

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
PAUL G. HORGAN

THE DETROIT EDISON COMPANY
QUALIFICATIONS OF PAUL G. HORGAN

Line
No.

1 **Q. Please state your full name and business address.**

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

4

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

6 A. I graduated from Michigan State University with a Bachelor of Arts degree in
7 Accounting. In addition, I received a Master of Business Administration
8 degree with a concentration in finance from Wayne State University.

9

10 **Q. Will you describe your work experience?**

11 A. In 1979, I was employed by ANR Pipeline Company ("ANR") as an
12 Accountant in the Controller's Activity. ANR is an interstate natural gas –
13 gathering, storage and transmission company regulated by the Federal
14 Energy Regulatory Commission ("FERC"). Within ANR's Controller's
15 Activity I held a variety of Staff Positions of increasing responsibility,
16 becoming a Supervisor in 1982. In 1986, I commenced working within
17 ANR's Rates Activity and remained there until 1997. During this period I
18 held various positions of increasing responsibilities including positions within
19 Gas Supply, Rates Research, and Jurisdictional Rates. I was promoted to
20 Manager of Jurisdictional Rates in 1991. In late 1997 I was promoted to
21 Director \ Consultant within ANR's Financial Planning Activity. I remained in
22 this position until early 2001, when ANR, as part of a merger, was moved to
23 Houston and I left the Company.

24

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1 **Q. Will you describe your work experience within ANR's Jurisdictional**
2 **Rates Department?**

3 A. While I was Manager of Jurisdictional Rates, my department was
4 responsible for the development, coordination, analysis, and resolution of
5 general rate case filings for ANR, High Island Offshore System ("HIOS") and
6 U-T Offshore System ("UTOS"). In developing rate cases my department
7 was responsible for determination of the Cost of Service\Revenue
8 Requirements, Cost Classifications\Allocations and Rate Design for the
9 various regulated services offered by ANR. While in Jurisdictional Rates I
10 actively participated in the preparation of ANR's last two major rate case
11 filings before the FERC; Dockets Nos. RP89-161 and RP94-43. In both of
12 these ANR dockets I presented testimony sponsoring various cost of service
13 components and participated as a witness in the rate case hearings.
14 Further, I have presented testimony in HIOS' Docket Nos.; RP89-37, RP92-
15 50 and RP94-162, as well as, UTOS' Docket No. RP94-161.

16

17 **Q. Will you describe your DTE Energy \ Detroit Edison work experience?**

18 A. I have been employed with DTE Energy Company ("DTE") since early 2001.
19 Initially I accepted a position in DTE's Corporate Development organization
20 as a Project Manager, where I worked on the economic analysis and
21 evaluation of DTE's major regulated and non-regulated capital projects and
22 acquisition opportunities.

23

24 **Q. While in DTE's Corporate Development department, were you involved**

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1 **in Detroit Edison's and MichCon's general rate case filings?**

2 A. Yes, in 2003 I actively supported Mr. Paul Geick as a witness and helped
3 prepare his exhibits and workpapers, in both Detroit Edison's U-13808 rate
4 case and Michigan Consolidated Gas Company's U-13898 rate case. In
5 both of these cases Mr. Geick was responsible for historic and projected
6 test year financial statements and presenting the financial statements in the
7 appropriate format for rate making purposes.

8

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

10 A. In June 2005 I was appointed Manager of Revenue Requirements within
11 DTE's Regulatory Affairs organization. I am responsible for Detroit Edison's
12 and Michigan Consolidated Gas Company's revenue requirements studies,
13 depreciation rate studies, and regulatory analysis \ research.

14 .

THE DETROIT EDISON COMPANY
DIRECT TESTIMONY OF PAUL G. HORGAN

Line
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1 **Q. What is the purpose of your testimony in this proceeding?**

2 A. I am providing testimony in two separate sections. In Section A, I am
3 supporting Detroit Edison's 2005 Total Electric historical test-year revenue
4 deficiency, based on the rate base, adjusted Net Operating Income ("NOI"),
5 overall rate of return used in determining return on rate base, and the
6 revenue gross-up multiplier. Further, I am sponsoring the NOI adjustments
7 for interest synchronization and income tax savings. In preparing my rate
8 case exhibits, I relied on information supplied by Detroit Edison witnesses;
9 Mr. VanHaerents and Mr. Stadnikia. I am also sponsoring the classification
10 of Mr. VanHaerents Total Electric 2005 Balance Sheet into either rate base
11 or capitalization. Further, I am sponsoring certain adjustments to adjusted
12 NOI.

13

14 In Section B I am sponsoring Detroit Edison's Total Electric 2007 projected
15 revenue deficiency, as well as its underlying revenue multiplier, interest
16 synchronization adjustment, income tax savings adjustment, and overall
17 rate of return. In addition, I support the calculation of the revenue deficiency
18 change from 2005 to 2007 relating to known and measurable proposed
19 changes through the end of the projected 2007 test year. My testimony will
20 summarize the reasons for Detroit Edison's 2007 revenue deficiency. For
21 both the historic and projected test periods, my calculations are performed
22 on a "**Total Electric**" basis. Where "**Jurisdictional Electric**" amounts are
23 required, Detroit Edison witness Mr. Heiser will support the jurisdictional
24 separation. To comply with the Commission's filing requirements; I will also

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1 provide forecasted revenue deficiencies for the years 2008 through 2011.

2

3 **Q. Will you identify the exhibits you are sponsoring in this proceeding?**

4 A. The following lists the historic and forecast exhibits that I am supporting or
5 sponsoring with other witnesses:

6

7 **Section A – 2005 Historic Year Exhibits**

8	<u>Exhibit</u>	<u>Schedule</u>	<u>Description</u>
9	DE-1	A1	Revenue Deficiency (Sufficiency) – Total Electric and
10			Jurisdictional Electric
11	DE-2	B1	Rate Base – Total Electric and Jurisdictional Electric
12	DE-2	B2	Adjustments to Rate Base
13	DE-2	B3	13-Month Average Adjusted Balance Sheet – Total
14			Electric
15	DE-2	B3-1	Year-End Adjusted Balance Sheet – Total Electric
16	DE-2	B3-2	Adjusted Balance Sheet – Total Electric
17	DE-3	C1	Adjusted Net Operating Income - Total Electric and
18			Jurisdictional Electric
19	DE-3	C4	Income Tax Effect of Interest Allowed in Ratemaking
20			Formula
21	DE-3	C5	Gross Revenue Conversion Factor
22	DE-3	C10	Synchronization Adjustment
23	DE-4	D1	Rate of Return Summary

24

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1	<u>Section B – Projected Test Year Exhibits (2007 – 2011)</u>		
2	<u>Exhibit</u>	<u>Schedule</u>	<u>Description</u>
3	DE-8	A1	Revenue Deficiency (Sufficiency) Comparison Total
4			Electric and Jurisdictional Electric Historic Year 2005
5			vs. Forecast Year 2007
6	DE-8	A1-1	Known and Measurable Adjustments - Revenue
7			Requirements Effects - Deficiency \ (Sufficiency)
8			Total Electric and Jurisdictional Electric -- 2005
9			Historic Year to 2007 Test Year
10	DE-9	A1	Revenue Deficiency (Sufficiency) – Total Electric and
11			Jurisdictional Electric for Year 2007
12	DE-10	B1	Rate Base - Total Electric and Jurisdictional Electric -
13			Average for Year 2007
14	DE-10	B1-1	Reconciliation of Rate Base of 2005 Historic Test Year
15			to Projected Test Year of 2007 - Total Electric and
16			Jurisdictional Electric
17	DE-10	B3-1	Adjusted Average Balance Sheet -Total Electric For
18			Year 2007
19	DE-11	C1	Adjusted Net Operating Income – Total Electric and
20			Jurisdictional Electric for Year 2007
21	DE-11	C4	Income Tax Effect of Interest Allowed in Ratemaking
22			Formula - Total Electric for Years 2005 and 2007
23	DE-11	C5	Gross Revenue Conversion Factor
24	DE-11	C10	Synchronization Adjustment -Total Electric for Years

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1

2005 and 2007

2

DE-12 D1

Rate of Return Summary for Year 2007 – Based on

3

Average 2007 Rate Base

4

DE-19 A1

Revenue Deficiency (Sufficiency) - Total Electric for

5

Years 2007 - 2011

6

7

Q. Were these exhibits prepared by you or under your direction?

8

A. Yes, they were.

9

10

Section A - Historic Period

11

12

Q. Will you explain Exhibit DE-1, Schedule A1, Revenue Deficiency \ (Sufficiency) – Total Electric and Jurisdictional Electric for Year 2005?

13

14

A. Schedule A1 shows the calculation of the Company's 2005 revenue

15

deficiency based on the 2005 adjusted Rate Base, Overall Rate of Return,

16

Adjusted NOI and Revenue Conversion Factor. Within this schedule, I am

17

sponsoring the, "Total Electric" column and Witness Mr. Heiser is

18

sponsoring the "Jurisdictional Electric" column. Line 16, Column (c) of

19

Schedule A1 shows that the Company experienced a Total Electric revenue

20

deficiency of \$64 million in 2005. This 2005 revenue deficiency is based on;

21

adjusted Rate Base of \$7,456 million adjusted and normalized NOI of \$492

22

million and a required overall actual rate of return of 7.14%. The return

23

required for the defined rate base and overall return is \$532 million. Total

24

Electric Rate Base is detailed in Exhibit DE-2, Schedule B1. NOI is

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1 adjusted and normalized on Exhibit DE-3, Schedule C1. NOI is normalized
2 for; elimination of residential rate caps, weather, removing regulatory assets
3 - recoveries, amortizations and cost deferrals, securitization tax revenues \
4 expenses and other O&M and tax related items. The 2005 Required Rate
5 of Return of 7.14% is set forth in Exhibit DE-4, Schedule D1.

6

7 **Q. Will you describe Exhibit DE-2, Schedule B1, Rate Base – Total Electric**
8 **and Jurisdictional Electric?**

9 A. Per the filing requirements, for the historic period, the 2005 net plant
10 amounts reflect year-end 2005 balances, while allowance for working capital
11 reflects a 13-month average balance for the period ending December 31,
12 2005. Schedule B1 identifies the major components of Net Plant along with
13 the working capital allowance that makes up Detroit Edison's 2005 Rate
14 Base. Again, within this schedule, I am sponsoring the, "Total Electric"
15 column and Witness Mr. Heiser is sponsoring the "Jurisdictional Electric"
16 column. 2005 Total Electric Rate Base is made up of \$7,536 million of Net
17 Plant and \$(80) million of Working Capital. The Total Electric Rate Base of
18 \$7,456 million, as shown on line 22, carries over to Exhibit DE-1, Schedule
19 A1, line 2, for use in the calculation of the 2005 revenue deficiency.
20 Adjustments to arrive at Total Electric rate base and capitalization are
21 shown and explained in Schedules B3, B3-1 and B3-2 of this exhibit.

22

23 **Q. Will you explain Exhibit DE-2, Schedule B2 Adjustments to Rate Base?**

24 A. There are no adjustments necessary to rate base as the exhibit already

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1 reflects year-end plant balances.

2

3 **Q. Will you explain Exhibit DE-2, Schedules B3, B3-1 and B3-2 Adjusted**
4 **Balance Sheet – Total Electric?**

5 A. In order to ensure compliance with filing requirements of using year-end net
6 plant amounts and a 13-month average working capital balance amounts,
7 rate base and capitalization were determined as follows:

8

9 1) Schedule B3 calculates Detroit Edison's "Total Electric" 2005 adjusted
10 balance sheet on a 13-month average basis, inclusive of required rate
11 case adjustments.

12 2) Schedule B3-1 calculates Detroit Edison's "Total Electric" 2005 adjusted
13 balance sheet on a year-end basis, inclusive of required rate case
14 adjustments.

15

16 On Schedules B3 and B3-1, Mr. VanHaerents supports the unadjusted
17 amounts and all column adjustments in developing Detroit Edison's Total
18 Electric perspective. On each of these schedules, I am sponsoring the rate
19 case classification of Mr. VanHaerent's Total Electric balance sheet, as
20 reflected on pages 3 and 4, into either; Net Plant, Working Capital, Common
21 Equity, Short-Term \ Long-Term Debt, Deferred Income Taxes or Job
22 Development - ITC.

23

24 3) Schedule B3-2 sets forth the 2005 "Total Electric" adjusted balance

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1 sheet both on a year-end basis (column b) and on a 13-month average
2 basis (column c). Column (d) reflects a \$186 million increase in both
3 net plant and capitalization for the incremental difference in using 2005
4 year-end net plant amounts rather than 13-month average balances.
5 Column (e) entitled "Adjusted Total Electric" reflects the combined 2005
6 balance sheet using year-end net plant amounts and the 13-month
7 average balances for working capital and other items. Column (e)
8 Adjusted Total Electric balance sheet is then classified in columns (f) –
9 (l) into the rate base and capitalization amounts for the 2005 historic
10 period that are carried into Exhibit DE-2, Schedule B1 and Exhibit DE-4,
11 Schedule D1.

12

13 **Q. Will you identify which line items on Exhibit DE-3, Schedule C1,**
14 **Adjusted Net Operating Income – Total Electric and Jurisdictional**
15 **Electric you are sponsoring?**

16 A. On this exhibit I am supporting the adjustments for:

17 1) Income Tax Effect of Interest (line 11), supported by Schedule C4

18 2) Synchronization Adjustment (line 12), supported by Schedule C10

19

20 **Q. Will you explain the nature of the Income Tax Effect of Interest shown**
21 **on line 11 of Exhibit DE-3, Schedule C1?**

22 A. This increased tax expense adjustment of \$1.6 million is calculated on
23 Schedule C4 of this exhibit. This adjusted tax expense reflects the
24 difference between the amount of interest tax deductions included in the

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1 rate case Rate of Return and Detroit Edison's 2005 actual interest expense
2 tax deductions.

3

4 **Q What are the mechanics of the calculation of the Income Tax Savings**
5 **of Interest reflected in Exhibit DE-3, Schedule C4?**

6 A. Exhibit DE-3, Schedule C4, is based on the premise that total capitalization
7 is equal to total utility rate base. Thus, the weighted capital cost
8 percentages developed in the overall rate of return summary on Exhibit DE-
9 4, Schedule D1, can be applied to rate base to yield the aggregate dollar
10 amount of expense associated with each individual capital component. Line
11 2 shows the 2005 rate base of \$7,456 million. Line 4 shows the weighted
12 cost of debt of 2.55%, which is the summation of the weighted costs
13 associated with long-term debt ("LTD"), and short-term debt ("STD"). Line 6
14 calculates the allowable ratemaking interest expense deduction of \$190.1
15 million. Line 9 shows Detroit Edison's 2005 interest expense deduction of
16 \$194.5 million for LTD and STD, which was included in Detroit Edison's
17 computation of federal income tax. Allowable ratemaking interest expense
18 is less than actual interest expense, which yields a lower tax deduction on
19 line 11 of \$4.4 million. This lower tax deduction increases federal income
20 tax and municipal tax expense and creates a corresponding decrease in
21 NOI of \$1.6 million as shown on line 23.

22

23 **Q. What is the Synchronization Adjustment shown on line 12 of Exhibit**
24 **DE-3, Schedule C1?**

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1 A. This decreased tax expense adjustment of \$1.3 million is calculated on
2 Schedule C10 of this exhibit. Tax law requires, and prior Commission
3 Orders have allowed, a return on Job Development Investment Tax Credits
4 ("JDITC") at the rate of return for permanent capital. This tax adjustment
5 represents the interest deduction for the debt component of that return.
6 Exhibit DE-3, Schedule C10, shows a reduction in income tax expense of
7 \$1.3 million due to the interest deduction associated with the debt
8 component portion of JDITC. JDITC is afforded a return equal to the
9 weighted cost of permanent capital as required by law and prior
10 Commission orders. This is a ratemaking adjustment to align the level of
11 interest expense inherent in the capital structure with the Company's rate
12 base. As shown on line 22, this Synchronization Adjustment to reduce
13 income tax expense by \$1.3 million results in a corresponding increase in
14 NOI of \$1.3 million.

15

16 **Q. What is the Gross Revenue Conversion Factor on Exhibit DE-3,**
17 **Schedule C5 and how is it derived?**

18 A. Schedule C5 provides the calculation of the gross revenue conversion factor
19 of 1.5731 used in the revenue deficiency (sufficiency) determination for the
20 2005 historic period. The 1.5731 factor incorporates the effect of the federal
21 income tax rate of 35%, the current Michigan Single Business Tax Rate of
22 1.9% and the composite municipal excise tax rate of 0.3036%. The 1.5731
23 gross revenue conversion factor converts after tax income into pre-tax
24 revenue. Each dollar of revenue the Company receives is subject to MSBT,

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1 municipal income tax, and federal income tax. Thus for every \$100,000 of
2 incremental revenue collected, Detroit Edison receives \$63,568 after
3 payment of the taxes mentioned above. Line 15 shows that the Company is
4 required to collect \$1.5731 in revenue in order to produce \$1.00 of after tax
5 income.

6

7 **Q. How was the 2005 effective composite municipal excise tax rate of**
8 **0.3036% on line 3 of Schedule C5 determined?**

9 A. The 2005 composite municipal tax rate of 0.3036% was developed
10 consistent with each respective municipality's method for apportioning city
11 income tax. The method for apportioning municipal income tax consists of a
12 weighted average based on three underlying factors. The underlying factors
13 that compose the weighting are the concentration of Detroit Edison's net
14 plant investment, payroll distribution, and sales within a specific taxing
15 jurisdiction divided by the total of each of those categories for all applicable
16 municipalities. These three individual factors are then averaged together to
17 develop a single apportionment percentage for each taxing jurisdiction. The
18 apportionment percentage is then applied to the municipal income tax rate
19 in each respective taxing jurisdiction to develop a composite rate.

20

21 **Q. Will you describe Exhibit DE-4, Schedule D1, Rate of Return**
22 **Summary?**

23 A. Exhibit DE-4, Schedule D1, is Detroit Edison's 2005 overall rate of return.
24 The capital structure is carried forward from the 2005 balance sheet on line

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1 83 columns (h through l) of Exhibit DE-2, Schedule B3-2, and equals the
2 rate base amount on line 22 Column (b) of Exhibit DE-2, Schedule B1.
3 Exhibit DE-4, Schedule D1 shows Detroit Edison's 2005 overall rate of
4 return of 7.14% (Line 17, Column (g)).

5

6 Long-term debt, shown on line 1 of Schedule D1 has been reduced by the
7 net amount of unamortized premium, discount, any funds on deposit with
8 trustees and the debt financing related to regulatory assets being eliminated
9 by Mr. VanHaerents. Detroit Edison's total long-term debt outstanding at
10 December 31, 2005 is detailed on Schedule D2. The weighted long-term
11 debt cost for 2005 of 5.79% was calculated using the net proceeds method,
12 as specified by the Commission, for each issue outstanding at the end of
13 2005. Exhibit DE-4 Schedule D2, sponsored by Mr. Stadnikia, details the
14 development of the weighted long-term debt cost of 5.79%. Line 3 of
15 Schedule D1 reflects that the Company has no preferred stock outstanding.

16

17 Line 5 of Schedule D1 shows common shareholders' equity, which includes
18 common stock outstanding, less expense, plus premium, retained earnings
19 and Other Comprehensive Income ("OCI") adjustments. The cost of
20 common shareholders' equity utilized for this exhibit is the 11% that was
21 authorized by the Commission in Case No. U-13808 as indicated on
22 Schedule D4 of this Exhibit.

23

24 The cost of short-term debt, on line 9, of 4.70% is the actual average short-

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1 term borrowing cost of the Company in 2005. The Job Development – ITC
2 amounts on lines 11 (JDITC – Debt) and 12 (JDITC – Equity) of Schedule
3 D1 reflect the corresponding permanent capital percentages of 51.50% for
4 Long-Term Debt and 48.50% for Common Equity. The associated returns
5 for JDITC – Debt and JDITC – Equity reflect the corresponding permanent
6 capital rates of 5.79% and 11.00%, respectively. This calculation complies
7 with the 1986 Internal Revenue Service Regulation, Section 1.46-6, to
8 assign a rate of return to JDITC at the weighted average cost of permanent
9 capital.

10

11 Deferred income taxes (line 15), as shown on Schedule D1 for 2005 are at
12 zero cost.

13

14 **Q. Does this complete your testimony with regard to the historic year**
15 **2005?**

16 A. Yes, it does.

17

18 **Section B - Forecast Period**

19

20 **Q. What is the purpose of Exhibit DE-9, Schedule A1, Revenue Deficiency**
21 **(Sufficiency) – Total Electric and Jurisdictional Electric for Year 2007?**

22 A. Exhibit DE-9, Schedule A1, shows Detroit Edison's 2007 Revenue
23 Deficiency (Sufficiency) from both a Total Electric and Jurisdictional Electric
24 perspective. I am co-sponsoring this exhibit with Mr. Heiser, who will cover

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1 the components underlying the jurisdictional deficiency in column (d). Line
2 23 of Schedule A1 shows that the Company will experience, for 2007, a
3 Total Electric revenue deficiency of \$34 million. This deficiency is based on
4 adjusting the 2005 revenue requirements for significant known and
5 measurable changes that are expected to take place through the end of the
6 2007 test year. These known and measurable changes impact rate base,
7 NOI and required rate of return and are detailed within the exhibits and
8 schedules of Mr. VanHaerents, Mr. Stadnikia and myself.

9

10 **Q. Will you explain Exhibit DE-10, Schedules B1, Rate Base Total Electric**
11 **and Jurisdictional Electric Average for Year 2007?**

12 A. Schedule B1 is the determination of Total Electric and Jurisdictional Electric
13 average rate base using beginning and end-of-year balances for the year
14 2007 with amounts derived from the average balance sheet on Exhibit DE-
15 10, Schedule B3. The 2007 Total Electric rate base amount of \$8,073
16 million is carried forward to the 2007 revenue deficiency calculation on
17 Exhibit DE-9, Schedule A1, column (c), line 2. As detailed on Schedule B1,
18 this average 2007 Total Electric rate base consists of a Net Plant balance of
19 \$8,381 million of Net Plant and a working capital allowance of (\$308) million.

20

21 **Q. How has Detroit Edison's 2007 Total Electric and Jurisdictional**
22 **Electric rate base per Exhibit DE-10, Schedules B1 changed from its**
23 **2005 rate base reflected in Section A in Exhibit DE-2, Schedule B1?**

24 A. Exhibit DE-10, Schedule B1-1, provides a comparison of Detroit Edison's

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1 2005 rate base from Section A to its 2007 average rate base contained here
2 in Section B. Column (c) of Schedule B1-1 shows that Total Electric; Gross
3 Utility Plant increased by \$1,354 million (line 8), Net Utility Plant increased
4 by \$845 million (line 12), Working Capital declined by \$228 million (line 23)
5 and the resulting 2007 Total Electric rate base increased by a net \$617
6 million. Lines 30 through 52 of Schedule B1-1, provides this same year to
7 year rate base comparison from a Jurisdictional Electric perspective.

8

9 **Q. Will you explain Exhibit DE-10, Schedules B3-1, Adjusted Average**
10 **Balance Sheet – Total Electric for the Year 2007?**

11 A. Schedule B3-1 is a two page schedule that reflects the 2007 average
12 balance sheet using beginning and ending year balances. Page 1 of 2
13 details the 2007 assets and other debits and page 2 of 2 details the
14 liabilities, equity and other credits. Mr. VanHaerents supports the
15 development of the Total Electric - Detroit Edison balance sheet amounts as
16 reflected in column (b) of this schedule. Columns (c) through (i) of Schedule
17 B3-1 shows the rate base and capitalization components for 2007 that are
18 used in Exhibit DE-10, Schedule B1 and Exhibit DE-12, Schedule D1,
19 respectively.

20

21 **Q. What adjustments on Exhibit DE-11, Schedule C1, Adjusted Net**
22 **Operating Income, Total Electric and Jurisdictional Electric, Year 2007**
23 **are you sponsoring?**

24 A. On this exhibit I am supporting the incremental adjustments from 2005 to

Line
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1

2007 for:

2

1.) Income Tax Effect of Interest (line 15) supported by Exhibit DE-11,

3

Schedule C4.

4

2.) Synchronization Adjustment (line 16) supported by Exhibit DE-11,

5

Schedule C10

6

7

Q. What is the adjustment for "Income Tax Effect of Interest" as shown

8

on line 15 Exhibit DE-11, Schedule C1?

9

A. This adjustment of (\$1.9) million, line 15 of Exhibit DE-11, Schedule C1, is

10

the incremental change from the 2005 base year to the 2007 test year in the

11

income tax effect of interest allowed. This adjusted tax expense reflects the

12

difference between the ratemaking amount of interest tax deductions

13

included in the filed return and the forecasted interest tax deductions

14

included in the 2007 NOI supported by Mr. VanHaerents. This incremental

15

change in the federal tax expense of \$(1.9) million is set forth in Exhibit DE-

16

11, Schedule C4. As shown on line 15 of Schedule C1, this incremental

17

adjustment decreased federal income tax expense by \$1.9 million resulting

18

in a corresponding increase in NOI of \$1.9 million.

19

20

Q. What is the "Synchronization Adjustment" shown on line 16 of Exhibit

21

DE-11, Schedule C1?

22

A. This adjustment of \$0.2 million on line 16 of Exhibit DE-11, Schedule C1 is

23

the rate case incremental change in the Synchronization Adjustment from

24

the 2005 historic year to the 2007 test year. As I have discussed previously

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1 in Section A of my testimony, tax law requires and prior Commission Orders
2 have allowed, a return on JDITC at the rate of return for permanent capital.
3 This incremental change in the federal tax expense of (\$0.2) million is set
4 forth in Exhibit DE-11, Schedule C10. As shown on line 16 of Schedule C1,
5 this incremental Synchronization Adjustment increased federal income tax
6 expense by \$0.2 million resulting in a corresponding decrease in NOI of
7 \$0.2 million.

8

9 **Q. Will you describe Exhibit DE-11, Schedule C5; Gross Revenue**
10 **Conversion Factor?**

11 A. Exhibit DE-11, Schedule C5 is essentially the same as my Exhibit DE-3,
12 Schedule C5 from Section A. The only difference is for 2007 the composite
13 municipal excise tax rate decreases from the 2005 level of 0.3036% to
14 0.2561%. This change results in a reduction to the 2007 gross revenue
15 conversion factor to 1.5724 from the 2005 level of 1.5731.

16

17 **Q. What is the nature of Exhibit DE-12, Schedule D1, Rate of Return**
18 **Summary for Year 2007 and is its underlying source data?**

19 A. Exhibit DE-12, Schedule D1, is the 2007 Rate of Return Summary. The
20 2007 average balance sheet capital structure amounts, in column (b), are
21 carried forward from Exhibit DE-10, Schedule B3; line 85, columns (e
22 through i), and collectively they equal the Total Electric rate base amount on
23 Exhibit DE-9, Schedule A1 of \$8,073 million. Schedule D1 calculates the
24 2007 weighted cost of capital as 7.36%, line 17, column (g). This 7.36%

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1 weighted cost of capital is carried forward to Exhibit DE-9, Schedule A1 and
2 is used in the determination of the 2007 revenue deficiency.

3

4 Total Electric long-term debt of \$3,437 million, shown on line 1 of Schedule
5 D1, has been reduced by the net amount of unamortized premium, discount,
6 any funds on deposit with trustees and the debt financing related to
7 regulatory assets being eliminated by Mr. VanHaerents. This average 2007
8 balance of long-term debt represents 50.6% of Detroit Edison's permanent
9 capital. Detroit Edison's total long-term debt outstanding at December 31,
10 2007 is detailed on Schedule D2. The weighted long-term debt cost of
11 5.91% was calculated using the net proceeds method for each issue
12 outstanding at the end of 2007 including the financing cost of new debt
13 issues supported by Mr. Stadnikia in Exhibit DE-12, Schedule D2. Line 3 of
14 Schedule D1 reflects that the Company has no preferred stock outstanding.

15

16 Line 5 of Schedule D1 shows 2007 average common shareholders' equity
17 of \$3,358 million, which includes common stock outstanding, less expense,
18 plus premium, retained earnings and OCI adjustments. This level of
19 average Common Equity represents 49.4% of Detroit Edison's permanent
20 capital in 2007. The cost of common shareholders' equity utilized for this
21 exhibit is 11.25%, which is supported by Detroit Edison witness Dr. Morin in
22 his testimony.

23

24 The cost of short-term debt, on line 9, of 5.4% is the forecasted average

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1 short-term borrowing cost of the Company in 2007 supported by Mr.
2 Stadnikia Exhibit DE-12, Schedule D5. The average 2007 Job
3 Development – ITC amounts on lines 11 (JDITC – Debt) and 12 (JDITC –
4 Equity) of Schedule D1 reflect the corresponding permanent capital
5 percentages of 50.6% for Long-Term Debt and 49.4% for Common Equity.
6 The associated returns for JDITC–Debt and JDITC–Equity reflect the
7 corresponding permanent capital rates of 5.91% and 11.25%, respectively.
8 This calculation complies with the 1986 Internal Revenue Service
9 Regulation, Section 1.46-6, to assign a rate of return to JDITC at the
10 weighted average cost of permanent capital.

11

12 Deferred income taxes of \$1,104 million (line 15), as shown on Schedule D1
13 for 2007 are at zero cost of capital.

14

15 **Revenue Requirement Comparison**

16

17 **Q. How does the revenue deficiency for the 2007 test year compare with**
18 **the revenue deficiency for the normalized 2005 historic year?**

19 A. Exhibit DE-8, Schedule A1, Revenue Deficiency (Sufficiency) Comparison -
20 Total Electric and Jurisdictional Electric; Historic Year 2005 vs. Forecast
21 Year 2007 shows this comparison. The detailed line items are on a
22 comparable basis and the changes between the two years are captured in
23 column (c). For Total Electric, line 16 of this exhibit shows the Company's
24 2007 revenue deficiency of \$34 million decreased by \$30 million compared

Line
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1 to the Section A 2005 deficiency of \$64 million. A reconciliation in the major
2 components underlying the Total Electric deficiency decrease of \$30 million
3 are detailed in Exhibit DE-8, Schedule A1 and are summarized on lines 20
4 through 24 as follows:

5	1) Rate Base Increases	\$69 million
6	2) Capital Structure and Costs Changes	\$28 million
7	3) Net Operating Income	\$(127) million

8
9 For Jurisdictional Electric, line 48 of this exhibit shows the Company's 2007
10 revenue deficiency of \$45 million decreased from the Section A 2005
11 Jurisdictional Electric deficiency of \$51 million. The major components
12 underlying the Jurisdictional Electric deficiency changed as follows;

13	1) Rate Base Increases	\$66 million
14	2) Capital Structure and Costs Changes	\$27 million
15	3) Net Operating Income	\$(102) million
16	4) Jurisdictional Separation Change	\$3 million

17

18 **Q. Will you explain the changes in the Company's 2005 to 2007 revenue**
19 **deficiency as detailed in Exhibit DE-8, Schedule A1-1?**

20 Exhibit DE-8, Schedule A1-1 details the changes in revenue deficiency from
21 2005 to 2007. Line 6 shows that rate base increased \$617 million (column
22 c) from 2005 to 2007 because of higher net utility plant investment from
23 increased level of construction expenditures. Offsetting this increase was
24 an increase in the negative working capital requirement. Column (g) of line

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1 6 shows that this rate base change increased the Total Electric revenue
2 deficiency by \$69 million. Line 18 shows that the overall rate of return
3 increased 22 basis points (7.14% to 7.36 %) from 2005 to 2007, which
4 increased the Total Electric revenue deficiency by \$28 million. The rate of
5 return increase is primarily driven by an increase in Common Equity as a
6 percent of total capitalization from 48.5% in 2005 to 49.4% on average in
7 2007. Also, the cost of Common Equity increased from 11% to 11.25% in
8 2007. Line 33 shows a summary of individual NOI known and measurable
9 changes defined in this case and their net \$81 million increase in NOI,
10 which decreased Detroit Edison's 2007 Total Electric deficiency by \$127
11 million from 2005 to 2007. The individual NOI changes are supported in
12 total by Mr. VanHaerents and individually by various Detroit Edison
13 witnesses. Column (h), of this exhibit, reflects the total Jurisdictional
14 Electric impacts of these revenue requirement changes.

15

16 **Beyond 2008 Revenue Requirements**

17 **Q. Will you explain Exhibit DE-19, Schedule A1, Revenue Deficiency**
18 **(Sufficiency), Total Electric, Years 2007 through 2011?**

19 A. Exhibit DE-19, Schedule A1 provides a five-year presentation of the
20 revenue deficiency for each of the years 2007 through 2011. Mr.
21 VanHaerents' Exhibit DE-14 Schedules B4 and B5 and Exhibit DE-15,
22 Schedule C1 supports the 2007 through 2011 forecasted NOI and Balance
23 Sheet amounts underlying each years Rate Base. Mr. VanHaerent's
24 adjustments made to NOI and the balance sheet for the 2007 test year were

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1 also made to the years, 2008 – 2011, to develop each years applicable rate
2 base and adjusted NOI. Mr. Stadnikia's testimony supports an increased
3 equity percentage target of 50% in the Company's capital structure by the
4 end of 2008. For the 2008 through 2011 forecast period, I have used Mr.
5 Stadnikia's defined costs of Long-Term Debt, for each applicable year, as
6 set forth in Exhibit DE-12 Schedule D2, Pages 2 through 5 and Schedule D5
7 for Short-Term Debt. I also continued to use Dr. Morin's recommended
8 11.25% 2007 Common Equity return for all of these years. Further, for the
9 years 2009 through 2011, the same permanent capital relationship of 50%
10 Long-Term Debt and 50% Common Equity has been maintained. Line 16 of
11 Exhibit DE-21 Schedule A1, indicates Detroit Edison's revenue deficiency
12 for each year from the 2007 test year through 2011.

13

14 **Q. Does Detroit Edison have an increase in its Revenue Deficiency in**
15 **2008, and, if so, what are the major drivers underlying the increase?**

16 A. Yes, as reflected on Exhibit DE-19, Schedule A1, for 2008, Detroit Edison is
17 projected to have a Total Electric revenue deficiency of \$91 million, an
18 increase of \$57 million over the 2007 deficiency level of \$34 million. This
19 2008 increase is driven by \$480 million in higher average rate base from
20 2007 due to higher levels of net plant investment. In addition the 2008
21 overall rate of return increases by 13 basis points from 2007. This rate of
22 return increase reflects the targeted level of 50% Common Equity
23 percentage on permanent capital by the end of 2008.

24

Line

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1 **Q. Mr. Horgan would you please summarize the scope of your testimony**
2 **in this proceeding?**

3 A. The following summarizes my testimony:

4 1) As shown in Section A, for 2005, using adjusted and normalized NOI for
5 2005, Detroit Edison's would have a Total Electric Revenue Deficiency
6 in base rates of \$64 million and a \$51 million Jurisdictional Electric
7 Revenue Deficiency as supported by Mr. Heiser.

8 2) Based on known and measurable changes through the end of 2007,
9 Detroit Edison's would have a Total Electric Revenue deficiency in base
10 rates of \$34 million and a \$45 million Jurisdictional Electric Revenue
11 Deficiency as supported by Mr. Heiser.

12 3) In 2008, without rate relief and with continued rate base growth, Detroit
13 Edison's Total Electric Revenue Deficiency in base rates would
14 escalate to \$91 million.

15

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

17 A. Yes, it does.

18