

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the Commission's own motion)
ordering **THE DETROIT EDISON COMPANY**)
to show cause why its retail rates for the sale)
and distribution of electric energy should not)
be decreased.)

Case No. U-14838

QUALIFICATIONS
AND
DIRECT TESTIMONY
OF
DANIEL G. BRUDZYNSKI

THE DETROIT EDISON COMPANY
QUALIFICATIONS OF DANIEL G. BRUDZYNSKI

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1 **Q. What is your full name and business address?**

2 A. My name is Daniel G. Brudzynski. My business address is The Detroit
3 Edison Company, 2000 Second Avenue, Detroit, Michigan 48226.

4

5 **Q. What is your educational background?**

6 A. I graduated from Wayne State University in 1982 with a Bachelor of Science
7 degree in Business Administration with concentration in finance and
8 accounting. I earned my Masters of Business Administration degree from
9 the University of Detroit in 1987.

10

11 **Q. What is your work experience?**

12 A. I joined The Detroit Edison Company ("Company", "Detroit Edison" or
13 "Edison") in 1997 as assistant controller. In this capacity, I was responsible
14 for all corporate related functions within the finance and accounting areas.
15 These included the areas of corporate accounting, budgeting, forecasting,
16 business planning process, corporate governance, board of directors
17 reporting and communication.

18

19 In February 2001, I was named Vice President and Controller of Detroit
20 Edison. In that position, I was responsible for an organization of
21 approximately 250 professionals encompassing all areas of accounting and
22 financial reporting.

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1 Prior to joining Detroit Edison, I held several positions of increasing
2 responsibility in the finance area at DaimlerChrysler Corporation from 1984
3 to 1997. Most recently, I was manager of the redesign of the forecast and
4 implementation of new processes and systems, encompassing the areas of
5 profit, cash, inventory, balance sheet and business planning. Before that
6 assignment, I held a variety of financial positions in the areas of
7 manufacturing, product development, engineering and corporate offices.

8

9 Prior to working at DaimlerChrysler, I worked in the commercial lending
10 division of First of America Bank as a commercial credit analyst, where I
11 constructed lending proposals, and presented loan packages before
12 executive committees for approval.

13

14 **Q. What is your current position?**

15 A. In November 2005, I was named Vice President of Regulatory Affairs for
16 DTE Energy. I am responsible for the development and implementation of
17 regulatory strategy for both Detroit Edison and Michigan Consolidated Gas
18 Company (MichCon).

19

20 **Q. Have you testified in other cases before the MPSC?**

21 A. Yes. I testified in the last general rate cases for both Detroit Edison and
22 MichCon, in Case Nos. U-13808 and U-13898, respectively.

23

THE DETROIT EDISON COMPANY
DIRECT TESTIMONY OF DANIEL G. BRUDZYNSKI

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1 **Q. What is the purpose of your testimony?**

2 A. The purpose of my testimony is to present and discuss the following matters:

- 3 • The overall methodology used to develop 2007 projected test year
- 4 amounts;
- 5 • Provide an overview and summary of the yearly savings the
- 6 Performance Excellence Process (PEP) is expected to achieve;
- 7 • Describe the related cost Edison must incur to achieve PEP savings
- 8 and the deferral and amortization of such costs;
- 9 • The Company's Corporate Staff Operation and Maintenance
- 10 Expense (O&M) and Capital Expenditures and related PEP savings;
- 11 • The minimum pension liability accounting treatment;
- 12 • The Pension and Other Post Employment Benefit (OPEB) expense
- 13 equalization mechanisms, (PEM) and (OEM), respectively.

14 My testimony will demonstrate that the expected annual steady-state

15 savings from Edison's implementation of PEP will create a first quartile,

16 cost efficient utility structure that is better customer focused, which will, all

17 else being equal, result in lower electric rates. As important, I will explain

18 how these customer benefits will exceed the one-time costs Edison must

19 incur to achieve the PEP savings. My testimony will also show that PEP

20 implementation will significantly reduce Corporate Staff O&M expense.

21

22 Finally, my testimony will show that Commission approval of PEM and an

23 OEM are sound and reasonable regulatory tools that will capture for

24 customers the benefits of lower than anticipated pension and OPEB

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1 expenses, and mitigate against Edison's need to file comprehensive
2 general rate cases to recover increased pension and OPEB expenses.

3

4 **Q. Are you sponsoring any exhibits in the proceeding?**

5 A. Yes. I am sponsoring the following exhibits:

6 Exhibit DE-16

7 Schedule F3 Capital Expenditures – Total Company

8 Schedule F3-6 Capital Expenditures – Corporate Staff

9 Schedule F5 O&M Expense – Total Electric

10 Schedule F5-7 O&M Expense – Corporate Staff

11 Schedule F5-12 Summary of Corporate Staff PEP Cost Savings

12 Schedule F5-13 Summary of Total PEP Cost Savings

13 Schedule F5-14 Summary of Cost to Achieve

14 Schedule F5-15 Summary of Net PEP Benefits

15 Schedule F5-16 Corporate Overhead Costs By Support Group - 2007

16 Forecast

17 Schedule F5-17 Massachusetts Formula – 2007 Forecast

18

19 **PROJECTED TEST YEAR AMOUNTS**

20 **Q. How were the projected O&M and capital expenditure amounts Edison**
21 **is supporting in this case developed?**

22 A. To determine the projected test year O&M expense and capital expenditure
23 levels for this case, Edison started with actual 2005 results normalized for
24 unusual, non-recurring items as well as adjusted to reflect normal weather.

25 The normalized 2005 O&M and capital expenditure amounts were then

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1 escalated for the effects of inflation and further adjusted to reflect known and
2 measurable changes that will occur from 2005 through 2011. With only
3 minor exceptions, all the Company's witnesses in this case with
4 responsibility for O&M or capital projections used this same methodology.

5

6 **Q. What types of O&M and capital expenditure projections were not**
7 **developed using the methodology you just described?**

8 A. As I indicated, most projections were developed using the Commission's
9 historical test year's actual plus inflation with known and measurable
10 changes methodology. However, certain expenditures that change
11 significantly from year to year or are influenced by unique accounting
12 guidelines required specific forecasts. Examples relative to O&M include
13 pension expense and retiree health care expense, which are developed by
14 our actuaries, Hewitt Associates, based on various financial and employee
15 demographic data. Another example is capital expenditures relative to
16 environmental compliance. These expenditures vary significantly from year
17 to year and, therefore, specific projects were used. Other Company
18 witnesses will address in greater detail the few instances where specific
19 projections were used.

20

21 **Q. Has the Commission adopted the projected test year methodology you**
22 **just described in previous Edison rate cases?**

23 A. Yes. The Commission used this same methodology to project the level of
24 O&M and capital expenditures in Detroit Edison's last general rate case,
25 Case No. U-13808.

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PERFORMANCE EXCELLENCE PROCESS**Q. What is the Performance Excellence Process?**

A. DTE Energy has for many years, through continuous improvement initiatives, endeavored to be cost efficient, as evidenced by the 10 year timeframe between its most recent rate case, Case No. U-13808 and its prior rate case, Case No. U-10102. We know from past experience that customers will benefit from the Company's efforts to hold down costs, which will moderate future upward pressures on rates. However, the Company finds itself in a particularly difficult business environment where electric rates are under intense economic pressure due to rising energy costs, and Edison must make significant infrastructure investments to meet environmental compliance standards, and improve system reliability.

To meet these challenges, DTE Energy initiated an enterprise-wide intensive review of all of its operations during 2005 called the Performance Excellence Process (PEP). The goal of PEP is consistent with the Company's cost competitiveness, customer service enhancement and operations reliability and performance efforts. More specifically, the PEP focuses on all areas of Detroit Edison, MichCon and Corporate Staff for the purpose of improving services while reducing costs. The ultimate goal of this process is to achieve top quartile performance by 2010 in the areas of improved customer satisfaction, increased productivity, and reduced costs. By focusing on all areas of Detroit Edison, MichCon and Corporate Staff, DTE expects substantial reductions in O&M, capital and Power Supply Cost

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1 Recovery (PSCR) costs.

2

3 **Q. Can you describe how PEP was developed?**

4 A. Yes. The PEP program, which began in early 2005, was developed in
5 phases with targeted milestones. During the initial phase in 2005,
6 performance aspirations were established by the Company to achieve top
7 quartile operating targets through sustainable performance improvements.

8

9 The next phase of PEP, later in 2005, was idea generation and
10 brainstorming, during which the Company utilized a disciplined process of
11 rigorous analysis across all areas of the regulated businesses and
12 Corporate Staff areas. Ideas were submitted from each organization,
13 involving over 50% of the employee population through a variety of means
14 (e.g., workshops, cross-functional reviews, group brainstorming). This effort
15 yielded over 12,000 ideas.

16

17 **Q. How were the ideas that were generated through this process**
18 **evaluated?**

19 A. All of the ideas were screened and risk assessed by key organizational
20 teams in areas such as internal controls, technology or system impact,
21 customer satisfaction, regulatory compliance and operations. If the risk from
22 any one factor, or the risk cumulatively from many factors, were deemed
23 greater than the value the idea was expected to generate, the idea was
24 eliminated from further review. Ideas that passed the risks screening were
25 then vetted internally by the appropriate senior leader and ultimately

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1 presented for approval by the Executive Steering Committee.

2

3 **Q. What is the Executive Steering Committee?**

4 A. The Executive Steering Committee is the PEP decision making group that is
5 comprised of DTE's most senior executive team.

6

7 **Q. Of the ideas that were initially generated, how many were actually**
8 **approved for implementation?**

9 A. The initial pool of 12,000 ideas was reduced to about 1,000 through the risk
10 assessment process I just described. These remaining ideas were further
11 consolidated into approximately 250 project initiatives, designed to improve
12 customer satisfaction, increase productivity and reduce costs. The
13 implementation of these final initiatives, beginning in mid-2006, will span a 2-
14 3 year time period.

15

16 **Q. Is PEP related to any other process improvement or process change**
17 **initiatives?**

18 A. Yes. The Company continuously reviews and analyzes its internal
19 processes and cost structure, systematically seeking improvements in its
20 processes in order to improve efficiencies, reduce cost or improve
21 customer satisfaction. Beginning in 2002, the Company adopted the DTE
22 Energy Operating System, which is the application of tools and operating
23 practices that have resulted in operating efficiencies, inventory reductions,
24 and improvements in technology systems, amongst other enhancements.
25 Another example of an extension of the DTE Operating System is the

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1 Company's efforts on the Enterprise Business System (EBS)
2 implementation. This common platform of information systems will be a
3 key enabler to achieving PEP efficiencies and sustainable longer term
4 operating savings.

5

6 **Q. How does the Company expect to improve customer satisfaction as**
7 **part of the PEP?**

8 A. PEP is not solely about cost reductions. PEP is also designed to improve
9 customer satisfaction through improved operations. While in part, the
10 PEP effort focuses on initiatives to reduce costs, none of these efforts will
11 detract from the Company's continued investments in its power plants and
12 electric distribution systems, which will improve reliability and decrease
13 outages. In addition, the Company will also continue investing in
14 technology and services to improve overall customer satisfaction.

15

16 **Q. Can you describe some of the initiatives that Detroit Edison intends**
17 **to implement in order to positively impact customer satisfaction?**

18 A. Yes. One way for Detroit Edison to improve customer satisfaction is for
19 the Company to improve its service reliability. For example, the Company
20 intends to significantly increase line clearance activities over current
21 levels. Automated meter reading is another initiative that will improve
22 customer satisfaction through outage detection, power quality monitoring
23 and load monitoring. Finally, in order to assure consistent reliability and
24 restoration of service, the PEP will not impact overhead and underground

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1 line and substation operator levels. These examples are a subset of the
2 overall improvements planned by the Company. Other Detroit Edison
3 witnesses will describe, in greater detail, these and other initiatives that
4 the Company intends to implement.

5

6 **Q. What other steps are being taken to increase productivity at Detroit**
7 **Edison?**

8 A. The PEP involves redesigning and restructuring processes, which when
9 coupled with the deployment of the new EBS software, will greatly
10 enhance productivity and efficiencies through the use of a common
11 technology architecture and platform, leading to greater employee self-
12 directed capabilities, improved data access and the standardization of
13 processes across the enterprise. These two efforts (PEP & EBS) should
14 not be viewed as separate and distinct initiatives with separate savings
15 streams, but rather as tightly integrated and inter-dependent subsets of
16 each other.

17

18 **Q. How will PEP implementation achieve cost savings?**

19 A. By focusing on all areas of Detroit Edison, MichCon and Corporate Staff,
20 DTE expects substantial reductions in O&M, capital and PSCR costs. The
21 types of savings expected fall into the following categories;

- 22 • Consolidation (processes, organizations, facilities)
- 23 • Productivity (time, cost, quality)
- 24 • Outsourcing / Contract Management (sourcing, terms, conditions)

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- 1 • Standardization (best practices, optimization)
- 2 • Plant operations (availability, fuel substitution, capacity utilization)
- 3

4 **Q. How will the initiatives you just described impact employee levels?**

5 A. Since a large portion of the Company's variable cost structure is labor-
6 based (internal and contracted), workforce reductions are an inevitable
7 and necessary element of the PEP effort to lower costs and, thus, realize
8 the benefits of streamlined processes. To the extent the Company can
9 reduce contractors, eliminate already vacant positions, take advantage of
10 natural employee turnover and use incentives for early retirement and
11 departures, DTE can minimize the impact on its employees and the need
12 for involuntary job separations.

13

14 **Q. Has the Company initiated a voluntary separation program?**

15 A. Yes. Early last month, the Company announced a voluntary separation
16 program to encourage employees not covered by collective bargaining
17 agreements to leave the Company. Under the program, some employees
18 will be eligible for a voluntary retirement option while others will be eligible
19 for voluntary incentive severance payments based on years of service with
20 the Company.

21

22 **Q. What are the expected PEP savings for Detroit Edison?**

23 A. As shown on Exhibit DE-16, Schedule F5-13, the O&M and capital
24 investment savings for Detroit Edison is expected to be approximately \$54
25 million for 2006, \$137 million for 2007, and \$190 million per year

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1 thereafter. PSCR savings are expected to be \$30 million in 2007 and \$50
2 million thereafter. These PSCR savings result in an immediate and direct
3 benefit to customers by lowering recoverable power supply costs.

4

5 As the Company is still in the early stages of the PEP process, there
6 remains risk and uncertainty to these projections. The timing and level of
7 these savings will be dependent upon a variety of key variables and
8 enablers, including the success of the voluntary separation program,
9 technology deployment, sourcing reviews and studies, and successful
10 resolution of collective bargaining issues. Absent a successful
11 represented labor outcome, the level of PEP savings could be significantly
12 affected. The breakdown of the total Edison savings for each year, by
13 operating group, is also shown on this exhibit. I will discuss in detail later
14 in my testimony anticipated savings associated with Corporate Staff
15 Groups. Other Company witnesses address anticipated PEP savings
16 relative to their area of responsibility.

17

18 **Q. Will Detroit Edison incur any costs relative to the implementation of**
19 **PEP?**

20 A. Yes. These costs will be referred to as the Cost to Achieve (CTA) and
21 consists of both capital CTA and O&M CTA. The capital CTA was netted
22 with the capital PEP cost savings shown on Exhibit DE-16, Schedule F5-13,
23 line 21. The O&M CTA is shown on Exhibit DE-16, Schedule F5-14.

24

25 **Q. What are the anticipated costs associated with implementing PEP?**

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1 A. Exhibit DE-16, Schedule F5-14, summarizes the preliminary estimates of
2 the Detroit Edison O&M CTA of \$165 million. Types of CTA include
3 severance and separation related costs of \$23 million, curtailment
4 (pension, OPEB) costs of \$77 million, consultants' support of \$40 million,
5 and IT systems and other costs of \$25 million.

6

7 **Q. How was the CTA relating to employee severance and separation**
8 **costs determined?**

9 A. Employee severance and separation costs were based on expected
10 acceptance rates, taking into consideration the impacted employee
11 groups' existing demographics. These estimates included the impact to
12 both active and retiree benefits, and were developed with the assistance
13 of our actuary, Hewitt Associates.

14

15 **Q. Are there any unusual impacts on the Company's pension and OPEB**
16 **expenses resulting from the significant reductions in employee**
17 **levels?**

18 A. Yes, there are. In certain circumstances significant reductions in
19 employee levels may lead to the requirement to recognize a curtailment
20 cost. A curtailment cost is the accelerated recognition of previously
21 unrecognized prior service costs. However, this curtailment cost is merely
22 an acceleration of costs previously subject to delayed recognition under
23 SFAS 87 and SFAS 106, which would have been recognized through the
24 normal systematic amortization of these costs. As such, the curtailment
25 costs are not additional costs. A curtailment may or may not occur

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1 depending on the number of employees that ultimately leave the
2 Company.

3

4 **Q. How were the pension and OPEB curtailment costs calculated?**

5 A. Curtailment costs within a company's pension or retiree health care plans
6 are triggered when an event or program representing a material change
7 occurs (change outside of a 10% corridor) that either; reduces significantly
8 the expected years of future service of present employees, or eliminates
9 for a significant number of employees the accrual of defined benefits for
10 future services. This "true-up" of the pension and retiree health care plans
11 is governed by the accounting guidance applicable to curtailments in
12 SFAS 88, *Employers' Accounting for Settlements and Curtailments of*
13 *Defined Benefit Pension Plans and for Termination Benefits*, and SFAS
14 106, *Employers' Accounting for Postretirement Benefits Other Than*
15 *Pensions*. Based on the projected separation program results, the
16 Company's actuary, Hewitt Associates, assisted in the estimation of the
17 plan curtailment costs. Again, the existence of, and/or the size of
18 curtailment costs is dependent on the number of individuals that leave the
19 Company. Further details of curtailment costs are explained in Mr.
20 Lueders' testimony.

21

22 **Q. How was PEP consultant support costs allocated to Detroit Edison?**

23 A. As described earlier, PEP is an employee led improvement initiative.
24 However, during various stages of the process, external support in the
25 form of consultants assisted the Company in its improvement efforts.

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1 These valuable resources provide proven frameworks, techniques and
2 approaches that allow us to push through the work in a quicker and more
3 efficient manner. The assignment of these costs to Detroit Edison was on
4 a direct basis for the operating groups (power generation, distribution),
5 while the allocation for the administrative groups (customer service,
6 corporate staff) were based on the cost-driver allocation process. This
7 process closely follows the cost allocation framework detailed later in my
8 testimony.

9

10 **Q. What is the timing of the CTA?**

11 A. The CTA is expected to be incurred over a 2-3 year time period.

12

13 **Q. What is the normal accounting for expenses associated with**
14 **organizational restructuring costs such as those related to PEP?**

15 A. Normally, the treatment for these restructuring costs follows the GAAP
16 accounting guidance of SFAS 146, *Accounting for Costs Associated with*
17 *Exit or Disposal Activities*, which requires that a liability for costs associated
18 with an exit or disposal activity be recognized and measured initially at its fair
19 value in the period in which the liability is incurred, except for a liability for
20 one-time termination benefits that is incurred over time. Once the conditions
21 for these one time termination arrangements are met (management commits
22 to the plan, participants identified, communicated, terms established, and is
23 unlikely to be withdrawn) then a liability shall be recognized in accordance
24 with SFAS 146, and these restructuring costs are accrued and expensed.

25

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1 However, in order to better match overall CTA and overall PEP savings, the
2 Company is proposing that the O&M CTA be deferred and amortized.
3 Absent this approach, and in light of the normal GAAP treatment of CTA, the
4 Company would incur all the costs associated with PEP, but customers
5 would realize virtually all of the benefits. Therefore, in order to better match
6 overall CTA and overall PEP savings, the Company is proposing that O&M
7 CTA be deferred and amortized over five years.

8
9 Such amortization would begin the year following the year the costs are
10 incurred. Thus, I am proposing that the amortization of the O&M CTA of
11 \$165 million, as shown on Exhibit DE-16, Schedule F5-14, be recognized as
12 an increase in the Company's revenue requirement. More specifically, I am
13 proposing that one-fifth of the O&M CTA applicable to Detroit Edison be
14 reflected in Edison's rates. This is appropriate since the Company is also
15 proposing that the PEP savings also be recognized in Edison's cost of
16 service in this proceeding.

17

18 **Q. Why is the Company recommending a five year amortization period?**

19 A. Although an amortization period less than five years is warranted in light of
20 the PEP savings, the Company is proposing the five year amortization in
21 order to provide substantial net benefits to customers through lower rates.
22 A five year amortization is appropriate because it affords the Company a
23 reasonable time to recover the CTA and also will provide meaningful
24 benefits to customers because of the significant PEP cost savings.

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1 Moreover, the five year amortization period is consistent with the
2 Commission's typical policy for one time costs incurred for the purpose of
3 generating future savings. For example, five year amortization periods
4 were adopted by the Commission in the past for the workforce reduction
5 costs and the pension settlement costs described later in my testimony.

6

7 **Q. Has Edison requested that the Commission grant deferral**
8 **accounting for O&M CTA?**

9 A. Yes. On May 31, 2006 both Edison and MichCon filed applications in
10 Case Nos. U-14907 and U-14909, respectively, seeking deferral
11 accounting for O&M CTA. The applications requested that the O&M CTA
12 be deferred in the year incurred and that amortization of such deferral
13 begin in the year following the deferral. The applications also requested a
14 five year amortization period for the deferred amounts.

15

16 **Q. Did the O&M CTA accounting applications request authority for cost**
17 **recovery of the amortized O&M CTA?**

18 A. No. The accounting applications in both of those proceedings requested
19 deferral accounting authority only, with the expectation that recovery of the
20 deferred amounts would be addressed in subsequent rate cases for each
21 company. For Detroit Edison, this is the case where the Company is
22 seeking recovery for the amortized CTA.

23

24 **Q. Has the Commission issued any previous orders addressing the**
25 **deferral and subsequent amortization of similar workforce reduction**

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1 **costs in other proceedings?**

2 A. Yes, it has. The Commission has routinely allowed the deferral and future
3 recovery of the costs of employee separation programs that enable the
4 utility to lower its operating costs. One specific instance is MichCon's
5 1979 early retirement program that resulted in the early retirement of
6 about 450 employees through the offering of incentives to certain qualified
7 employees and involuntary terminations. In November 1978, MichCon
8 filed for the authorization to defer the costs of this program in the year
9 incurred and proposed the five-year amortization of the costs. While
10 MichCon's request for accounting authorization was resolved through a
11 stipulation and settlement of the parties that allowed the deferral of the
12 costs, MichCon also had a pending rate case at the same time. Thus, the
13 issue of cost recovery was addressed on an almost contemporaneous
14 basis. In that rate case, only the Attorney General objected to the
15 recovery of the early retirement program cost based on the claim that the
16 costs of eliminating excessive workforce levels should not be recoverable.
17 The Commission concluded in its Order on November 6, 1979 in Case No.
18 U-5955, that the costs of the program should be included in rates because
19 programs that facilitate corporate efficiency are beneficial to ratepayers.

20
21 The Commission also approved the deferral and amortization of certain
22 costs associated with the reduction in the workforce of Southeastern
23 Michigan Gas Company in 1985 (Case No. U-8088), and in 1986, for a
24 workforce reduction program of Michigan Gas Utilities (Case. No. U-8405).

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1 **Q. Can you summarize the net impact that PEP savings and PEP CTA will**
2 **have on Edison's cost structure?**

3 A. Yes. Exhibit DE-15, Schedule F5-15, shows PEP savings far exceed the
4 amortization of PEP CTA. Since the PEP savings exceed CTA, customers
5 will realize a net benefit even during the CTA amortization period. The net
6 PEP benefits during this period are expected to be \$34 million in 2006, \$81
7 million in 2007, and \$128 million per year in 2008 through 2011. After the
8 amortization period, customer savings will be substantially larger (totaling
9 \$161 million per year). For these reasons, the Commission should adopt the
10 Company's proposed CTA amortization and PEP savings proposal in this
11 case.

12

13 **CORPORATE STAFF GROUP COSTS**

14 **Q. What is the Corporate Staff Group ("CSG")?**

15 A. The CSG was established following the MCN Energy acquisition as part of
16 the Company's "shared services" business process approach, whereby
17 corporate staff functions previously residing in separate corporate entities
18 (Detroit Edison, MichCon, and/or MCN Energy) were centralized and
19 consolidated into various Staff organizations. This consolidation resulted in
20 efficiencies, cost savings and enhanced governance and internal controls.
21 Each organization within the CSG provides services enterprise wide.

22

23 **Q. What organizations are included in the CSG?**

24 A. The organizations within the CSG provide a variety of Administrative and
25 General ("A&G") type services to the Company. These include:

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- 1 • Audit Services
- 2 • Accounting and Finance
- 3 • Tax
- 4 • Treasury
- 5 • Corporate and Governmental Affairs
- 6 • Communications
- 7 • Corporate Offices and Services
- 8 • Human Resources
- 9 • Information Technology
- 10 • Legal
- 11 • Regulatory Affairs

12

13 **Q. Are there “shared service” type groups other than the CSG?**

14 A. Yes. The customer service and regulated marketing functions also operate
15 under a shared service model, but their span of support is only to the
16 regulated electric and gas (Detroit Edison and MichCon) distribution
17 operations versus the enterprise-wide orientation of the CSG.

18

19 **Q. Why are staff functions centralized?**

20 A. The centralization of the corporate staff functions was integral to achieving
21 operating efficiencies. These staff groups provide services to all business
22 units. Similar to others in our industry and within business more broadly,
23 the Company implemented a “shared service” approach whereby
24 efficiencies in the form of long-term reductions in costs are gained by

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1 streamlining and standardizing processes and strengthening internal
2 controls. Improvements in overall governance within corporate functions
3 have also been gained from the “shared service” approach. Additionally,
4 customers benefit from a leaner, more efficient organization and
5 processes that are more cost effective.

6

7 **Q. Have you developed O&M expense estimates for the CSG that reflect**
8 **expected PEP savings and other cost level changes from 2005**
9 **through 2011?**

10 A. Yes. Exhibit DE-16, Schedule F5-7, provides the detailed expense
11 projections for each of the CSG organizations while Exhibit DE-16,
12 Schedule F5 provides the detailed expense projections for the Total
13 Company. These O&M expenses, summarized on line 33, are projected
14 to decrease from \$299 million in 2005, to \$282 million in 2007 and \$292
15 million by 2011. A key factor in this decline is the \$50 million of steady
16 state annual PEP savings targeted for the CSG. (Note: enterprise
17 targeted PEP savings for the CSG is \$75 million, which includes MichCon,
18 since this group supports both regulated entities) These savings are the
19 highest targeted level of any area within the PEP effort, and represent
20 approximately 1/3 of the overall total PEP savings. Cost inflation and the
21 absorption of increasing administrative demands over this same time
22 period (i.e., homeland security requirements, increasing Sarbanes-Oxley
23 compliance, business continuity planning, etc) will off-set some of the PEP
24 savings over this time period.

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The Company continues to be committed to pursuing all opportunities, at all management levels, to improve the efficiency of its operations, and lower A&G expense in its corporate staffs. Indeed, Edison has experience in identifying and capturing cost savings, be it savings made possible through DTE Energy's acquisition of MCN Energy, or the cost savings made possible through the deployment of the DTE Operating System, and soon to be expected through the implementation of the EBS business system. This commitment to maximize the cost effectiveness of its back and front office operations, while driving to top quartiles of performance, is further re-enforced by the deployment of PEP, which brings together the process efforts of the Operating System with the technology/infrastructure improvements anticipated as part of the EBS deployment. It is expected that this effort will generate significant savings, an approximate 18% reduction in CSG cost, while continuing to focus on delivery of quality support to its customers.

17

18 **Q. Have you developed a summary of anticipated PEP savings for all of**
19 **Detroit Edison's Corporate Staff Groups?**

20 A. Yes. See Exhibit DE-16, Schedule F5-12, which summarizes the PEP
21 targeted savings by CSG group.

22

23 **Q. What is the nature of the anticipated PEP savings?**

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1 A. Targeted PEP savings for the CSG fall into similar categories as the
2 overall company PEP effort and leverage the deployment of the EBS
3 platform in the areas of Finance, Accounting, Human Resources and
4 Supply Chain. These categories include:

- 5 • Consolidation of operations, organizations, and processes
- 6 • Improved productivity
- 7 • Outsourcing
- 8 • Improved contract / contractor management
- 9 • Standardization and optimization

10

11 **Q. What are the anticipated PEP savings relative to Corporate Offices**
12 **and Other?**

13 A. The targeted savings for the Corporate Offices and Other groups amount
14 to \$7 million annually on a steady state basis in 2008 and beyond (Exhibit
15 DE-16, Schedule F5-12, line 2).

16

17 **Q. What are the anticipated PEP savings for Corporate Services?**

18 A. The targeted savings for the Corporate Services group amounts to \$14
19 million annually on a steady state basis in 2008 and beyond (Exhibit DE-
20 16, Schedule F5-12, line 3). The types of savings include; consolidation of
21 vehicle, equipment and parts contracts, outsourcing, consolidating
22 warehousing facilities, and harvesting underutilized assets.

23

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1 **Q. What are the anticipated PEP savings relative to Detroit Edison's**
2 **General Counsel Organization?**

3 A. The targeted savings for the General Counsel group amounts to \$3 million
4 annually on a steady state basis in 2008 and beyond (Exhibit DE-16,
5 Schedule F5-12, line 4). The types of savings include; redesigning the
6 contractor indemnification and insurance processes, standardizing
7 contract administration process, realignment of employee skill levels
8 relative to the work, and eliminating unnecessary paper filings.

9

10 **Q. What are the anticipated PEP savings relative to Detroit Edison's**
11 **Finance and Accounting Organizations?**

12 A. The targeted savings for the Finance and Accounting groups amounts to
13 \$9 million annually on a steady state basis in 2008 and beyond (Exhibit
14 DE-16, Schedule F5-12, lines 5 and 6). The types of savings include;
15 outsourcing, increasing productivity and automation with EBS,
16 consolidation of similar functions, standardizing of financial processes, and
17 insurance policy and coverage changes.

18

19 **Q. What are the anticipated PEP savings for Detroit Edison's Human**
20 **Resources area?**

21 A. The targeted savings for the Human Resources group amounts to \$4
22 million annually on a steady state basis in 2008 and beyond (Exhibit DE-
23 16, Schedule F5-12, line 7). The types of savings include; greater use of
24 internal resources for technical training, greater employee self service with

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1 the implementation of EBS, outsourcing, and increased computer based
2 training.

3

4 **Q. What are the anticipated PEP savings relative to Corporate**
5 **Communications and Governmental Affairs?**

6 A. The targeted savings for the Communications and Governmental Affairs
7 groups amount to \$3 million annually on a steady state basis in 2008 and
8 beyond (Exhibit DE-16, Schedule F5-12, line 8). The types of savings
9 include; converting communications planning to an on-demand orientation,
10 reducing the scope of services provided, and organizational
11 realignments/downsizing.

12

13 **Q. What are the anticipated PEP savings for Information Technology**
14 **Services (ITS)?**

15 A. The targeted savings for the ITS group amounts to \$11 million annually on
16 a steady state basis in 2008 and beyond (Exhibit DE-16, Schedule F5-12,
17 line 9). The types of savings include; eliminate the mainframe and
18 migrating, or retiring its applications, improving project management,
19 organization consolidation, reducing infrastructure and enhancements,
20 and greater use of remote versus on site physical support.

21

22 **Q. How is Detroit Edison's allocable share of the CSG costs determined?**

23 A. The centralization of the CSG provides demonstrated value to customers
24 through the efficiencies and cost savings of this centralized corporate staff

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1 model. In order to attribute a reasonable and appropriate share of the CSG
2 costs to Detroit Edison, we utilize a combination of methods that includes
3 direct assignment and verifiable cost drivers that reflect the unit of work
4 performed by staff functions for the utility.

5

6 **Q. How are the CSG cost billings accomplished?**

7 A. Certain CSG related costs can be directly recorded within Detroit Edison,
8 such as uncollectible expense, while others are billed to Detroit Edison
9 through the use of cost drivers based on resource consumption. More
10 specifically, each department within a corporate staff organization identifies
11 products and services it provides by legal entity and/or business unit to
12 determine resource consumption. These products and services are then
13 analyzed to determine the most appropriate measure, which represents a
14 unit of work, to be used in determining the billing of products or services
15 being provided to Detroit Edison by the administrative function. This
16 measurement mechanism is called a cost driver. The cost driver, in cost
17 accounting terms, is the unit of work/output that is used to determine a
18 formula for billing the products or services to Detroit Edison and other DTE
19 entities. As departments incur costs during the year, they are billed to
20 Detroit Edison pursuant to the appropriate cost driver. Exhibit DE-16,
21 Schedule F5-16, details these by organization.

22

23 **Q. Has this cost allocation methodology been accepted by the**
24 **Commission in the past to establish Detroit Edison's rates?**

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1 A. Yes. This methodology is the same cost allocation methodology
2 supported by Edison and effectively approved by the Commission in
3 Edison's last general rate case, Case No. U-13808.

4

5 **Q. Could you provide examples of how this cost driver process works?**

6 A. Cost drivers represent units of work that best reflect the content of the
7 work performed. For example, the Company's payroll department within
8 Corporate Services processes paychecks. Given the transactional nature
9 of this work, the volumetric cost driver of "paychecks processed" provides
10 the best indication of work performed by this group for a specific legal
11 entity. This department provides services for Detroit Edison and other
12 entities, hence, costs billed are based on the volume of paychecks
13 processed for Detroit Edison during the year. Other examples within the
14 CSG include invoices paid, number of PC desktops serviced, and
15 applications maintained.

16

17 **Q. How often are the cost drivers and level of support reviewed?**

18 A. Cost drivers are evaluated and established during the 4th quarter of the
19 prior year based on resource consumption. These cost driver standards
20 and levels of support are reviewed during the following year to reflect
21 actual experience. True-up adjustments, based on actual resource
22 consumption, are made to reflect the proper billing of administrative costs.

23

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1 **Q. Why don't CSG departments directly charge all costs to corporate**
2 **entities or business units rather than bill costs as described above?**

3 A. The Company adopted the shared service delivery model for the corporate
4 administrative groups to achieve greater efficiency in operations, higher
5 quality of services, and lower operating cost. The Company considered
6 the 100% direct charge concept and discarded this alternative since the
7 costs to implement and administer outweigh the benefits given the
8 significant additional transactions created on a monthly basis across
9 multiple general ledger platforms. Other non-direct charge options were
10 reviewed and the Company selected this cost driver model because it is
11 accurate, efficient, cost effective and representative of costing standards
12 utilized in a variety of applications across many industries. Whatever
13 slight differences that may exist between cost driver billings and what
14 direct charge billings would be, are small and overshadowed by the
15 significant cost necessary to gain the perceived accuracy of direct
16 charges.

17

18 **Q. How has the Company billed costs for which no direct cost driver**
19 **was discernable?**

20 A. While the vast majority of costs, about 93%, have been billed to Detroit
21 Edison and its affiliated companies based on the direct cost drivers I have
22 described, a limited number of administrative activities are shared across
23 the enterprise that do not possess cost driver attributes (a unit of work
24 directly attributed to a legal entity), or that are incurred on behalf of the

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1 parent, DTE Energy, that indirectly benefits Detroit Edison. It is in these
2 cases that the Company uses the commonly accepted cost allocation
3 methodology traditionally referred to as the Massachusetts Formula
4 (“Mass Formula”). The Mass Formula is designed to measure relative
5 size and complexity as a means of assessing the degree of support
6 services attributable to each individual company, within the context of the
7 broader enterprise.

8

9 **Q. Why is the Mass Formula an appropriate cost driver?**

10 A. The Mass Formula utilizes a blend of metrics (based on relative size and
11 resource utilization) to quantify an entity’s impact on the enterprise as a
12 means of providing a consistent and equitable allocation of common or
13 “shared” costs. In that regard, the Mass Formula had traditionally
14 consisted of three equally weighted components:

- 15 • Gross plant
- 16 • Gross revenue
- 17 • Labor costs

18

19 As originally configured for purposes of allocating State taxable income for
20 multi-state companies in Massachusetts, these three components were
21 deemed to be relevant indicators of the relative magnitude of a corporate
22 entity. Subsequently, these same determinants have been routinely used
23 by the Commission for allocating common costs that are not susceptible to
24 direct assignment.

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1

2 **Q. Has the Commission used the Mass Formula in billing common**
3 **costs?**

4 A. Yes, it has. In a number of rate cases over the last 20 years, the
5 Commission has set rates based on the use of the Mass Formula for
6 shared costs, or some derivative thereof. In some instances, the revenue
7 component has been revised to reflect gross margin as measured by
8 revenue less the cost of goods sold. This modification was designed to
9 avoid year-to-year distortions based solely on the variability of commodity
10 prices. Similarly, the Mass Formula has been routinely adjusted to
11 recognize net plant rather than gross plant. Most recently, the
12 components have been adjusted to include investments in Joint Ventures
13 that are not recognized as plant investments. All of these modifications
14 have been adopted in pursuit of a reasonable method for assessing the
15 benefit received arising from the occurrence of common costs.

16

17 **Q. Why is it important to bill these common costs?**

18 A. The critical need is to recognize that most of the common costs allocated
19 by the Mass Formula are costs that would be borne completely by the
20 utility in the absence of a holding company or affiliates. Thus, it is
21 imperative to balance the tangible cost efficiencies and benefits gained for
22 customers through centralizing these common activities along with
23 recognizing that a reasonable share of these common costs should be
24 borne by the utility. The Mass Formula is a reasonable and widely

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1 accepted means of striking that balance in developing the basis for
2 common cost allocations.

3

4 **Q. What components have you reflected in your derivation of the Mass**
5 **Formula?**

6 A. I have developed a Mass Formula cost allocation using three components.

7 1) Gross margin: Revenue less the cost of goods sold. Thus, electric
8 sales at Detroit Edison are reduced by the power supply costs.
9 Similarly, MichCon revenues are reduced by its cost of purchased gas
10 sold. Non-utility revenues have been reduced by the cost of
11 commodity purchases reflected in their cost of goods sold. This
12 mirrors the approach previously adopted by the Commission.

13 2) Net Plant and Joint Venture investments: This component has been
14 adjusted, consistent with traditional Commission practice, to be based
15 on net plant rather than gross plant. Detroit Edison's net plant
16 balance has been adjusted to include the net book value of the Fermi
17 II assets securitized in 2001. While the impairment and subsequent
18 securitization reduced Detroit Edison's net plant, it is appropriate to
19 recognize the capital invested in Fermi II for the purpose of allocating
20 common costs. This also includes Joint Venture investments not
21 recognized in the consolidated net plant balances.

22 3) Labor costs: All direct payroll costs for all companies.

23

24 Details of the Mass Formula calculation used in 2005 are detailed in

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1 Exhibit DE-16, Schedule F5-17.

2

3 **Q. What common costs have you billed based on the Mass Formula?**

4 A. Common costs billed based on the Mass Formula include; investor
5 relations activities, shareholder services, corporate secretary work and
6 Board of Directors' expenses. In each case, these are costs that either
7 could not be directly assigned, or that did not have a definable resource
8 consumption-based cost driver.

9

10 **CORPORATE STAFF CAPITAL EXPENDITURES**

11 **Q. Have you developed capital expenditure estimates for CSG that**
12 **reflect expected PEP savings and other changes from 2005 through**
13 **2011?**

14 A. Yes, Exhibit DE-16, Schedule F3-6 provides the detailed capital
15 projections for each of the CSG organizations while Exhibit DE-16,
16 Schedule F3 provides the detailed capital projections for the Total
17 Company. These expenditures, summarized on line 28 of Schedule F3-6,
18 are projected to increase in 2006 by \$49 million, primarily due to the
19 implementation of the EBS business system. Following the
20 implementation of EBS, capital expenditures decline \$66 million and \$54
21 million in 2007 and 2008, respectively. Other material known and
22 measurable changes during this time period relate to the required
23 maintenance and improvements to the company's headquarters complex.
24 Offsetting some of these changes are targeted PEP capital reductions of

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1 \$14 million in 2006, and \$8 million on a steady state annual basis in 2007,
2 and thereafter.

3

4 **MINIMUM PENSION LIABILITY**

5 **Q. What is the purpose of your testimony regarding employee pension**
6 **and benefits costs?**

7 A. I will address why Edison recorded an offsetting regulatory asset to the
8 Company's minimum pension liability.

9

10 **Q. Why did the Company record the minimum pension liability?**

11 A. The minimum pension liability was recognized pursuant to the
12 requirements of SFAS 87 and Statement of Financial Accounting
13 Standards 130, *Reporting Comprehensive Income* ("SFAS 130").

14

15 **Q. What amounts were recorded relating to the minimum pension**
16 **liability?**

17 A. As of December 2005, the Company recognized an additional liability for
18 its pension plan of approximately \$261 million, which represented the
19 excess of the Accumulated Benefit Obligation ("ABO"), over the actual
20 assets in the pension trust. In addition, SFAS 87 also required the
21 Company to write-off the prepaid pension asset of \$317 million. Offsetting
22 these amounts was an intangible asset of \$35 million, which represented
23 unamortized prior service costs and transition obligations. These amounts
24 totaled \$543 million. After providing for deferred income taxes of \$190

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1 million, the net charge to Other Comprehensive Income (“OCI”) was \$353
2 million. This charge to OCI was a reduction to the Company’s Common
3 Equity balance.

4

5 **Q. What is the amount of the Regulatory Asset related to the Minimum**
6 **Pension Liability?**

7 A. As of December 31, 2005, the Company recognized a Regulatory Asset
8 related to the Minimum Pension Liability of \$543 million. Similarly,
9 Common Equity and Deferred Income Taxes were increased by \$353
10 million and \$190 million, respectively.

11

12 **Q. Why is it appropriate to recognize a Regulatory Asset for the impact**
13 **of the minimum pension liability?**

14 A. An offsetting Regulatory Asset was recognized to prevent the minimum
15 pension liability accounting from distorting both the rate base and the
16 measure of capital resources invested in support of the Company’s rate
17 base. The accrual of this minimum pension liability did not change the
18 level of capital required to support the Company’s utility operations or the
19 sources of capital. Rather, it was a non-cash accrual to recognize a
20 potential future liability.

21

22 **Q. What was the basis for recognizing the Regulatory Asset?**

23 A. The regulatory asset, which was initially recognized in Edison’s 2002
24 MPSC annual report, was recognized based on our belief that the

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1 practices and precedent of the MPSC relative to pension costs provided
2 adequate assurance that the costs reflected in this liability would be
3 recognized in future rates. The standard for recognizing this regulatory
4 asset pursuant to the Statement of Financial Accounting Standards 71,
5 regarding *Accounting for the Effects of Certain Types of Regulation*
6 (“SFAS 71”) required a conclusion that the MPSC had adopted practices
7 and precedents that allowed recovery of pension costs as measured
8 under SFAS 87 and the cost of pension plan curtailments under SFAS 88
9 regarding *Accounting for Settlements and Curtailments of Defined Benefit*
10 *Pension Plans* (“SFAS 88”) in utility rates.

11

12 **Q. What MPSC practices and precedents did you rely on in concluding**
13 **that the accrual for the Regulatory Asset was appropriate?**

14 A. The Commission’s historical practice regarding pension cost has been to
15 recognize both the expense and working capital impacts consistent with
16 SFAS 87. Prior to the adoption of SFAS 87, utility rates included pension
17 expense as determined by the cash funding of pension plans. In the
18 Commission’s Order in Case No. U-10102, which was Edison’s first
19 general rate case subsequent to the implementation of SFAS 87, Edison’s
20 revenue requirement reflected pension costs based on SFAS 87. The
21 Commission has recognized pension costs as determined under SFAS 87
22 in the revenue requirements of other utilities subject to the Commission’s
23 rate setting jurisdiction when the company requested such treatment.

24

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1 Similarly, as described in the context of the deferral of the PEP related
2 costs, and early retirement plans, it has been the Commission's policy to
3 allow the current period cost deferral with the subsequent amortization of
4 such costs in future rates, when such deferral was requested by the utility.
5 MichCon received accounting and subsequent ratemaking authority for the
6 deferral and amortization in future rates of the costs of an early retirement
7 plan in 1979 (Case Nos. U-5976 and U-5955). Additionally, the MPSC
8 approved deferred accounting requests of Southeastern Michigan Gas
9 Company and Michigan Gas Utilities in 1985 and 1986 (Case Nos. U-8088
10 and U-8405, respectively). Moreover, in a 1989 Order in a Consumers
11 Power ("Consumers") gas rate case, the Commission captured the gain
12 arising from a partial settlement of its pension plan obligation through the
13 purchase of an annuity. While \$28 million of the total \$39 million gain was
14 used to offset current period costs of an early retirement program, \$10
15 million of the gain was reflected as a revenue requirement reduction
16 through a five-year amortization. This gain was determined according to
17 SFAS 88. Of special interest is the following excerpt from that Order:

18 "The Commission finds that Consumers' exception is not well-
19 taken. Consumers' ratepayers funded the purchase of the
20 pension assets. It is undisputed that if Consumers had not
21 settled its pension obligation through the purchase of an
22 annuity, the gain in the market value of the pension assets
23 would have accrued to the ratepayers pursuant to SFAS 87.
24 Only by amortizing the gain over a period of years may
25 Consumers' ratepayers realize any benefit from a transaction
26 entirely funded with their money." (Case No. U-8678, et al,
27 December 7, 1989, p. 71)
28

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1 In light of these practices and precedents regarding both pension costs as
2 measured under SFAS 87 and the cost of pension plan curtailments under
3 SFAS 88, it was determined that the accrual of the regulatory asset was
4 appropriate. Deloitte and Touche, Detroit Edison's independent auditing
5 firm, concurred with our conclusion.

6

7 **Q. Does recognition of the Regulatory Asset increase the Company's**
8 **revenue requirement?**

9 A. No, it does not. Since the Regulatory Asset is merely an offset to the
10 minimum pension liability and eliminates the reduction to common equity,
11 the Company's revenue requirement is not impacted by the recognition of
12 this asset.

13

14 **Q. Has the Commission addressed the regulatory asset related to the**
15 **minimum pension liability in any prior case?**

16 A. Yes. In Detroit Edison's last general rate case, Case No. U-13808, the
17 Commission addressed the minimum pension liability and the related
18 regulatory asset. In its order dated November 23, 2004 in that case, the
19 Commission adopted Staff's proposed rate base level, which included the
20 Regulatory Asset associated with the minimum pension liability.

21

22 **PENSION EQUALIZATION MECHANISM**

23 **Q. What is the Pension Equalization Mechanism (PEM)?**

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1 A. In Edison's last general rate case, Case No. U-13808, the Commission
2 adopted the Company's proposal to implement the PEM, as modified by the
3 MPSC Staff. The PEM allows the Company to annually defer the
4 difference between pension expense included in rates with the actual
5 annual pension expense recorded by the Company pursuant to SFAS 87,
6 exclusive of the impact of any plan changes. If such annual pension
7 expense is greater than the expense in rates, this difference is recognized
8 as a regulatory asset for future recovery. Similarly, if such annual pension
9 expense is less, the Company recognizes a regulatory liability for
10 distribution to its customers.

11

12 **Q. How are these deferrals recognized in future rates?**

13 A. The Company makes an annual submission to the MPSC that reflects the
14 amounts deferred and accrued. The amounts deferred as regulatory
15 assets or regulatory liabilities are reflected in Edison's rates pursuant to
16 the outcome of these annual submissions. This annual review process is
17 combined with the PSCR reconciliation process for administrative
18 convenience. Combining the PEM with the PSCR reconciliation
19 eliminates the need for a separate proceeding.

20

21 **Q. Is Edison proposing that the Commission retain the PEM in this**
22 **proceeding?**

23 A. Yes. Both the Company and its customers benefit from the assurance
24 that the pension expense included in rates matches the actual pension

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1 expense incurred by the Company. The potential volatility in pension
2 expense created by any changes in interest rates and the uncertainty of
3 the actual return on assets makes it unlikely that the Company would be
4 assured of full recovery of the actual pension expense or that customers
5 would not pay more than the Company's actual cost in the absence of the
6 PEM. Therefore, the PEM should be retained in this proceeding.

7

8 **OTHER POST EMPLOYMENT BENEFIT EQUALIZATION MECHANISM**

9 **Q What is the purpose of your testimony in this case relative to Other**
10 **Post Employment Benefits?**

11 A. In the Commission's Order in Case No. U-13808, issued on November 23,
12 2004, the Commission's discussion of Other Post Employment Benefits
13 (OPEB) concluded with the statement that Edison should submit a
14 proposal to establish an OPEB equalization mechanism in its next rate
15 case (Case No. U-13808, November 23, 2004, p. 59). Therefore, the
16 Company is proposing that the Commission authorize Edison to
17 implement an OPEB Equalization Mechanism (OEM) that would meet the
18 Commission's requirement.

19

20 **Q. Has Edison previously requested implementation of an OEM?**

21 A. Yes, it has. Pursuant to the Commission's directive in its Final Order in
22 Case No. U-13808, the Company filed on February 10, 2005 an
23 Application in Case No. U-14428 requesting Commission authorization to
24 adopt an OEM. The MPSC Staff supported this request with certain

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1 modifications. Specifically, the MPSC Staff proposed that the cost of any
2 benefit plan changes be excluded from the OPEB expense included in the
3 OEM and that the Company commit to externally fund the OPEB expense
4 included in the OEM. In addition, the MPSC Staff proposed that the
5 amount externally funded be limited to the amount deductible for Federal
6 income tax purposes.

7

8 **Q What was the outcome of that proceeding?**

9 A. While the Company had filed its request for the implementation of the
10 OEM coincident with the Company's request to realign and unbundled its
11 rates in Case No. U-14399, the Commission concluded that Case No. U-
12 14399 was not a general rate case because it did not encompass issues
13 such as revenue and rate of return. Because the Commission determined
14 Case No. U-14399 was not a general rate case, the Commission rejected
15 the Company's request to implement an OEM. Specifically, the
16 Commission concluded that: "The Commission finds that the OEM
17 proposal should be reviewed in the 2007 general rate case (or sooner if a
18 general rates case is filed sooner.)"

19

20 **Q. Is this proceeding a general rate case within the meaning of the**
21 **Commission's directive to file for an OEM as discussed in Case Nos.**
22 **U-13808 and U-14428?**

23 A. Detroit Edison believes that it is because all aspects of the Company's
24 revenue requirements, including revenue and rate of return are being

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1 reviewed in this case.

2

3 **Q. What is OPEB expense?**

4 A. OPEB is a cost recognized pursuant to the Financial Accounting
5 Standards Board's Statement of Financial Accounting Standards No. 106,
6 *Employers' Accounting for Postretirement Benefits Other than Pensions*
7 (SFAS 106). SFAS 106 was issued in 1990 and was effective for calendar
8 year 1993. While health care related costs (medical and prescription
9 drugs) are the largest component of these costs, OPEB also includes life
10 insurance and any other non-pension related retiree benefits. Mr.
11 Lueders, covers the components of OPEB expense in greater detail in his
12 testimony.

13

14 **Q. Are OPEB cost components subject to great variability?**

15 A. Yes, very much so. OPEB cost components are dependent upon
16 assumptions regarding long-term interest rates, expected and actual
17 return on assets, health care cost inflation, employee turnover and benefit
18 usage and the long-term cost of the post retirement benefits. As a result,
19 total OPEB expense can vary widely from year to year based on changes
20 in interest rates, actual returns on assets and current and future benefit
21 payments.

22

23 **Q. Will future OPEB expense continue to be subject to variability?**

24 A. Yes, it will. While the impact of historically low interest rates and the

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1 relatively poor recent asset returns have led to dramatically higher OPEB
2 expense, in the future, rising interest rates and/or improved asset
3 performance could lower OPEB expense. Similarly, changes in medical
4 cost trends will impact future OPEB expense. While current health care
5 and prescription drug costs have increased dramatically in recent years, it
6 is possible that such trends will not continue.

7

8 **Q. Do you have a proposal to address this potential future volatility in**
9 **OPEB expense?**

10 A. Yes, I do. Because of the prospect for continued variability in future
11 OPEB expense, I propose that the Commission adopt the OEM.

12

13 **Q. What is the OEM?**

14 A. The OEM closely parallels the PEM authorized by the Commission in its
15 order in Case No. U-13808. The OEM insulates Edison and its customers
16 from the impact of changes in future OPEB expense relative to the OPEB
17 expense reflected in Edison's Commission approved rates. The OEM
18 eliminates the impacts of variability in future OPEB expense through the
19 deferral and subsequent rate recovery of any difference between the
20 OPEB expenses collected in rates and the actual OPEB expense incurred.
21 More specifically, if annual net OPEB expense is greater than the net
22 expense collected in rates, this difference would be recognized as a
23 regulatory asset to be collected from customers. Conversely, if annual net
24 OPEB expense is less than the net expense collected in rates, the

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1 Company would recognize a regulatory liability for distribution to its
2 customers. This regulatory asset or regulatory liability would be
3 considered along with the review of the Commission's recently-ordered
4 PEM for either recovery or distribution to Edison's customers at the same
5 time the Company's annual PSCR reconciliation filings are reviewed.

6

7 **Q. Do you agree with the modifications to the OEM proposed by the**
8 **MPSC Staff in Case No. U-14428?**

9 A. Yes, but with clarification. First, the impact of any modifications in the
10 Company's benefit plans relative to the plan design inherent in the OPEB
11 expense adopted in this case will be excluded from the OPEB expense
12 included in the OEM. This clarification addresses the potential for plan
13 redesign that may include some enhancements combined with plan
14 reductions. The exclusion of the impact of enhancements should only be
15 relative to the overall net impact of plan design changes.

16

17 Second, The Company commits to externally fund the revenue collected
18 from its customers related to OPEB expense, but that such commitment to
19 externally fund will be subject to a ceiling of the amount of OPEB funding
20 that will be currently deductible on the Company's Federal income tax
21 returns. In order to match the cash flow impacts of the OEM with the
22 Company's funding commitment, it is proper to measure the funding
23 requirement based on the OPEB expense included in the Company's cash
24 receipts from its customers during each calendar year rather than the

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1 OPEB expense recognized in each calendar year.

2

3 Further, to the extent the Company is unable to realize a current reduction
4 in its Federal income taxes from the external funding, the lost tax savings
5 resulting from the inability to realize the full tax benefit will reduce the
6 amount funded. Such amount will be computed by reducing the amount
7 included in rates by the Federal income tax rate. Thus, if \$100 million of
8 OPEB expense is included in rates and the Company is unable to
9 currently deduct any external funding, the funding obligation would be
10 reduced by \$35 million (35% of \$100 million). The resulting OPEB funding
11 requirement of \$65 million would thus equal the \$100 of cash inflow from
12 customers less the Federal income tax of \$35 million on the \$100 million
13 of pretax income, since there would be no offset to taxable income for any
14 OPEB funding.

15

16 **Q. How do you propose the amounts arising from the annual operation**
17 **of the OEM be collected from or distributed to customers?**

18 A. The Company will file with the Commission an annual report of the
19 amounts computed under the OEM in conjunction with its annual PSCR
20 reconciliation filing. A temporary surcharge or credit will be developed for
21 each rate schedule on an equal cents per kWh basis. The amounts
22 collected or distributed would be subject to subsequent reconciliation.

23

24 **Q. Will customers benefit from the OEM?**

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1 A. Yes. As I described earlier, OPEB expense is highly sensitive to a variety
2 of assumptions and experience. As a result, OPEB expense has varied
3 widely between years. Since this variability is likely to continue,
4 customers will benefit from the timely recognition of the changes in OPEB
5 expense in rates. Customers will have the benefit of lower rates if
6 changes in assumptions and experience lead to lower OPEB expense.
7 Similarly, the Company will be less likely to file comprehensive general
8 rate cases to seek recovery of any higher overall expense, including
9 increased OPEB expense.

10

11 **Q. Does this complete your testimony?**

12 A. Yes, it does.

13

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the Commission's own motion)
ordering **THE DETROIT EDISON COMPANY**)
to show cause why its retail rates for the sale)
and distribution of electric energy should not)
be decreased.)

Case No. U-14838

EXHIBITS
OF
DANIEL G. BRUDZYNSKI

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the Commission's own motion)
ordering **THE DETROIT EDISON COMPANY**)
to show cause why its retail rates for the sale)
and distribution of electric energy should not)
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Case No. U-14838

WORKPAPERS
OF
DANIEL G. BRUDZYNSKI