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DEPARTMENT OF ATTORNEY GENERAL



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July 14, 2006

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Dear Ms. Kunkle:

**Re: MPSC Case No. U-14702**

I am electronically filing the Attorney General's Exceptions to the Proposal for Decision pursuant to the instructions in the Commission's notice of hearing. I am also filing the attached proof of service.

Sincerely,  
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**PROOF OF SERVICE - U-14702**

The undersigned certifies that a copy of the Attorney General's Exceptions to the Proposal for Decision was served upon the parties listed below, by mailing the same to them at their respective addresses with first class postage fully prepaid thereon, on the 14th day of July 2006.

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STATE OF MICHIGAN  
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the Matter of the Application of The Detroit Edison  
Company for Authority to Implement a Power Supply  
Cost Recovery Plan in its Rate Schedules for 2006  
Metered Jurisdictional Sales of Electricity

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MPSC Case No. U-14702

**Attorney General's Exceptions to the Proposal for Decision**

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July 14, 2006

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## **Introduction**

Attorney General Michael A. Cox files the following exceptions to the proposal for decision (PFD) issued by Administrative Law Judge Daniel E. Nickerson, Jr. (the ALJ). The PFD is organized as follows:

1. Pages 1-4 in the PFD provide an outline of the proceedings in this case.
2. Pages 4-6 in the PFD outline statutory requirements found in MCL 460.6j(3)-(7), but those pages fail to describe MCL 460.6j(1), which provides statutory definitions relevant to disputed issues in this case. MCL 460.6j(1) will be discussed below.
3. Pages 6-7 in the PFD discuss an electric choice contingency factor (ECCF) proposed by The Detroit Edison Company (DECo or the Company), and the ALJ recommends rejecting that proposal.
4. Pages 8-10 in the PFD discuss DECo's proposal to roll dollars related to the Company's projected 2005 PSCR under recovery into 2006 PSCR factors. The ALJ recommends denying that proposal.
5. Pages 10-14 in the PFD discuss DECo's request for approval to use regulatory asset and liability accounts to record financial transmission rights (FTRs) and to include the results of that accounting in PSCR costs. The ALJ recommends rejecting the accounting request and excluding interim FTR gains and losses from PSCR costs, but recommends including the final settled value of FTRs in PSCR costs.
6. Pages 14-17 in the PFD discuss DECo's projected \$13.681 million of NO<sub>x</sub> costs. The ALJ recommends rejecting a \$4.199 million reduction in DECo's projection and concluding that DECo's projection is reasonable and prudent.
7. Pages 17-19 in the PFD discuss DECo's proposal to include sulfur dioxide (SO<sub>2</sub>) allowance costs in PSCR expense. The ALJ recommends including those cost in PSCR expense because those costs are linked to the availability of generation.
8. Pages 19-21 in the PFD discuss DECo's proposal to include magnesium hydroxide [Mg(OH)<sub>2</sub>] treatment costs in PSCR expense. The ALJ recommends including those costs because they bear directly on fuel costs in terms of lowering the cost of the blend of fuel.

9. Pages 21-24 in the PFD discuss DECo's projected revenues from wholesale sales of electricity to third parties. The ALJ recommends rejecting the Attorney General's proposed \$45.088 million increase in DECo's projected third party revenues because third party revenues can be achieved only by increasing sales or by charging prices much higher than the market price.
10. Page 24 in the PFD discusses allowing DECo to reverse the effects of the 0.5 mills/kWh reduction adopted by the MPSC in setting a temporary factor. The ALJ recommends adopting DECo's proposal.
11. Pages 24-25 in the PFD discuss requests by MEC/PIRGIM to reverse earlier rulings striking testimony and denying a request for declaratory relief. The ALJ declines to reverse his prior rulings.
12. Page 26 in the PFD recommends adopting unopposed transcript corrections proposed by DECo.
13. Page 26 in the PFD states that the ALJ recommends approval of DECo's 2006 PSCR plan and five-year forecast consistent with the findings above.

The Attorney General will discuss these recommendations in the following exceptions.

### **Exception No. 1**

#### **The MPSC should adopt the Attorney General's proposed \$4.199 million reduction in DECo's projected NO<sub>x</sub> costs**

Exhibits A-7 and A-1 include \$13,861,000 for NO<sub>x</sub> costs. Mr. Byron described the details of DECo's projected NO<sub>x</sub> costs (3 T 428-433). The Attorney General's witness Mr. Walter recommended reducing the \$13.681 million requested by DECo for NO<sub>x</sub> allowances by \$4.199 million unless DECo shows that the number of allowance purchase and the price paid for allowances were based upon a thorough study and sound reasoning (5 T 593 & 595-599).

The PFD concludes: "While the ALJ finds Detroit Edison's explanation and calculation in Exhibit A-31 lacking in several respects, it is Detroit Edison's overall compliance strategy which shows a reasonable and prudent approach."

The ALJ errs because DECo's testimony regarding its overall air emissions compliance strategy required the Company to project the need for more NO<sub>x</sub> allowances than the Company previously projected for 2006. Exhibit AG-1 is a copy of the 2005-2009 NO<sub>x</sub> emission allowance projections filed by DECo in Case No. U-14275. Exhibit AG-2 is the 2004-2010 NO<sub>x</sub> emission allowance projections filed by DECo in Case No. U-13808. Exhibit AG-3 presents the Attorney General's proposed reductions to the NO<sub>x</sub> emission allowance projections filed by DECo in this case. Yes DECo presented testimony indicating that the Company postponed scrubbers on Monroe 3, but DECo's witnesses presented no testimony describing or quantifying how this postponement increased the need to purchase 2006 NO<sub>x</sub> emission allowances. Mr. Byron presented a "simple example showing how emission control dollar balance could increase without an increase in the balance of allowances (5 T 636), but Mr. Byron carefully avoided testifying that DECo is projecting those circumstances to occur and affect 2006 costs. Mr. Byron

discussed the operation of the EPA's flow control regulations (5 T 637-639), but he did not testify that flow control regulations were "a" reason for the level of expense projected by DECo in this case.

In conclusion, the ALJ may have accurately concluded that DECo's overall compliance strategy is a reasonable and prudent approach, but DECo presented did not explain why its compliance strategy created a need to increase its level of 2006 NO<sub>x</sub> emission allowances above the Company's prior projections. So the MPSC should adopt a \$4.199 million reduction in projected 2006 NO<sub>x</sub> emission allowance costs.

### **Exception No. 2**

#### **The MPSC should defer inclusion of SO<sub>2</sub> costs from this case to DECo's 2006 PSCR reconciliation case.**

In Case No. U-13808, the Commission refused to include SO<sub>2</sub> allowance costs in DECo's PSCR costs. DECo candidly acknowledged that ruling, but went on to request the Commission to add those costs to its PSCR expenses. Mr. Johnston acknowledged that in U-13808 the Commission denied DECo's request to include SO<sub>s</sub> emission costs in its PSCR recovery and included those costs in DECo's base rates (4 T 504). Mr. Byron identified DECo's incremental SO<sub>s</sub> emission costs, which resulted in \$139,000 offset by a credit of \$1.45 million for a net credit of \$1.311 million (4 T 433-436).

Mr. Walter noted that DECo now proposes recovery of SO<sub>2</sub> allowance expenses in its PSCR cost and that DECo has projected costs totaling \$139,000 offset by an allowance of \$1.45 million from the Company's base rates, which resulted in a credit of \$1.311 million. In light of

this impact in this plan case compared with the future impact, he recommended deferring consideration of recovery to DECo's 2006 PSCR reconciliation—noting that it would be a dangerous precedent to allow piecemeal transfer of base rate items to the PSCR process (5 T 599-600). For example, in 2010, DECo's projects costs will rise to over \$78 million (5 T 600).

Page 4 in the Staff's initial brief argued that SO<sub>2</sub> allowance costs offset by the amount in base rates and by any proceeds made by selling allowances should be included in DECo's PSCR cost because those allowances are an important consideration in decisions that the Company make in deciding which plants to dispatch. MCL 460.6j contains no language stating that costs may be recovered via the PSCR process whenever a cost is considered by a utility in deciding how to plan its generation.

Page 18 in the PFD acknowledges that the Attorney General has correctly concluded that there must be clear and unmistakable statutory language to create a power and that the words expressed in a statute control over any unexpressed motivations of the legislature. But the PFD responds that the relevant provision in MCL 460.6j is subsection (6) and that subsection (6) requires the Commission to consider the cost and availability of the electrical generation available to the utility. The PFD concludes that the MPSC can lawfully include SO<sub>2</sub> allowance costs in PSCR expense because those costs fall squarely within the scope of planning, which the MPSC must evaluate.

The PFD's conclusion is specious at best. “[T]he meaning of the Legislature is to be found in the terms and arrangement of the statute without straining or refinement, and the expressions used are to be taken in their natural and ordinary sense.” *Gross v General Motors Corp*, 448 Mich 147, 160; 528 NW2d 707 (1995). Courts consider the plain meaning of the critical word or phrase as well as its placement and purpose in the statutory scheme, and

statutory language must be read and understood in its grammatical context, unless it is clear that something different was intended. *Sun Valley Foods Co v Ward*, 460 Mich 230, 237; 596 NW2d 119 (1999).

MCL 460.6j(1) provides the following relevant definitions:

As used in this act:

- (a) “Power supply cost recovery clause” means a clause in the electric rates or rate schedule of a utility which permits the monthly adjustment of rates for power supply to allow the utility to recover the booked costs, including transportation costs, reclamation costs, and disposal and reprocessing costs, of fuel burned by the utility for electric generation and the booked costs of purchased and net interchanged power transactions by the utility incurred under reasonable and prudent policies and practices.
- (b) “Power supply cost recovery factor” means that element of the rates to be charged for electric service to reflect power supply costs incurred by an electric utility and made pursuant to a power supply cost recovery clause incorporated in the rates or rate schedule of an electric utility.

On the other hand, MCL 460.6j(6) provides:

In its final order in a power supply and cost review, the commission shall evaluate the reasonableness and prudence of the decisions underlying the power supply cost recovery plan filed by the utility pursuant to subsection (3), and shall approve, disapprove, or amend the power supply cost recovery plan accordingly. In evaluating the decisions underlying the power supply cost recovery plan, the commission shall consider the cost and availability of the electrical generation available to the utility; the cost of short-term firm purchases available to the utility; the availability of interruptible service; the ability of the utility to reduce or to eliminate any firm sales to out-of-state customers if the utility is not a multi-state utility whose firm sales are subject to other regulatory authority; whether the utility has taken all appropriate actions to minimize the cost of fuel; and other relevant factors. The commission shall approve, reject, or amend the 12 monthly power supply cost recovery factors requested by the utility in its power supply cost recovery plan. The factors shall not reflect items the commission could reasonably anticipate would be disallowed under subsection (13). The factors ordered shall be described in fixed dollar amounts per unit of electricity, but may include specific amounts contingent on future events. (Emphasis added.)

Subsection (6) does not negate the definitions in subsection (1). Those subsections must be read together and harmonized. courts must avoid an interpretation that would render any part of a

statute surplusage or nugatory. *State Farm Fire & Casualty, Co v Old Republic Ins Co*, 466 Mich 142, 146; 644 NW2d 715 (2002), and *Koontz v Ameritech Services, Inc*, 466 Mich 304; 645 NW2d 34 (2002). Whenever sections of a statute could be in tension or conflict, then, if possible, courts construe an act as a whole to harmonize its provisions, carry out the purpose of the Legislature, and give meaning to each provision. *Nowell v Titan Ins Co*, 466 Mich 478, 483-483; 648 NW2d 157 (2002).

The PFD's analysis effectively concludes that any cost qualifies as a PSCR cost—despite the definitions in subsection (1)—whenever a cost relates to or affects the availability of generation. But in its grammatical context the availability of generation does not relate to whether a cost qualifies as a statutorily defined cost. The availability of generation relates to whether a cost that falls within the scope of defined costs is reasonably and prudently incurred. For example, if a utility's PSCR cost would decrease by \$1 million if a utility replaces a part costing \$10,000, then the utility would not reasonably and prudently incur that \$1 million. This does not turn the cost of the replacement part into a PSCR cost. On the other hand, spending \$1.4 million for  $\text{Mg}(\text{OH})_2$  to save \$10 million in fuel costs may be reasonable and prudent, but reasonableness and prudence does not convert the cost into a booked cost within the meaning of subsection (1).

Mr. Johnston said that DECo is requesting the Commission to include three new cost elements in PSCR expense: (1) the cost of  $\text{SO}_x$  emission allowances, (2) the cost of mercury (Hg) emission allowances, and (3) the cost of fuel additives (4 T 501). He said that accounting for those expenses are not determinative of their rate treatment because MCL 460.6j does not refer to the MPSC's uniform system of accounts (USOA) and does not indicate recovery of costs is entirely dependent upon the account into which costs are booked (4 T 502). Mr. Johnston also

said that the MPSC has allowed for non-conformity between accounting and ratemaking by including transmission expense and NO<sub>x</sub> costs in Case No. U-13808 (4 T 502).

With regard to costs of fuel additives, Mr. Johnston said that DECo has not previously included such costs in base rates or PSCR costs but that Florida has allowed recovery of similar costs in its fuel cost recovery clause (4 T 507-508).

Mr. Hicks supported fuel additive costs and testified:

**Q. What costs have been included in your fossil fuel expense forecast that have not previously been included in PSCR costs?**

A. Approximately \$1.9 million has been added to St. Clair Power Plant's low sulfur western coal (LSW) expense to reflect the use of magnesium hydroxide, Mg(OH)<sub>2</sub>. The St. Clair Power Plant units burn high sulfur eastern coal to mitigate some of the negative boiler performance impacts that result from burning lower cost LSW coal. This chemical, when injected into the boiler furnace, has been shown, through St. Clair's experience over the past two years, to create a physical change in the deposits that form on the outside of boiler tubes (i.e., slag build-up and fouling) enabling the boiler cleaning devices (e.g., sootblowers) to remove the deposits more effectively. The enhanced cleaning effectiveness for these units that were not designed to burn LSW coal is especially helpful due to the fact that a majority of the LSW coal burned at St. Clair is the higher sodium Montana coal which characteristically has an ash deposit that is more difficult to remove. Overall, the injection of Mg(OH)<sub>2</sub> results in a reduction in the amount of high sulfur eastern coal needed in the coal blend and increases the units' ability to generate at higher load levels when needed compared to when Mg(OH)<sub>2</sub> is not injected, which results in savings from lower fuel, replacement generation, and SO<sub>2</sub> emission allowance costs in excess of double the cost of the Mg(OH)<sub>2</sub>.

The amount of chemical needed is variable and dependant upon such factors as unit generation demands and the quality of the high sulfur eastern and low sulfur western coals being burned. Furthermore, the savings can vary not only with the amount of chemical needed but also as the result of changing market prices of coal, power, and SO<sub>2</sub> emission allowances and therefore is an integral element of the fuel and power supply acquisition decision-making analysis. Considering that the use of Mg(OH)<sub>2</sub> injection results in a substantial savings in the overall generation expense, it is reasonable and prudent to include this cost in fossil fuel expenses. (3 T 293-294)

Mr. Walter recommended disallowing DECo's \$1.871 million projection for fuel additive (magnesium hydroxide [Mg(OH)<sub>2</sub>]) costs (5 T 601-605). He said that the cost of magnesium hydroxide, like that of any other chemical used in a generating unit should be treated as an O&M cost (5 T 602). DECo's response STDE 1.2/2 indicates that DECo's so-called fuel additive program targets the problem areas of the furnace instead of targeting the fuel (5 T 602). Mr. Walter noted that other utilities with which he is familiar that use a similar desulfurization process do not include those costs in fuel factors (5 T 603). In addition, a study attached to DECo's Response No. STDE1.1/1a indicates that the benefit of using magnesium hydroxide reduces projected maintenance costs, which have not been included in DECo's projection for this case; therefore, Mr. Walter concluded that DECo's \$1.871 million cost should not be included in PSCR costs (5 T 603-604).

Even though Mr. Walters disagreed with Mr. Johnston and Mr. Hicks, this issue is primarily a legal question involving an application of the law to undisputed facts. DECo expects to incur \$1.871 million during 2006 for magnesium hydroxide. Magnesium hydroxide treatment target problem areas of the furnace instead of targeting the fuel (5 T 602). Magnesium hydroxide treatment reduces projected maintenance costs (5 T 603-604). Mr. Walter recommended treating the \$1.871 million as an O&M cost and excluding it from DECo's projected net PSCR costs (5 T 601-605). Mr. Johnston (4 T 507-508) and Mr. Hicks (3 T 293-294) recommended including that cost in PSCR expense.

At best, the magnesium hydroxide expense included in DECo's projections represents a cost of handling the coal after DECo has received it. So under MCL 460.6j(13)(d) the MPSC must remove that cost from DECo's net PSCR expense. On the other hand, the nature of magnesium hydroxide treatment described by the witnesses indicates that the cost is an O&M

expense, and O&M expenses other than the booked costs of fuel burned do not fall within the scope of MCL 460.6j(1).

Assuming only for the sake of argument that  $\text{Mg}(\text{OH})_2$  costs are a cost of fuel burned within the scope of Account 501, MCL 460.6j(13)(d) states that the MPSC must disallow handling expenses incurred after the receipt of fuel by a utility. DECo's arguments concerning  $\text{Mg}(\text{OH})_2$  relate to the way the Company burns (handles) its coal.

The Commission previously ruled that scrubber oil cost is not a part of the cost of fuel. *In re the PNI Adjustment of Detroit Edison*, MPSC Case No. U-5502, Opinion & Order on Reconciliation dated May 2, 1980, p 4. Likewise, MCL 460.6j(1) limits cost recovery to booked costs of fuel burned and booked costs of purchased and net interchange (PNI) power. The  $\text{Mg}(\text{OH})_2$  additive plays a role analogous to scrubber oil—it changes plant performance.

In conclusion, the Commission cannot lawfully treat costs for  $\text{Mg}(\text{OH})_2$  as a PSCR cost because those costs are not a booked cost of fuel burned within the scope of MCL 460.6j(1). DECo's and the PFD's construction of MCL 460.6j(1), i.e., that costs can be included so long as they are an integral part of the decision-making process or part of the evaluation of available generation, conflicts with the plain language in the statute and negates subsection (1). So the MPSC must be guided by the statute. *Consumers Power Co v PSC*. 460 Mich 148, 157, n 8; 596 NW2d 126 (1999).

### Exception No. 3

#### **The MPSC should increase DECo's projected third party revenue dollars by \$45.088 million.**

Mr. Byron presented projected sales of power and energy in Exhibit A-6 (4 T 414). Exhibit A-6 identifies 2006 sales totaling 2,677 GWh yielding total revenues of \$185,083,000. Mr. Walter testified that the Commission should include \$230.171 million for third party sales revenues in this case instead of \$185.083 million, which would reduce net PSCR expense by \$45.088 million (5 T 594). Mr. Walter testified that DECo projected \$230.171 million for 2006 third party sales in Case No. U-14275 instead of \$185.083 million in this case (5 T 604-605). Exhibit AG-4 is a copy of DECo's revised Exhibit A-2 from Case No. U-14275. **[There are two sets of exhibits marked and numbered AG-1 through AG-8. The first set relates to the temporary factor phase of this case. The second set relates to the final relief phase of this case. These exceptions refer to the second set.]** Mr. Walter testified that DECo's 2004 historical sales reported in Case No. U-13808-R are also much higher than the level projected by DECo in this case (5 T 605). Exhibit AG-5 is a copy of DECo's second revised Exhibit A-7 from consolidated Case Nos. U-13808-R and U-14474. Since the 2006 level projected in Exhibit AG-4 more closely matches historical sales than the level projected in this case, Mr. Walter recommended substituting that projection for DECo's projection in this case (5 T 605).

With regard to Mr. Walter's recommendation to increase projected third party revenues, Mr. Byron said that Mr. Walter ignored economic dispatch considerations, the increase in DECo's net system output (NSO), and changes in DECo's periodic maintenance plans (5 T 631).

Noting that Mr. Walter based his recommendation on historical observations, Mr. Byron presented Exhibit A-29 to identify DECo's 2000-2005 NSO, purchased power, and third party

sales (5 T 631-632). He said that DECo's projection of NSO requirements and third party sales are consistent with these historical numbers (5 T 633).

Next, Mr. Byron noted that Mr. Walter's proposed adjustment does not indicate how the additional revenues would be realized and does not include increased purchased power expense, and he said that purchased power expense would increase by \$86.242 million if 5,503 GWh is multiplied by \$15.97 per MWh (5 T 633). Mr. Byron criticized Mr. Walter for not providing any projection or providing any market analysis and also testified as follows (5 T 634):

I have described and supported the reasonableness of the Company's projection of the third party wholesale power sales in my direct testimony on pages 12 and 23 (4 T 417, 428). I also testified in cross examination concerning the dispatch modeling and projection of the sale of wholesale power. (4 T 451, 456, 462, 463, 467, 468, 479, 480).

The calculations in Exhibit AG-4 and AG-5 are DECo's previous exhibits, not exhibits prepared by Mr. Walter. Exhibit AG-4 identifies a much higher level of projected third party sales revenues for 2006 than DECo has projected in this case. Exhibit AG-5 identifies actual third party revenues for 2005 that are also much higher than DECo has projected in this case. In light of this information, Mr. Walter's proposed revenue increase is justified. His revenue increase does not reflect any increased PSCR expense for the increased sales, but Mr. Byron's rebuttal testimony would support an even higher net increase.

The PFD responds that Mr. Walter's proposed revenue increase could occur only as a result of higher prices or higher sales and, therefore, that it would not be reasonable and prudent to project higher revenues. The problem with this interpretation is that the evidence in this case fails to prove that price changes from the time of DECo's two previous projections to the filing in this case are the reason for DECo's reduced sales level. Logically, unless market prices have declined since the date of DECo's previous forecasts or unless DECo's costs have increased since

those dates, DECo should be able to achieve the level of sales the Company previously predicted for 2006. DECo has the burden of proof and has failed to satisfy that burden of proof.

First, Mr. Byron's rebuttal regarding economic dispatch considerations is general and fails to explain why dispatch modeling in this case reduced projected sales and revenues.

Second, Mr. Byron's suggestion that different levels of NSO could explain the different results fails because he did not explain what information included in the dispatch modeling resulted in reduced sales.

#### **Exception No. 4**

##### **Page 24 in the PFD failed to consider the Attorney General's Reply Brief**

Exhibit A-18, column (h), line 8 identifies DECo's proposed baseline PSCR factor of 4.99 mills per kWh. That exhibit is included in Attachment A to DECo's initial brief. However, because the MPSC issued an order setting temporary factors, including escalating quarterly PSCR factors and a 0.5 mill-per-kWh reduction in DECo's proposed level, DECo has proposed new PSCR factors in Attachment B ( Brief, p 22). Page 23 recommends adopting DECo's proposal.

The problems with Attachment B are that DECo's brief fails to explain the mathematics in columns (c) through (g) and it fails to recognize that the MPSC has no legal power to adjust PSCR factors upward during the remainder of a PSCR plan period to reflect previous plan period under recoveries. See MCL 460.6j(10) and the Commission has explicitly ruled that including so-called intra period over or under recoveries in factors is not appropriate. *In re Aquila Networks, Inc.-MGU*, MPSC Case No. U-13550, Opinion & Order dated October 29, 2003, pp 6-

11 and *In re Consumers Power Co*, MPSC Case No. U-7785, Opinion and Order Granting Motion for Partial and Immediate Summary Judgment dated July 3, 1984, pp 8-10.

A statute must not be construed as including a subject when statutory language contains no language including that subject. *Pierce v General Motors Corp*, 443 Mich 137, 147-148; 504 NW2d 648 (1993). Conclusions having no basis in the plain language of a statute cannot be engrafted into a statute by interpretation. *Jones v Dept of Corrections*, 468 Mich 646, 655-656; 664 NW2d 717 (2003). Until it reaches subsections (12) through (16), MCL 460.6j does not address over or under recoveries; therefore, the MPSC has correctly concluded that it should not include intra-period under recovery amounts in its plan case orders.

Finally, the Commission must base its decisions regarding PSCR factors exclusively upon the record. MCL 24.285. In this case, except for the 0.5 mills per kWh, DECo's brief fails to describe how the record supports its proposed adjustments to the PSCR factors identified in column (a) of Attachment B.

**Relief Requested**

The Attorney General requests the Michigan Public Service Commission to issue a final order that amends DECo's 2006 PSCR plan and factors as proposed in these exceptions.

Respectfully submitted,

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