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May 17, 2006

Ms. Mary Jo Kunkle
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Dear Ms. Kunkle:

Re: MPSC Case No. U-14702

I am electronically filing the Attorney General's Reply Brief pursuant to the instructions in the Commission's notice of hearing. I am also filing the attached proof of service.

Sincerely,

DonaldEErickson

Digitally signed by DonaldEErickson

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Donald E. Erickson

Assistant Attorney General

c All Parties

PROOF OF SERVICE - U-14702

The undersigned certifies that a copy of the Attorney General's Reply 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, on the 17th day of May 2006.

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STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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

MPSC Case No. U-14702

Attorney General's Reply Brief

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Introduction

The Detroit Edison Company (DECo or the Company), Attorney General Michael A. Cox (the Attorney General), the Michigan Public Service Commission's (MPSC or the Commission) Staff (the Staff), the Association of Businesses Advocating Tariff Equity (ABATE), and the Michigan Environmental Council (MEC) and the Public Interest Research Group (MEC & PIRGIM) filed initial briefs. This reply brief supplements the fundamental positions stated in the Attorney General's initial brief and responds to the arguments presented in the initial briefs filed by the other parties.

Replies concerning magnesium hydroxide [Mg(OH)₂] costs

DECo has projected and included \$1.9 million for [Mg(OH)₂] costs in its 2006 PSCR costs and factors (3 T 293-294). On page 14 of its brief, DECo argues: (1) that the Attorney General's opposition to including the \$1.9 million is simply wrong, (2) that Mg(OH)₂ is injected into the boiler furnace, (3) that Mg(OH)₂ creates a physical change in the deposits that form on the outside of boiler tubes, (4) that the boiler furnace and boiler tubes are equipment physically configured before the flue, (5) that injection of Mg(OH)₂ reduces the amount of high sulfur eastern coal burned, and (6) that injection of Mg(OH)₂ increases the unit's ability to generate at higher load levels, which saves money.

DECo's six arguments are spurious. DECo's second, third, and fourth arguments are misleading. Mr. Walter quoted DECo's Discovery Response STDE 1.2/2 (5 T 603-604). That discovery response indicates Mg(OH)₂ targets problem areas of the furnace instead of targeting the fuel. Therefore, where DECo injects Mg(OH)₂, the physical effects of the Mg(OH)₂, and the

location of the boiler furnace and tubes become irrelevant to determining whether or not $\text{Mg}(\text{OH})_2$ costs can be included in DECo's PSCR expenses.

Throughout its brief, DECo argues that the Commission should include costs in PSCR expense because those costs are an integral part of the fuel procurement and generation decision-making process. That argument has a specious appeal. Logically, many costs are an integral part of the fuel procurement and generation decision-making process, but that relationship does not convert such costs into the booked costs of fuel—as DECo argues in this case. For example, the fuel procurement and generation decision-making process integrally involves costs related to the salary of purchasers and personnel operating DECo's plants. The fuel procurement and generation decision-making process integrally involves costs related to computer programs to make generation decisions. The fuel procurement and generation decision-making process integrally involves costs for scrubbers to operate certain plants. The bottom line is that costs of this nature are not booked costs of fuel burned; they are operation and maintenance (O&M) expenses (5 T 602-604).

On page 4 of its brief, the Staff argues that DECo's $\text{Mg}(\text{OH})_2$ should be included as a PSCR cost because DECo presented testimony the power cost savings exceed the costs of the chemical. Like DECo's arguments, the Staff's argument is also specious. The logic of Staff's argument would treat the cost of plant additions as a PSCR expense so long as those costs would be designed to increase the capacity of a plant to avoid more expensive purchased power costs. Making a plant addition to reduce PSCR costs could be reasonable and prudent, but that motivation does not transform the plant addition costs into either a booked cost of fuel burned or a booked cost of purchased power.

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. It should be obvious that 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. Even DECo does not contend that its additive costs are a booked cost for PNI because using the additive helps DECo reduce the level of PNI power costs.

In conclusion, the Commission cannot 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 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, conflicts with the plain language in the statute. So the MPSC must be guided by the statute. *Consumers Power Co v PSC*. 460 Mich 148, 157, n 8; 596 NW2d 126 (1999).

Replies concerning reasonable and prudent costs for NO_x expense

Page 11 in DECo's brief argues that no party has challenged the reasonableness and prudence of DECo's projected PSCR costs. That argument misses the point of the Attorney General's position regarding recovery of NO_x costs.

Pages 12-13 in DECo's brief argue that the \$4.199 million disallowance for NO_x costs proposed by the Attorney General is easily dismissed. DECo argues that the Company considered actual NO_x emission allowance requirements, that the Company had to purchase more NO_x emission allowances from the market for 2006, and that the Attorney General ignores the flow control aspect of the NO_x emission allowance program. However, as pages 17-18 in the Attorney General's initial brief point out, DECo's rebuttal testimony fails to quantify or describe how postponing scrubbers on Monroe 3 affected the Company's forecast in this case. Even though Mr. Byron said that emission control dollar balances could increase, Mr. Byron did not testify that DECo's is projecting changes for 2006 like the ones described in Mr. Byron's example. Finally, Mr. Byron did not testify how flow control regulations resulted in an increase to DECo's projected NO_x costs.

In U-13808, DECo projected a significant drop from 2005 to 2006 in NO_x allowances (5 T 598 & Exhibit AG-2). In U-14275, DECo projected a 2005 ending NO_x allowance balance of 3,127 tons valued at only \$381,543, yielding an average cost of only \$122/ton (5 T 597 & Exhibit AG-1). The beginning NO_x allowance balance for 2006 presented in Exhibit A-7 in this proceeding has increased to 3,764 tons valued at \$6,866,000—an average value of \$1,824/ton (5 T 597).

Although DECo's rebuttal testimony describes how costs increases can occur, DECo has provided no explanation concerning how its projected inventory value increased by nearly 6.5 million dollars over what DECo had originally projected for the end of 2005 and the beginning of 2006 without significantly increasing the number of allowance tons available (5 T 597).

In conclusion, the Commission should disallow \$4.199 million of the \$13.681 million projected by DECo for NO_x expense (5 T 598 & Exhibit AG-4). Of course, DECo would still be

entitled to prove by a preponderance of the evidence in its 2005 PSCR reconciliation that its actual expenditures were reasonable and prudent.

Replies concerning SO₂ and mercury (Hg) expenses

In Case No. U-13808, the Commission refused to include SO₂ allowance costs in DECo's PSCR costs. DECo candidly acknowledged that ruling (4 T 504), but goes on to request the Commission to add those costs and mercury admission costs to its PSCR expenses.

Page 4 in the Staff's brief argues that SO₂ 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 which plants to dispatch. Therefore, Staff's argument is not supported by clear and unmistakable statutory language. The MPSC's power must be created by clear and unmistakable statutory language. *Union Carbide Corp v PSC*, 431 Mich 135, 151; 428 NW2d 322 (1988).

Compare *Grand Rapids & I R Co v Michigan Railroad Comm'n*, 183 Mich 383, 392; 150 NW 154 (1914), which held that a statute conferring power to require maintenance of connections with private lines did not confer the power to establish conditions under which a railroad would provide side tracks. 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). The words expressed in a statute are the law, and unexpressed motivations or intentions of legislators are not the law. *Maier v General Telephone Co*, 466 Mich 879; 645 NW2d 254 (2002)(concurring opinion by Corrigan, C.J.).

Based upon testimony of Mr. Byron, DECo argues the SO₂ allowances are a component of the "as burned booked cost of coal" (Brief, p 13). Similarly, DECo argues that the Commission should include mercury emission allowance in its PSCR expenses (Brief, pp 16-19.

The proper interpretation of a statute is a question of law. *Casco Twp v Secretary of State*, 472 Mich 566, 571; 701 NW2d 102 (2005). So the MPSC cannot lawfully rely upon testimonial opinions regarding the meaning of the words in MCL 460.6j. Neither the cost of SO₂ allowances nor the cost of mercury emissions is a charge for fuel burned; it is a cost based upon the tons of SO₂ or mercury emitted. The amount of SO₂ tons emitted and the amount of mercury emitted are related to the nature and amount of the fuel burned. But they are not a booked cost for fuel burned. MCL 460.6j(1) does not encompass costs for SO₂ or mercury allowances.

In any event, the Attorney General's witness (5 T 599-600) and the Attorney General's initial brief (pp 16-19) contend that the Commission should defer consideration of DECo's requests related to SO₂ and mercury allowances.

DECo is attempting to persuade the Commission to act now by raising the issue in the context of a projected 2006 SO₂ credit and projected 2006 zero costs for mercury allowances. These costs are expected to rise to significant levels in future years (5 T 600 & Exhibit A-1). The Commission should not approve piecemeal transfer of base rate costs to the PSCR process (5 T 600).

Replies concerning DECo's projected 2005 PSCR under recovery

DECo originally projected a 2005 PSCR under recovery totaling \$97 million (4 T 508 & Exhibit A-18). Subsequently, Mr. Harvill testified that DECo is projecting a \$191 million 2005 under collection of PSCR expense of which \$125 million is attributable to commercial and

industrial customers (2 T 34). Pages 20-22 in DECo's brief return to the Company's original testimony and exhibit and request authorization to include \$97 million in the Company's 2006 PSCR factors charged to commercial and industrial customers.

MCL 460.6j(15) empowers the MPSC to address any PSCR under recoveries saying:

In its order in a power supply cost reconciliation, the commission shall authorize a utility to recover from customers any net amount by which the amount determined to have been recovered over the period covered was less than the amount determined to have been actually expensed by the utility for power supply, and to have been incurred through reasonable and prudent actions not precluded by the commission order in the power supply and cost review. For excess costs incurred through management actions contrary to the commission's power supply and cost review order, the commission shall authorize a utility to recover costs incurred for power supply in the reconciliation period in excess of the amount recovered over the period only if the utility demonstrates by clear and convincing evidence that the excess expenses were beyond the ability of the utility to control through reasonable and prudent actions. For excess costs incurred through management actions consistent with the commission's power supply and cost review order, the commission shall authorize a utility to recover costs incurred for power supply in the reconciliation period in excess of the amount recovered over the period only if the utility demonstrates that the level of such expenses resulted from reasonable and prudent management actions. Such amounts in excess of the amounts actually recovered by the utility for power supply shall be apportioned among and charged to the customers of the utility utilizing procedures that the commission determines to be reasonable. The commission may adopt different procedures with respect to customers served under the various rate schedules of the utility and may, in appropriate circumstances, order charges to be made in proportion to the amounts which would have been paid by such customers if the amounts in excess of the amounts actually recovered by the utility for cost of power supply had been included in the power supply cost recovery factors with respect to such customers during the period covered. Charges for such excess amounts shall be spread over a period that the commission determines to be appropriate. (Emphasis added.)

In other words, the Legislature empowered the Commission to address under recoveries in PSCR reconciliation orders. This represents a statutory exception to the legal prohibition on retroactive ratemaking. Based upon this express and exclusive statutory language, the Attorney General contends that the MPSC should deny DECo's request to include a projected 2005 PSCR under recovery in the calculation of 2006 PSCR factors.

Page 20 in DECo's brief argues that the Commission should include 2005 dollars as a more accurate price signal. This argument ignores the nature and appearance to customers of 2006 PSCR factors. Adding a 2005 dollar total to a PSCR factor to be charged during 2006 based upon 2006 sales sends a misleading, not a more accurate, price signal about 2006 PSCR costs.

Page 20 in DECo's brief argues that including the under recovery would mitigate or eliminate PSCR under recoveries. Of course, any increase to a PSCR factor will tend to mitigate or eliminate PSCR under recoveries, but MCL 460.6j(12)-(15) address over and under recoveries and provide express mechanisms to redress reasonably and prudently incurred over or under recoveries. The MPSC cannot exceed the powers and limitations clearly and unmistakably conferred upon it.

Pages 21-22 in DECo's brief argue that the Company's goal is to match revenues with expenses and that self-implementation of lower PSCR factors provides ample protection from high PSCR factors. The Attorney General contends that the MPSC is the watchdog for retail customers and should not perform this duty by setting a maximum possible PSCR factor.

Assuming that revenue/expense matching is wise, the wisdom of the PSCR plan and reconciliation procedures is a matter for the exercise of legislative discretion, and the MPSC should not attempt to correct procedural choices adopted by the Legislature. *People v McIntire*, 461 Mich 147, 159; 599 NW2d 102 (1999). *Accord, Jones v Department of Corrections*, 468 Mich 646, 655; 664 NW2d 717 (2003).

Page 5 in Staff's brief argues that the MPSC should not include DECo's 2005 PSCR under recovery in 2006 PSCR factors, but the Staff's brief argues that the Commission should

authorize inclusion of prior-year over/under recoveries in future plan years. Staff's position is inconsistent.

Since MCL 460.6j(14) & (15) states that the MPSC shall address over or under recoveries in an order in a PSCR reconciliation case, the Attorney General contends that the MPSC should not authorize including a prior-year's under recovery in the next year's PSCR factor. The express mention of one thing in a statute implies the exclusion of other similar things. *Bradley v Saranac Community Schools Bd of Ed*, 455 Mich 285, 298; 565 NW2d 650 (1997); *Alcona County v Wolverine Environmental Production, Inc*, 233 Mich App 238, 247; 590 NW2d 586 (1998). So the Commission should not add over or under recoveries to the PSCR plan/factor process.

Replies concerning costs of financial transmission rights (FTR)

Pages 6-9 in the Staff's brief describe the Staff's position regarding FTRs in the PSCR process. The Staff supports following the Uniform System of Accounts (USOA) for accounting and PSCR purposes, including final FTR settlements in PSCR expense but not following generally accepted accounting principles for interim gains and losses. Page 2 in ABATE's brief appears to support DECo and the Staff. Pages 22-23 in the Attorney General's initial brief supports the Staff's position.

Page 12 in DECo's brief simply contends that the Company's position is most appropriate. Since MCL 460.6j encompasses only "booked" costs and since the USOA governs DECo's accounting for regulation by the MPSC, the Attorney General contends that the Staff's position should be adopted.

Replies concerning DECo's proposed PSCR factor matrix

Pages 20-22 in DECo's brief argue that the Commission should adopt the Company's proposed PSCR factor matrix to send more accurate price signals, to mitigate or eliminate PSCR under recoveries, to address uncertainties, and to address regulatory lag. Pages 4-5 in the Staff's brief argue that the Commission should reject DECo's matrix because it addresses only one variable, because DECo can amend its projections, because DECo can reopen a PSCR plan case, and because under recoveries can be recovered via the reconciliation process. Page 1 in ABATE's brief also opposes DECo's proposed matrix. Page 21 in the Attorney General's brief opposes DECo's matrix for similar reasons.

In conclusion, the Attorney General requests the ALJ to reject the proposed matrix.

Replies concerning third-party sales revenue projection

Pages 14-15 in DECo's brief argue that the Commission should reject the \$45.088 million reduction in DECo's projected net PSCR expense. Pages 19-21 in the Attorney General's initial brief address that question.

The calculations in Exhibit AG-4 and AG-5 are DECo's exhibits from U-14275 and U-13808-R. 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 propose revenue increase is justified.

It is true that his revenue increase does not reflect any related increased PSCR expense for the increased sales, but pages 20-21 in the Attorney General's initial brief shows how

corrected figures discussed in Mr. Byron's rebuttal testimony would support an even higher net increase. Therefore, the Attorney General requests the ALJ to recommend adopting Mr. Walter's adjustment.

Replies concerning the calculation of DECo's final PSCR factor

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).

The problems with Attachment B are that DECo's brief fails to explain the mathematics in columns (c) through (g) and that the MPSC has no legal power to adjust PSCR 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.

Replies concerning MEC's and PIRGIM's brief

The initial brief filed by MEC and PIRGIM argue that the ALJ should reverse his ruling striking the evidence submitted by MEC and PIRGIM and that the Commission should adopt the substantive claims presented in the stricken evidence.

MEC and PIRGIM have filed an application for leave to appeal the ruling striking its evidence. That process must be completed first. Furthermore, since their proposed evidence was stricken, there is no record upon which the Commission can legally base a substantive decision in favor of MEC and PIRGIM under MCL 24.285.

Relief Requested

The Attorney General requests the Administrative Law Judge to issue a proposal for decision that recommends disallowing \$1.9 million for $\text{Mg}(\text{OH})_2$ costs, that recommends reducing NO_x expense by \$4.199 million, that recommends deferring SO_2 credits and mercury expense from this PSCR case, that recommends adopting the Staff's position on FTRs, that recommends rejecting DECo's proposed PSCR matrix, that recommends increasing third party revenue credits by \$45.088 million, and that recommends ignoring the merits of MEC's and PIRGIM's stricken testimony.

Respectfully submitted,

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