need to be addressed in the first true-up proceedings. Thus, the MPSC found that CECo and DECo should file true-up applications by March 31, 1999. Finally, because the prudence of implementation costs would be addressed in the true-up proceedings, page 29 of the order finds that the MPSC should grant CECo's and

DECo's requests for deferred accounting of implementation costs and associated tax-timing differences. Effective June 5, 2000, the Legislature enacted 2000 PA 141 and 2000 PA 142. Among other things, 2000 PA 141 adds MCL 460.10a(5) to 1939 PA 3 and ratifies the orders described above.

DECo's made its initial implementation cost filing in MPSC Case No. U-11956, and that case was consolidated with CECo's application in U-11955. In U-11956, DECo requested recovery of 1998 implementation costs totaling $7.5 million. On October 24, 2000, the MPSC issued its Opinion and Order in Case Nos. U-11955 and U-11956. On pages 4-5 of that order, the Commission stated:

> Prior to discussing the implementation costs actually incurred during and before 1998, **the Commission would emphasize that simply incurring costs to implement Michigan's retail open access program is not a sufficient justification for their recovery.** Expenditures associated with the implementation of the retail open access programs must produce results. Procedures, policies, methods, or electronic data interfaces that prove to be ineffective, inefficient, or unworkable may not entitle the company to recover the costs of those systems.
>
> Because very little retail open access load is currently being served, it is difficult for the Commission to judge the effectiveness of Consumers' and Detroit Edison's implementation programs at this time. The Commission notes, however, that it expects Consumers and Detroit Edison to file information in their 2000 and 2001 true-up cases from which the Commission can determine the effectiveness of the implementation costs that the companies seek to recover.
>
> **For purposes of the present case, the Commission has reviewed the expenditures on the record and has granted deferred recovery as appropriate. However, it would caution the parties that these findings are conditional. If subsequent events reveal that costs were incurred for projects or systems that ultimately prove to be ineffective, inefficient, or unworkable or otherwise impede the progress to retail open access, the Commission reserves the right to undertake another review of those costs and may foreclose their recovery.** (emphasis added)

Subject to these conditions, the MPSC approved deferred recovery of $6,921,040 in U-11956.

In MPSC Case No. U-12359, DECo filed an application requesting the MPSC to approve recovery of $21 million in 1999 implementation costs. Subject to conditions set forth in previous orders in U-11955/U-11956 and in U-12478, the MPSC issued an order in U-12359, which authorized recovery of $20.4 million for 1999 implementation costs.

In DECo's securitization case (MPSC Case No. U-12478), the MPSC addressed a variety of issues, including recovery of implementation costs. Pages 10-11 of that order state:

> d. <u>Implementation and customer education</u>
>
> The Staff recommends excluding the non-incremental labor costs for 1998 and 1999 because those costs are already reflected in rates. 3 Tr. 596. It recommends excluding the implementation costs for 2000 and the customer education costs because those are forecasts that the Staff has not been able to audit for reasonableness and prudence and are similar to items that the Staff has contested in past cases. 3 Tr. 612. On the other hand, the Staff does not oppose recovery of reasonable and prudent implementation costs in some other manner. Detroit Edison accepts the Staff's adjustment for 1998 and 1999. 2 Tr. 350-351. For the other costs, it proposes to use actual costs (or the most accurate estimates available) at the time it issues the bonds and to file reports with the Staff. 2 Tr. 351.
>
> ABATE, the Attorney General, Energy Michigan, and Plastipak argue that the Commission should exclude the costs of implementation and customer education. They argue that neither set of costs has been reviewed by the Commission. The Attorney General argues that the implementation costs should be addressed in other cases where it can be determined whether the costs are incremental costs caused by ROA and prudently incurred.
>
> The Commission adopts the Staff's view that costs for 1998 and 1999 that are non-incremental should not be securitized. The Commission adopted the Staff's adjustment to the costs incurred through 1998 in its October 24, 2000 order in Cases Nos. U-11955 and U-11956, the transition cost true-up cases for Consumers and Detroit Edison, respectively. It is reasonable to treat the costs for 1999 in the same manner. **The Commission does not find that all of the costs for 1998 and 1999 should be disallowed. As noted above, the Commission granted conditional approval to some of those costs in Cases Nos. U-11955 and U-11956.** Further, it finds that the estimated costs for 2000 and the customer education program should not be securitized until there has been an opportunity for review. As discussed below, Detroit Edison may treat those costs as regulatory assets, and may seek recovery as appropriate in other proceedings. (emphasis added)

B. <u>Evidentiary Record</u>

The record in this case consists of testimony and exhibits from Mr. Joseph A. McCormick on behalf of DECo and from Ms. Nancy G. Katsarelas on behalf of the MPSC's Staff. The testimony and exhibits were bound into the record by stipulation without cross examination.

Mr. McCormick described DECo's costs totaling $28,269,326 (2 T 14-18). He testified that these actual expenditures were lower than previous forecasts because of lower than forecasted participation in electric choice (2 T 18-19). He also proposed recovery of the implementation costs pursuant to the recommendations presented by Mr. VanHaerents in MPSC Case No. U-12639 (2 T 19).

Ms. Katsarelas described the Staff's audit of DECo's 2000 program costs (2 T 25). Ms. Katsarelas testified that DECo's calculations include $1,044,037 of non-incremental labor costs, and she said that this sum should be removed from the $27,360,033 implementation costs before carrying costs are computed (2 T 26-27). In addition, she said that the Staff's audit did not include an evaluation of DECo's electric choice program (2 T 27). As a result, Ms. Katsarelas recommended approving $27,225,289 for 2000 (2 T 27 & Exhibit S-3).

Arguments

The Attorney General contends that the MPSC should decide the present case in a manner consistent with its prior decisions in U-11956 and U-12359. The MPSC should approve deferred recovery of non-incremental costs that were reasonably and prudently incurred. However, as the Commission ruled in U-11956, simply incurring costs to implement Michigan's retail open access program is not a sufficient justification for their recovery. Expenditures associated with the implementation of the retail open access programs must produce results. Procedures, policies, methods, or electronic data interfaces that prove to be ineffective, inefficient, or unworkable may not entitle the company to recover the costs of those systems.

As the Commission did in Case Nos. U-11956 and U-12359, it should rule that if subsequent events reveal that costs were incurred in 2000 for projects or systems that ultimately prove to be ineffective, inefficient, or unworkable or otherwise impede the progress to retail open access, then the Commission should reserve the right to undertake another review of those costs and foreclose their recovery.

Applying these rulings to the current record, the Attorney General contends that the MPSC should adopt the Staff's proposed disallowance of $1,044,037 for non-incremental labor costs. This would result in approving deferred recovery of $27,225,289 shown in Exhibit S-3. That recovery would be subject to the conditions previously stated in U-11956, U-12359, and U-12478. In other words, prior to approval of an actual mechanism to implement recovery DECo should be required to show in a future case that the $27,225,289 was incurred for projects or systems that ultimately proved to be effective, efficient, and/or workable and that did not otherwise impede the progress to retail open access.

Relief Requested

For the reasons stated above, Attorney General Jennifer M. Granholm requests the Administrative Law Judge to issue a proposal for decision in this case that recommends conditional approval for deferred recovery of $27,225,289 shown in Exhibit S-3.

Respectfully submitted,

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