

STATE OF MICHIGAN
STATE OFFICE OF ADMINISTRATIVE HEARINGS AND RULES
FOR 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	)	Case No. U-14702
metered jurisdictional sales of electricity.	)	
_____	)	

NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on June 30, 2006.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before July 14, 2006, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before July 21, 2006. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing of exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for

Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before they are due.

STATE OFFICE OF ADMINISTRATIVE
HEARINGS AND RULES
For the Michigan Public Service Commission

Daniel E.
Nickerson, Jr.

Digitally signed by Daniel E.
Nickerson, Jr.
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Daniel E. Nickerson, Jr.
Administrative Law Judge

June 30, 2006
Lansing, Michigan
dmp

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PROPOSAL FOR DECISION

I.

HISTORY OF PROCEEDINGS

On September 30, 2005 The Detroit Edison Company (Detroit Edison) filed its 2006 power supply cost recovery (PSCR) plan with the Michigan Public Service Commission (Commission). Detroit Edison requests approval to include a levelized PSCR factor of 4.99 mill per kWh for residential customers¹and a PSCR factor of 8.29 mills per kWh for Commercial and Industrial (C&I) customers². Detroit Edison filed its five-year forecast and supporting testimony and exhibits of its witnesses with its application. Detroit Edison also filed for approval to recover its projected 2005 PSCR plan year under collection for customers not subject to rate caps during 2005.

On November 10, 2005 the Commission pursuant to MCL 460.6j(8) issued an order setting an abbreviated interim hearing to determine whether a temporary order

¹ The bills of residential customers were subject to the 2000 PA 141 rate caps during 2005.

² The bills of C&I customers were not subject to the 2000 PA 141 rate caps during 2005.

should issue before Detroit Edison implemented its proposed PSCR factors on January 1, 2006. Detroit Edison filed the direct testimony of Terry S. Harvill on November 18, 2005 as set forth by the November 2005 order.

On November 22, 2005 a prehearing conference was held before Administrative Law Judge Daniel E. Nickerson, Jr. (ALJ). Detroit Edison was represented by attorneys Jon P. Christinidis and David G. Pettinari; Commission Staff (Staff) was represented by Assistant Attorney General Patricia S. Barone; The Attorney General of the State of Michigan (AG) was represented by Assistant Attorney General Donald E. Erickson; The Association of Businesses Advocating Tariff Equity (ABATE) was represented by attorney Eric J. Schneidewind; The Residential Ratepayer Consortium (RRC) was represented by attorney David L. Shaltz and The Michigan Environmental Council and Public Interest Research Group in Michigan (MEC/PIRGIM) was represented by attorney Don L. Keskey. The ALJ ruled to grant the AG, ABATE, the RRC and MEC/PIRGIM Intervention.

Two schedules were set at the prehearing conference. One schedule was set to accommodate the abbreviated interim review based on the time frames set by the Commission in its November 2005 order. The other schedule was reached by agreement of the parties to consider and examine Detroit Edison's 2006 PSCR plan in total.

On December 6, 2005 a hearing was held concerning the implementation of the temporary PSCR factor. Mr. Harvill testified on behalf of Detroit Edison. Nicholas I. Nwabueze testified for Staff. On December 9, 2005 briefs were filed by Detroit Edison,

Staff, the AG, ABATE and MEC/PIRGIM. On December 16, 2005 reply briefs were filed by Detroit Edison, Staff, the AG and ABATE.

On December 22, 2005 the Commission issued an order authorizing Detroit Edison to implement temporary PSCR factors for bills beginning with the January 2006 billing month. The PSCR factors were consistent with those proposed by Staff on a quarterly basis. The approved temporary PSCR factors ordered by the Commission are as follows:

0.38 mills per kWh	January-March 2006
7.00 mills per kWh	April-June 2006
7.98 mills per kWh	July-September 2006
2.15 mills per kWh	October-December 2006 ³

On January 11 and 12, 2006 cross-examination was conducted on Detroit Edison's direct case. At these hearings, Detroit Edison presented the testimony of Messrs. Aldo F. Colandrea, James J. Musial, Theresa M. Uzenski, Michael W. Shields, David H. Hicks, Paul R. Kiel, James H. Byron and Kenneth D. Johnston.

On February 10, 2006 three of the parties filed direct testimony. Staff filed the testimony of William G. Aldrich and Ronald J. Ancona. The AG filed the testimony of Bruce W. Walter. MEC/PIRGIM filed the direct testimony of Geoffrey C. Crandall and Martin G. Kushler. On March 17, 2006 Detroit Edison filed rebuttal testimony and was the only party doing so.

On March 29, 2006 Detroit Edison and Staff filed motions to strike the testimony of both of MEC/PIRGIM witnesses in their entirety. On April 3, 2006 MEC/PIRGIM filed a response to the motion to strike.

³ MPSC Case No. U-14707, dated December 22, 2005, p. 7 and Exhibit A.

On March 30, 2006 MEC/PIRGIM filed a request for Declaratory Ruling along with a brief in support of its request. On April 3, 2006 and April 4, 2006 Staff and Detroit Edison filed responses to MEC/PIRGIM's motion for Declaratory Ruling.

On April 5, 2006 an evidentiary hearing was held. At the commencement of the hearing, the motions to strike were held, the ALJ granted the motions to strike. The ALJ declined to rule on MEC/PIRGIM's request for Declaratory Ruling determining it was a matter proper for consideration by the Commission and not the ALJ. After the hearing of the motions and by agreement of the parties the testimony of the remaining witnesses was bound into the record.

The record in this case consists of five volumes of transcripts totaling 653 pages with an additional volume of transcript covering a separate record of 29 pages which contains the testimony stricken from the record by the ALJ. There were 51 exhibits offered for evidence with 46 exhibits admitted into evidence. Five exhibits relating to the stricken testimony was not admitted into the record. Briefs were filed by Detroit Edison, Staff, the AG, ABATE, and MEC/PIRGIM. Reply briefs were filed by Detroit Edison, Staff, the AG and MEC/PIRGIM.

II.

STATUTORY REQUIREMENTS

Subsection 6j(3) of Act 304 requires a utility with a PSCR clause to annually file a complete PSCR plan describing the expected sources of electric power supply and the changes in the cost of power supply anticipated over a future 12-month period. Based on this information, the utility is to request specific PSCR factors for each of the 12

months covered by its PSCR plan. The PSCR plan must also describe all major contracts and power supply arrangements for the 12-month period.

Subsection 6j(4) of Act 304 requires the utility to file contemporaneously with the submission of its PSCR plan, a five-year forecast of its power supply requirements, its anticipated sources of supply, and its projections of power supply costs, all in light of its existing sources of electric generation and sources of electric generation under construction.

Subsection 6j(5) of Act 304 provides that, after a utility files its PSCR plan and five-year forecast, the Commission is to conduct a proceeding to review the reasonableness and prudence of the PSCR plan and to establish PSCR factors for the period covered by the plan. It further provides that this review shall be conducted as a contested case proceeding pursuant to Chapter 4 of the APA.

Subsection 6j(6) of Act 304 provides that, in its final order in a PSCR plan case, the Commission shall evaluate the reasonableness and prudence of the decisions underlying the plan and shall approve, disapprove, or amend the plan accordingly. In evaluating the decisions underlying the utility's plan, this subsection continues, the Commission shall consider the cost and availability of the electrical generation open to use by the utility; the cost of available short-term firm purchases; the availability of interruptible service; the ability of the utility to reduce or 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 steps to minimize the cost of fuel; and other relevant factors. This subsection also provides that the Commission must, in its final order regarding this plan, specifically approve, reject,

or amend the 12 monthly PSCR factors requested by the utility. Moreover, it demands that those factors shall not reflect any items that the Commission could reasonably anticipate would be disallowed under Subsection 6j(13), which sets forth the criteria to be considered in a subsequent PSCR reconciliation concerning the 12-month period covered by the plan in question.

Subsection 6j(7) of Act 304 is also relevant to this proceeding. It provides that when evaluating the decisions underlying the five-year forecast, the Commission may identify any cost items that, on the basis of the present evidence, it would be unlikely to permit the utility to recover from its customers in rates, rate schedules, or PSCR factors established in the future.

III.

DISCUSSION

For the most part, Detroit Edison's PSCR plan and five-year forecast is not opposed. However, there are significant specific issues raised by Staff, the AG and ABATE for resolution. These issues are addressed below.

Electric Choice Contingency Factor

An Electric Choice Contingency Factor (ECCF) is proposed by Detroit Edison to permit it to adjust its power supply costs to cover a wide range of fluctuations of Choice sales for this PSCR plan and implementation in future PSCR cases. The actual application of the ECCF is mathematical in nature and in operation. Detroit Edison calculated a baseline Net Operating System (NSO) of 52,062 GWh with an estimated power supply cost of \$984,903,000 and transmission and MISO costs of \$182,767,000.

Adjusting from the baseline of 52,062 GWh, Detroit Edison would adjust its NSO requirements in increments of 1,072 GWh and develop new power supply costs for each increment by increasing or decreasing power supply costs using a market price of \$61/MWh. The transmission costs would be adjusted by the average cost per MWh according to the baseline NSO.

Detroit Edison proposes the ECCF due to the difference in timing between when it files its PSCR plan in September and when Choice customers' notifications to Detroit Edison are submitted in December or possibly February. Detroit Edison argues that this timing difference results in more difficult supply planning. Mr. Johnston testified that the ECCF would provide, in addition to improved supply planning, a more immediate and accurate cost signal to customers. 5 Tr. 644. Mr. Johnston also described how the ECCF addresses the present reality of Customer Choice in Michigan. 5 Tr. 644.

Staff opposes the ECCF. Mr. Ancona testified that the present PSCR plan process permits Detroit Edison to project plan year costs through the use of experts and sophisticated models to project every variable which can impact PSCR costs. Mr. Ancona testified that Choice sales is not a major variable in PSCR costs when compared with warmer than normal summers or increased economic activity or extended plant outages. Staff further argues that the PSCR process itself provides sufficient safeguards through supplemental filings or reopening of the plan case.

The AG also opposes the proposed ECCF. Mr. Walter testified that Detroit Edison will file refined projections of Choice sales and market conditions based on updated PROMOD runs. Mr. Walter recommends that Detroit Edison file revised Choice sales estimates before adopting any revised PSCR factor.

The ALJ concurs with Staff and the AG concerning the ECCF. The ALJ is persuaded that even though there is a timing difference of several months between when Detroit Edison files its PSCR plan and when Choice customers are required to notify the company there are sufficient available means by which Choice sales may be appropriately addressed in the PSCR plan without the need to establish an ECCF. As Staff points out typically in the PSCR plan the company can file supplemental filings or file to reopen a PSCR plan case. Also, the ALJ agrees with Staff's assessment that Choice sales relatively speaking is not a significant factor driving PSCR costs as say a cooler or warmer than normal summer. Also, the ALJ finds that the level of uncertainty concerning Choice sales asserted by Detroit Edison will certainly diminish as over time as the electric choice market matures and becomes more definitive thus diminishing the difficulties with power supply projections for Choice sales while increasing the accuracy of projecting for those sales.

2005 PSCR Reconciliation

Detroit Edison proposes to rollover its 2005 PRSC Reconciliation underrecovery as part of this case, its 2006 PSCR plan case. Staff opposes the request. Mr. Ancona discussed Staff's position. He states:

Depending on the Commissions' determinations of the issues in that case, the over recovery could be significant and thus the 2005 under recovery could be significantly reduced. In addition, Fermi 2 experienced an extended outage of about three weeks during the summer of 2005. This outage and the resulting replacement power costs will be the subject of review in the reconciliation case. Any under recovery related to this outage should not be collected from customers until the review has been completed. 5 Tr. 576.

Even though Staff does not support Detroit Edison's request in this case at this time, Staff does support Detroit Edison's request and supports granting ratemaking

authority to Detroit Edison to reflect prior year over/under recoveries in future plan cases. Staff recommends approval of Detroit Edison's proposed methodology for recovery of all over or underrecoveries in future plan years beginning with its 2007 plan case. Staff further recommends that in its 2007 case filing the requested roll-in should be limited to its 2006 costs only and not include its 2004 or 2005 over or underrecoveries.

The AG also opposes Detroit Edison's request in this case. The AG argues that simply accounting for those 2005 PSCR expenses is not determinative of their rate treatment under MCL 460.6j. The booked costs, submits the AG, does not indicate Commission approved recovery of those costs simply because those costs may be accurately reflected into an account for which costs are booked under the Uniform System of Accounts (USoA).

ABATE would prefer that the 2005 underrecoveries be recovered in Detroit Edison's 2005 reconciliation case which it notes Detroit Edison has already filed. ABATE argues that there is no reason to burden the record in this case with further review of those costs.

Detroit Edison replies that Staff incorrectly reasoned that the Fermi 2 outages and a similar proposal to "rollover" its 2004 overrecovery into its 2005 PSCR reconciliation proceedings will significantly affect or impact on the amount of the 2005 PSCR underrecovery. Detroit Edison notes that its proposal is a means to address significant load volatility associated with Electric Choice. Mr. Johnston testified concerning load volatility in the realm of Customer Choice. He states:

Now that a customer has the opportunity to choose its supplier of electricity, a under recovery "rollover" mechanism would provide more

immediate and accurate cost signals to customers, will facilitate proper economic decisions and will serve to apply the credits and surcharges to the customers that actually caused the over (under) collection to occur. 5 Tr. 644.

The ALJ is not persuaded that the “rollover” in this particular case achieves the ends Detroit Edison seeks without the assumption of numerous risks which in the ALJ’s opinion outweigh the possible benefit. While Detroit Edison does not believe that the Commission’s review of its 2005 PSCR cost underrecoveries is not likely to result in any significant disallowances, the ALJ is not so persuaded given Staff’s identified areas of concern for review in the reconciliation process. The point here is not to conduct a PSCR reconciliation review of those costs in this case. The point here is to determine whether under the circumstances at this time there exists sufficient rational basis to question a request to recommend authorizing the collection of a rather significant amount \$100+ million. The ALJ finds that the questions raised provide such a rational basis to conclude there may arise legitimate issues in the PSCR reconciliation which could impact in a material manner the proposed “rollover”.

Financial Transmission Rights (FTR)

Detroit Edison is requesting approval for the use of regulatory asset and liability accounts for Financial Transmission Rights (FTR) accounting. Detroit Edison asserts that the regulatory accounts are for consistency with the Statement of Financial Accounting Standards No. 71 (FAS 71) to account for derivatives and hedging activity.

Ms. Uzenski describes FTRs as instruments, “designed to provide market participants with a hedge against price risk arising from physical congestion on the network, associated with the delivery of energy to a particular load or generator node.”

3 Tr. 183. Ms. Uzenski states that MISO created FTRs to manage transmission congestion and maintain the transmission system reliability.

The dispute in this case concerns the proposed accounting procedure for treatment of FTRs. Ms. Uzenski explains that the proper accounting treatment for FTRs found at FAS No. 133 (FAS 133) involves the recording of derivative instruments on the balance sheet at fair value with gains or losses recognized in earnings in the period of change. Detroit Edison believes FTRs are properly classified as derivative instruments. She explains that the accounting under FAS 133 requires the fair value—and any subsequent fluctuations in fair value—to be recognized over the life of the contracts. These changes in value are recognized before the contracts settle and is referred to as “mark-to-market accounting”.

Concerning whether the treatment afforded FTRs under a PSCR proceeding, Ms. Uzenski states:

As contracts are settled, any gains or losses on those contracts allocable to PSCR customers are included in the PSCR mechanism. It is inaccurate to reflect any future value of these contracts, prior to settlement, in net income when that value will not be retained by Detroit Edison. With Commission approval, FAS 71 requires that gains that will be returned to customers in future periods be recorded as regulatory liabilities and losses that will be recovered from customers be recorded as regulatory assets. 3 Tr. 187. Exhibit A-25, revised.

Staff opposes Detroit Edison’s request. Mr. Aldrich states that in his opinion, Detroit Edison is requesting that the final settled value of the FTRs be recovered through the PSCR mechanism. While, interim gains or losses would not be used for recovery through the PSCR mechanism. Mr. Aldrich testified that Detroit Edison failed to recognize the difference between general-purpose financial accounting and

accounting purposes for financial reporting under the Commission rules consist with the USoA. Mr. Aldrich testified as follows:

FAS 133 requirements pertain only to the general-purpose financial statements. While the Commission has often adopted new accounting pronouncements for use in MPSC financial statements, the Commission is not bound by generally accepted accounting principles in determining the appropriate MPSC financial reporting requirements. 5 Tr. 583.

Mr. Aldrich continues and distinguishes general purpose financial statements which are released to the public-at-large which must comply with SEC regulations and GAAP requirements from those statements complying with reporting requirements for Commission financial statements under USoA. The former is subject to requirements under FAS 133 according to Mr. Aldrich while the latter is not subject to the requirements of the SEC or GAAP. Staff concludes with a concurrence to Detroit Edison's request regarding the final settled value of FTRs being included in Detroit Edison's power supply costs subject to the same level of review as other PSCR costs.

However, Staff is opposed to Detroit Edison's request to instituting mark-to-market accounting under FAS 133 for deferred accounting authority for the interim gains and losses on FTRs. Staff contends that the USoA was last revised prior to the issuance of FAS 133 and as a result does not contemplate mark-to-market accounting so there are essentially no account designations and descriptions for the recognition of interim gains and losses on derivatives. Staff believes that there is no need for the Commission to establish deferral accounting for interim gains or losses.

While Staff does concur with Detroit Edison that the final settled value of FTRs be included in Detroit Edison's power supply costs, Staff recommends a different accounting than that proposed by Detroit Edison for the final settled value of FTRs.

Staff contends that its proposed accounting method yields the same result but it is consistent with Commission financial statements. Staff recognizes that this creates an issue for Detroit Edison's consideration which is whether the probable standard of FAS 71 has been met for the recording of the interim gains or losses.

For the accounting reasons stated above, Staff opposes the approval of Detroit Edison's request for the establishment of regulatory accounting authority treatment for mark-to-market financial accounting. In addition, Staff points out that there is no mention of regulatory assets and regulatory liabilities described in the USoA.

ABATE states that with today's wholesale power market and with Day 2 LMP pricing, "it is imperative for utilities to utilize financial transmission rights in order to hedge their positions".⁴ ABATE supports Detroit Edison's request that the final settled value of FTRs be properly included in Detroit Edison's power supply costs. However, ABATE concurs with Staff regarding the actual accounting under FAS 133. ABATE urges the Commission to not permit FAS 133 interim gains or losses to be recorded in Commission financial reporting statements. ABATE further sees no need to establish deferral accounting.

The ALJ recommends that Detroit Edison's request for accounting practices for FTRs be denied. This recommendation however does not extend to Detroit Edison's actual practice and use of FTRs beyond the scope of Commission reporting purposes which has not been contested in this case. Detroit Edison may apparently continue its use of FTRs but based on the findings contained herein, Detroit Edison shall account for the gains and losses in the manner prescribed under the USoA.

⁴ ABATE initial brief, p. 2.

The ALJ finds that Ms. Uzenski's description of the requirements of FAS and GAAP fail to rise above the reporting requirements of USoA. Staff is correct in noting that the two reporting requirements serve different purposes. The ALJ finds that this is an area where the Commission accounting requirements are quite precise and detailed. Detroit Edison fails to show that FAS and GAAP accounting would be necessary or required where USoA is applicable. There has been no showing by Detroit Edison that FAS 133 requires application beyond the reporting requirements for general accounting purposes or to meet SEC accounting requirements in other words required for accounting under the USoA. The ALJ further recommends the adoption of Staff's proposed methodology to account for the final settled value of FTRs.

Further, the ALJ agrees with Mr. Aldrich where he testified that the interim gains and losses should not be recovered through the PSCR mechanism. The USoA does not provide for mark-to-market accounting necessary for the recovery of interim gains and losses. USoA contains no provisions for the recognition of interim gains and losses on derivative instruments. However, beyond the USoA provisions, the Commission in authorizing the interim gains and losses would be recognizing only booked gains and losses based on a derivative instrument. There must be a recognition that these are not actual gains or losses but rather accounting gains and losses based on derivative instruments.

NOx Emissions

Detroit Edison requests \$13.681 million for NOx costs. Exhibit A-1 and A-7. Mr. Byron described the details of Detroit Edison's projected NOx costs and explained that in 2006 Detroit Edison coal-fired generation exceeded the projections in 2004 and

2005. As a result, Detroit Edison was required to purchase more NOx emission allowances from the market in 2006. Mr. Byron testified that this increased the inventory value of Detroit Edison's allowances, all things being equal. 5 Tr. 635-636, Exhibit A-31.

Mr. Byron also described the delay in the scheduled installation of the selective catalytic reduction (SCR) equipment at the Monroe Power plant. The installation was rescheduled to coincide with a periodic outage. Mr. Byron also testified that while this delay increased the amount of the cost of NOx emission allowance it avoided a planned outage and permitted the company to take advantage of a declining market price for NOx emission allowance.

Mr. Rogers confirmed Detroit Edison's compliance strategy relative to the NOx State Implementation Plan (SIP). Mr. Rogers references Mr. Harwood's testimony in MPSC Case No. U-13808 outlining Detroit Edison's compliance strategy. Mr. Rogers reiterates that it is still Detroit Edison's compliance strategy. This strategy is designed to maintain enough flexibility to manage the tradeoffs between regulatory compliance, market conditions and demands, technological risks to minimize the cost of compliance. In order to achieve compliance with the NOx SIP call Detroit Edison weighs four possibilities. They are:

1. A shutdown of a generating unit or a reduction in output during the annual ozone season.
2. The purchase of NOx emission allowances from the market to offset actual emissions.
3. NOx reduction equipment installation to actually reduce the level of emissions.
4. Any combination of the three listed above.

Staff supports Detroit Edison's request for NOx allowances. Staff also explains that any amounts approved in the PSCR factor must be offset by the amount currently in base rates. Staff would also seek an offset against NOx allowances for any proceeds from the selling of allowances.

The AG recommends reducing Detroit Edison's NOx emission allowances by \$4.199 million unless Detroit Edison shows that the number of allowances purchased and the prices paid were based upon a thorough study and sound reasoning. The AG bases his position on his review of the 2005-2009 NOx emission allowance projections filed in MPSC Case No. U-14275 and MPSC Case No. U-13808. Exhibit AG-2.

The ALJ finds that Detroit Edison's request for 2006 NOx emission allowance in the amount of \$13.681 million is reasonable and prudent. Detroit Edison's actual NOx emission allowances actually consumed in 2004 and 2005 were 18,763 and 24,302 versus the projected amounts of 16,757 and 18,464. Exhibit A-30. As plainly observed, the actual NOx emission allowances exceed the projected amounts by 13.2% and 30.6%. The ALJ rejects the AG's approach to show that Detroit Edison's compliance strategy is unreasonable. Basically, the AG focused on the increase in Detroit Edison's inventory level without a comparable increase in the number of allowances. This approach fails to properly consider the compliance strategy as a whole and the weighing of choices available to Detroit Edison to achieve compliance. While the ALJ finds Detroit Edison's explanation and calculation in Exhibit A-31⁵ lacking in several

⁵ This was an attempt by Detroit Edison to substantiate the increase in emission allowance value by showing two examples side by side. In one example there was not any additional purchase of NOx emission allowance and in the second there was.

respects, it is Detroit Edison's overall compliance strategy which shows a reasonable and prudent approach.

Sulfur Dioxide (SO₂) Emission Allowances

Detroit Edison asserts statutory authority in MCL 460.6j for inclusion of Sulfur Dioxide (SO₂) and Mercury (Hg) emission allowance expense in its PSCR costs. Detroit Edison believes that these expenses are an integral part of the booked cost of fuel burned for generation as well as being an integral part of fuel procurement and generation decision making. Detroit Edison is seeking an incremental allowance based on \$1.45 million which was approved by the Commission in Detroit Edison's rate case.

The AG first points out that the Commission initially denied Detroit Edison's request to include SO₂ emission costs as a component of the PSCR plan case. MPSC Case No. U-13808. The AG is concerned that a dangerous precedent could be set by allowing a piecemeal transfer of a base rate item to the PSCR process. The AG states that while the dollar amount here today is relatively insignificant, an overall credit of \$1.311 million, this dollar amount will become more significant based on Detroit Edison's 2010 projected cost of over \$78 million for SO₂ allowances.

The AG is recommending that this issue be deferred to the PSCR reconciliation case. Contending that a serious legal question has arisen concerning the lawfulness of including SO₂ allowance expenses, the AG seeks the deferral until the PSCR reconciliation case to await future legal developments. In its reply brief, the AG points out that the legal issue in question concerns the statutory authority of MCL 460.6j. According to the AG, MCL 460.6j lacks a grant of authority to consider a cost based on

a decision concerning which plant to dispatch. The AG contends that such authority must be created by clear and unmistakable statutory authority.

Staff now in this case supports Detroit Edison's request to have the SO₂ allowance expense included in the PSCR plan. Staff adopts Detroit Edison's rationale set forth in the testimony of Detroit Edison's witness Mr. Johnston.

The ALJ finds that MCL 460.6j provides sufficient statutory authority for the Commission to approve the recovery of SO₂ allowances in the PSCR plan. The relevant portion of MCL 460.6j relied upon by the ALJ is paragraph 6 which provides that, "the commission shall consider the cost and availability of the electrical generation available to the utility." The AG is correct in his assessment that there must be clear, unmistakable statutory language and correct in his assessment that the words expressed in the statute control over any unexpressed motivations or intentions of the legislature which themselves are not law. The ALJ is persuaded that the actual practice concerning the balancing of the purchase of SO₂ allowance, the mix of coal for fuel and the determination of how much generating capacity to be dispatched at a particular plant fall squarely within the scope of MCL 460.6j.

Mr. Johnston testified that the relationship of the SO₂ allowance to the fuel burned to generate the energy to produce electricity. He explained that through the use of SO₂ allowances more alternatives are created including the procurement of higher priced low-sulfur coal, an increase in the amount of purchased power or even a reduction in third party sales. Mr. Johnston testified that the purchase of SO₂ allowances is a less expensive alternative when considering the compliance plan as a whole.

In addition, Mr. Johnston states that SO₂ allowances are expected to increase materially over the next five years. For PSCR purposes, he states that it is the nature of the volatility, difficult to predict, which makes SO₂ allowances more appropriate for review in a PSCR plan case than a rate case. He also testified that the expense is inextricably linked to power supply decisions, “it is properly reflected in the Company’s model for economic dispatch of its generation resources, including the price at which it offers its generating units to MISO.” 4 Tr. 505-506.

The ALJ finds the above description showing the linked relationship between the purchase of SO₂ allowances and its role in Detroit Edison’s compliance plan which goes directly to the nature of the authority for Commission’s review under MCL 460.6j. The ALJ finds the statutory language sufficiently descriptive of Detroit Edison’s compliance plan. The ALJ finds that the term “cost” is not directly linked in the statute to the cost of fuel but linked to the availability of electric generation. This language defeats the AG’s argument that they are not booked cost for fuel burned. Further, the ALJ finds that these expenses due to the nature of volatility and direct application on alternative availability of electric generation are more appropriate for PSCR plan and PSCR reconciliation cases than rates cases.

Magnesium Hydroxide Fuel Additive

Detroit Edison is requesting the inclusion of the fuel additive Magnesium Hydroxide (Mg(OH)₂) for recovery as a PSCR expense. Detroit Edison projects its Mg(OH)₂ costs at \$1.9 million for use at the St. Clair coal-fired power plant in 2006. The St. Clair plant was a site which was used the past two years to test the use. Mr. Hicks describes the benefits of Mg(OH)₂. The benefits include a physical change in

deposits which form on the outside of the boiler tubes. This physical change enables the cleaning devices to remove the deposits more effectively. Also, Detroit Edison is able to use less high sulfur eastern coal in its coal blend. This, in turn, increases the ability to generate at higher load levels which results in savings several ways including lower fuel costs, replacement generation and SO₂ emission allowance costs. Mr. Hicks testified that these savings are in excess of double the cost of Mg(OH)₂.

Staff qualifies its supports of Detroit Edison's request. The qualification is to the extent that power cost savings exceed the costs of the chemical. Staff did not present any testimony on this point.

The AG notes that the Mg(OH)₂ targets problem areas of the furnace instead of targeting the fuel. The AG argues it is therefore irrelevant where the Mg(OH)₂ is injected. It is irrelevant what physical effects the injection causes. And the location of the boiler furnace is irrelevant. The AG contends that the cost of the Mg(OH)₂ should be treated as an Operation and Maintenance (O&M) expense because it targets problem areas of the furnace instead of targeting the fuel. The AG asserts that this is an issue which is primarily legal in nature.

The ALJ finds that this is an intriguing issue because there is evidence to support the positive effect of Mg(OH)₂ on both the cost of coal and the O&M expenses. So the question is whether the expense should be properly included in the PSCR plan or in O&M expense. In reply, Consumers notes that Mg(OH)₂ is not merely a cleaning solution related to ordinary O&M costs and refers to Mr. Hick's direct testimony. The ALJ finds that based on Mr. Hicks testimony, the Mg(OH)₂ is properly included in the PSCR plan as an integral element of the fuel and power supply acquisition. The ALJ is

persuade by Hicks testimony. The most persuasive portion of his testimony on this issue is as follows:

Overall, the injection of $Mg(OH)_2$ 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 $Mg(OH)_2$ is not injected, which results in savings from lower fuel, replacement generation, and SO_2 emission allowance costs in excess of double the cost of the $Mg(OH)_2$. 3 Tr. 294.

While Mr. Hicks clearly references, in another part of his testimony, lower maintenance costs it appears as though the lower maintenance cost is more a beneficial side effect than the primary purpose which the ALJ finds is the permitting of a an option in the decision analysis concerning the blend of coal for use at the St. Clair plant based, in part, of the option of $Mg(OH)_2$ injection. The ALJ is persuaded that the most appropriate significance to be attached to the injection of $Mg(OH)_2$ is that it bears directly on fuel costs in terms of lowering the cost of the blend of coal that Detroit Edison is able to burn at the St. Claire plant thus lowering the total cost. In addition, there is a savings from SO_2 emission again as a direct result of the injection of the $Mg(OH)_2$ which is also a cost effective benefit.

Third Party Sales Revenues

Mr. Byron described third party wholesale power sales (third party sales) as, "wholesale sales made by the Company to other utilities and wholesale power marketers under FERC approved tariffs." 4 Tr. 417. Mr. Byron testified that for 2006 the Company projects third party sales totaling 2,877 GWh and revenue from third party sales in the amount of \$185,083,000. Exhibit A-6. Mr. Bryon testified that Detroit Edison's NSO increased thus reducing the electric generation available for third party

sales. Mr. Byron laid the basic framework for Detroit Edison's dispatch of its generating resources. Mr. Byron testified:

...the Company's generating resources are operated based on economic dispatch that factors in dispatched costs, unit availability, periodic maintenance and market power prices to forecast the system generation, purchased power, and off-system sales. 3 Tr. 631.

Concerning off-system sales which would include third party sales, Mr. Byron states:

Off-system sales are made when the Company has generation available in excess of its own NSO and when this available excess generation is below the market price of power. Thus, when the Company has an increase in its own customer load and/or an increase in generating unit maintenance, this reduces the available excess generation to be sold into the market and reduces the quantity of off-system sales. 3 Tr. 631.

The AG argues that the Commission should essentially impute to Detroit Edison \$230.171million for third party sales to reduce net PSCR expense by \$45.088 million. Mr. Walter testified that Detroit Edison projected third party sales of \$230.171 million for 2006 in MPSC Case No. U- 14275 instead of the reduced amount of \$185.083 million in this case. Mr. Walter points out that Detroit Edison's 2004 third party sales from MPSC Case No. U-13808 are higher than those projected in this case. The AG argues that since the projection in Exhibit AG-4 more closely matches Detroit Edison's historical sales level than the projections in this case, he recommends substituting the projection in Exhibit AG-4 for Detroit Edison's revised projection in Exhibit A-6.

The AG contends that Mr. Byron's calculation which is actually a reply to the AG's argument for imputation of \$45.088 million double counts the level of increased sales. The ALJ disagrees. The point being demonstrated here by Mr. Byron is simply that as one of the means to arrive at the \$45.088 million difference between the

company's projection and the AG's projection, there would need be an assumption of an increase in market price if the third sales level remained the same. The ALJ believes that this is a key point of the demonstration. While the ALJ found that the second part of Detroit Edison's demonstration was perplexing it was immaterial to the determinations here.

The ALJ rejects the AG's argument. First, the AG fails to recognize that Detroit Edison had the most freed up generation due to Electric Choice participation in 2004 so the historical comparison is not completely appropriate. The AG also ignores the fact that the company could certainly reach the increased level of third party sales but it could only do so at a price. The price as noted by Mr. Byron is that Detroit Edison would have to purchase at a higher market. These additional market price purchases would be included in the additional purchased power expense and virtually wipe out any additional revenue.

In its reply brief, Detroit Edison states that the AG confused the level of third party wholesale power sales with the level of power purchases. The ALJ agrees. The ALJ finds Mr. Byron's testimony on this point credible. Mr. Bryon states:

If the additional revenue is based on the same level of third party wholesale power sales of 2,877 GWh, then the market price that the power is sold at must be \$15.67/MWh higher (\$45.088 million divided by 2,877 GWh). If the market price of power is \$15.67/MWh higher then the Company's projected cost of purchased power will also increase. The increased purchased power expense resulting from an increase in market price of \$15.67/Mwh would be \$88.242 million (5,503 GWh multiplied by \$15.67/Mwh). The net result of the increased third party wholesale power sales revenue and increased purchased power costs would be a net increase in PSCR cost of \$41 million. 5 Tr. 633.

The ALJ finds that Mr. Byron's explanation more accurately describes the calculation of the costs of making third party sales. The ALJ rejects the AG's argument

that Detroit Edison is double counting the level of increased sales. The ALJ agrees with Detroit Edison's assessment that it can only achieve the higher levels of third party sales requested by the AG in one of two ways. One is through increased levels of sales in GWh and the other is through increased prices on a given level of third party sales. The ALJ further finds that Detroit Edison is correct, it is unrealistic to assume that the company can make third party sales at a price much higher than the market price.

Temporary Order PSCR Factor Reduction

The Commission in its December 22, 2005 Temporary Order ordered a 0.5 mills/kWh reduction to Detroit Edison's PSCR factor. Detroit Edison urges the Commission to permit it authority to reverse the effects of the 0.5 mills/kWh reduction. Staff concurs with Detroit Edison's request. There is not any other opposition to Detroit Edison's request. The ALJ recommends that the Commission consider Detroit Edison's request.

2006 PSCR Plan

Detroit Edison is correct in its assessment that the vast majority of its evidentiary presentation is not opposed. Further, there has been no question regarding the reasonableness or prudence of its 2006 PSCR plan and five-year forecast other than as presented above. Therefore, the ALJ recommends except as indicated above the approval of Detroit Edison's 2006 PSCR plan and five-year forecast.

MEC/PIRGIM's Sundry Requests for Relief

MEC/PIRGIM requests that the ALJ should reverse his earlier rulings striking all of its evidence which it argues violated the Michigan Constitution, Article 6, Section 28, and Section 85 of the Administrative Procedures Act, MCL 460.6a and Act 304, MCL

460.6j. MEC/PIRGIM also takes exception to the ALJ's denial to hear its request for Declaratory Ruling.

The ALJ declines to reverse either of his earlier rulings. First, concerning the request for declaratory ruling, under the Commission Rules of Practice and Procedure a request for declaratory ruling is within the discretion of the Commission. The specific rules states, "The decision to issue a declaratory ruling is within the discretion of the commission." R 460.17701(3). Furthermore, the ALJ concurs with the ruling of Administrative Law Judge Mark E. Cummins in MPSC Case No. U-14701, 5 Tr. 167-169, March 21, 2006, involving the very issue presented here.⁶

Addressing now the ruling on the motions to strike, MEC/PIRGIM in its proffered testimony raises the issues of demand-side management and generation resources preferences. These issues have historically been addressed not in the PSCR proceedings but rather in separate proceedings under MCL 460.6c. The Commission has similarly held in several cases when presented with "energy efficiency" evidence in an Act 304 case that these issues are beyond the authority of the Commission to force a utility to engage in energy efficiency and conservation programs. MPSC Case No. U-13060.

In addition, MEC/PIRGIM is not without a forum to present demand side management and energy efficiency concerns. The Commission, on its own motion, has initiated a proceeding for just that purpose. *In the matter, on the Commission's own motion, regarding administration and operation of the Low-Income and Energy Efficiency Fund, MPSC Case No. U-14667.*

⁶ Coincidentally, the issue in that case was also raised by MEC/PIRGIM.

Corrections to Transcript

On February 2, 2006, Detroit Edison filed a request for corrections of errors it found in volumes three and four of the transcript. There have been no objections or comments filed with regard to Detroit Edison's request. The ALJ recommends the corrections as identified by Detroit Edison.

IV.

CONCLUSION

The ALJ recommends approval of Detroit Edison's 2006 PSCR plan and five-year forecast consistent with the findings above.

STATE OFFICE OF ADMINISTRATIVE
HEARINGS AND RULES
For the Michigan Public Service Commission

**Daniel E.
Nickerson, Jr.**

Daniel E. Nickerson, Jr.
Administrative Law Judge

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ISSUED AND SERVED: June 30, 2006

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

STATE OF MICHIGAN	)		
	)	SS.	Case No. U-14702
County of Ingham	)		
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P R O O F O F S E R V I C E

Dawn M. Prawdzik deposes and says that on the 30th day of June 2006, she served a copy of the attached Proposal for Decision, upon those persons shown on Attachment A, by enclosing same in a sealed envelope addressed as indicated above and delivering the envelope to the Commission's mail courier for (1) postage prepayment and deposit with the United States Postal Service, or (2) delivery through interdepartmental mail (I.D.M.).

**Dawn M.
Prawdzik**

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Subscribed to before me this 30th
day of June, A.D. 2006.

Sharron A. Allen

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Notary Public, Ingham County, Michigan

My Commission expires 8-16-2011.

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