

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  
ROBERT J. BUCKLER

**THE DETROIT EDISON COMPANY**  
**QUALIFICATIONS OF ROBERT J. BUCKLER**

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

2     A.   My name is ROBERT J. BUCKLER.  My business address is The Detroit  
3       Edison Company, 2000 Second Avenue, Detroit, Michigan  48226.

4

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

6     A.   I am President and Chief Operating Officer of The Detroit Edison Company  
7       ("Edison" or "Company").

8

9     **Q.   Please state your educational background.**

10    A.   I graduated from the University of Michigan in 1971 with a Bachelor of  
11       Science Degree in Mechanical Engineering.  In 1973 I received a Masters of  
12       Science Degree in Mechanical Engineering from the Horace Rackham  
13       School of Graduate Studies at the University of Michigan.

14

15    **Q.   Please describe your work experience.**

16    A.   My employment with Edison began in May, 1973 as an engineer.  
17       Subsequently, I held a number of positions with increasing responsibility in  
18       the Company in areas that include: power generation engineering, operation  
19       and construction; fuel supply; customer service and corporate planning.

20

21       In 1990, I was appointed Vice President-Divisions.  My primary  
22       responsibilities included management of organizations which served as the  
23       primary contact for customers including; electrical distribution system

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1 engineering, operation, maintenance and construction and divisional  
2 customer service, sales and marketing.

3

4 In 1992, I became a Senior Vice President of Energy, Marketing and  
5 Distribution and then Executive Vice President – Energy Distribution in  
6 1997. Additional responsibilities included engineering, construction,  
7 operation and maintenance of the electrical transmission system,  
8 management of customer service, marketing and sales for major usage  
9 customers as well as operation and maintenance of the steam system.

10

11 I became President and Chief Operating Officer (“COO”) of DTE Energy  
12 Distribution in 1998. This unit consisted of all of the above activities plus  
13 responsibility for a non-regulated distributed generation company and  
14 selected corporate support functions including IT.

15

16 In October, 2005, I was elected President and COO of Edison, with  
17 responsibility for the entire electric utility’s operations. The utility’s  
18 operations had previously been separated in anticipation of the state’s move  
19 to electric deregulation. This change represents a return to the conventional  
20 utility operating structure under one central control point.

21

22 **Q. Are you a member of any professional organizations?**

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1 A. Yes. I am a registered Professional Engineer, State of Michigan and a  
2 member and fellow of the Engineering Society of Detroit and the American  
3 Society of Mechanical Engineers.

4

5 **Q. Have you testified or submitted testimony in prior rate cases or other**  
6 **regulatory proceedings?**

7 A. I have testified or submitted testimony before the Michigan Public Service  
8 Commission ("Commission") on several occasions regarding the Fermi 2  
9 construction schedule, fuel supply and electrical distribution restoration and  
10 improvement.

11

12 .

**THE DETROIT EDISON COMPANY**  
**DIRECT TESTIMONY OF ROBERT J. BUCKLER**

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

2     A.   My testimony will summarize recent Edison proceedings that have impacted  
3         customer rates; explain the reasons why Edison is filing this case; discuss  
4         cost and market pressures being experienced by Edison; and address what  
5         is being done to meet the challenging electric marketplace that exists today.  
6         I will also introduce each of Edison's witnesses and summarize the  
7         information being submitted in support of the Company's response to the  
8         Show Cause Order issued by the Commission.

9

10        Part I of my testimony provides an overview of the Company, a discussion  
11        of Edison's two recent rate proceedings (previous rate case and unbundling  
12        case), and the rationale behind this case presentation.

13

14        Part II provides an overview of the major risks and challenges confronting  
15        Edison.  These challenges include: the competitive electric market; the  
16        economic situation existing in the State; environmental compliance  
17        requirements; increasing cost pressures including raw material commodity  
18        prices, pension, healthcare and maintenance costs; service quality  
19        standards, and future generation supply adequacy.

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21        Part III summarizes describes the initiatives undertaken by Edison to  
22        manage these various cost pressures.

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1 Part IV describes Edison's recent financial results and the need for  
2 substantial external financing over the next five years.

3

4 Part V summarizes Edison's rate relief request.

5

6 Part VI provides an overview of this rate case filing, and discusses the  
7 scope of the testimony of the other Company witnesses in this proceeding.

8

9 **Q. Are you sponsoring any exhibits in this case?**

10 A. Yes, I am sponsoring the following exhibits:

11

| <u>Exhibit</u> | <u>Schedule</u> | <u>Description</u>                               |
|----------------|-----------------|--------------------------------------------------|
| DE-21          | RJB-1           | Annual Choice Sales: Actual and Forecast (2001 - |
|                |                 | 2007)                                            |
| DE-21          | RJB-2           | Changes in Revenue Deficiency since Case No. U-  |
|                |                 | 13808                                            |

17

18 **Part I – Company Overview and Recent Rate Proceedings**

19

20 **Q. Please provide a brief overview of Detroit Edison and summarize its**  
21 **last general rate case, Case No. U-13808.**

22 A. Founded in 1903, Edison is the largest electric utility in Michigan and one of  
23 the largest in the nation. Edison generates and distributes electricity to 2.2  
24 million customers in southeastern Michigan. With approximately an 11,000

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1 megawatt system capacity, the Company uses coal, nuclear fuel, natural  
2 gas, fuel oil, and hydroelectric pumped storage to generate its electrical  
3 output.

4

5 The Company's last general rate case was filed on June 20, 2003. Edison,  
6 through a series of subsequent related updates, requested final rate relief in  
7 Case No. U-13808 of approximately \$583 million. The Commission issued  
8 a final order on November 23, 2004. This order authorized Edison to  
9 increase its annual base revenues by approximately \$374 million, effective  
10 on and after November 24, 2004. In addition to the rate relief stated above,  
11 the Commission order also authorized recovery of regulatory assets;  
12 directed that certain emission allowance costs and transmission costs and  
13 fees paid to the Midwest Independent System Operator be included in  
14 Power Supply Cost Recovery ("PSCR") costs going forward; implemented a  
15 renewable energy program; determined a level of Electric Choice sales to  
16 be reflected in rates; made changes to the existing Electric Choice program  
17 and established a pension equalization mechanism to reconcile changes in  
18 pension expenses.

19

20 The Commission order also required Edison to file a subsequent application  
21 to unbundle its rates as required by Public Act 141 and if desired, adjust  
22 rates to remove rate differentials or other inequalities including subsidies  
23 inherent in its then current rates (commonly referred to as "deskewing").

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1 **Q. Did Edison file its unbundling/deskewing application as directed by**  
2 **the November 23, 2004 Commission order?**

3 A. Yes. On February 4, 2005, Edison submitted its required filing in Case No.  
4 U-14399. In this revenue neutral proceeding, the Company “unbundled” its  
5 current rates into rates to collect under “power supply” (including  
6 transmission) and “distribution” costs. In addition, Edison proposed to  
7 phase out inter-class rate subsidies.

8

9 **Q. Describe what you mean by inter-class rate subsidies.**

10 A. Prior to Case No. U-14399, most rates for Edison were not reflective of the  
11 actual cost to serve. Rather, residential customers were paying less than if  
12 their rates were based on the cost to serve them. Conversely, commercial  
13 and industrial customers taking bundled electric service were paying rates  
14 higher than their actual cost of service. This inter-class rate subsidy reflects  
15 a long-standing Commission policy to have commercial and industrial  
16 customers provide a subsidy to residential customers. Edison proposed  
17 that the unbundled power supply and distribution rates be based on a fully-  
18 allocated cost of service study, thus eliminating all subsidies under a phase-  
19 out program. Additionally, Electric Choice customers were paying a lower  
20 distribution rate than the distribution portion of Edison’s bundled service  
21 rates. Edison proposed to eliminate these intra-class rate subsidies as well.

22

23 The general intent of the filing was to ensure that all customers, including  
24 those taking Electric Choice, pay a fair and proportionate share of each

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1 element of electric service. This would have eliminated both the inter- and  
2 intra-class subsidies. Removing inter- and intra-class subsidies would have  
3 also ensured that customers would be able to make rational economic  
4 decisions regarding whether to purchase generation service from Edison or  
5 from an Alternative Electric Supplier ("AES").

6

7 **Q. Please summarize the Commission's December 22, 2005 order with**  
8 **respect to Case No. U-14399.**

9 A. While the Commission did not order the comprehensive realignment of rates  
10 as requested by Edison, the order did take some initial steps to improve the  
11 competitive imbalance that existed with respect to Michigan's Electric  
12 Choice program. The Commission ordered that distribution charges for both  
13 bundled and Electric Choice customers be based on cost of service.  
14 However, the residential rate subsidies continue to be completely funded by  
15 bundled service commercial and industrial ("C&I") customers, and no phase-  
16 out of the residential subsidy was established even though the Company  
17 and virtually all other parties in the case proposed some form of phase-out.  
18 In addition, the Commission ordered Edison to file a general rate case by  
19 July 1, 2007.

20

21 **Q. Why is Edison filing this rate case now, instead of on July 1, 2007 as**  
22 **ordered by the Commission in its order in Case No. U-14399?**

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1 A. On March 22, 2006, the Commission issued an order initiating this  
2 proceeding and requiring Edison to explain why its retail electric rates  
3 should not be reduced.

4

5 **Q. What were the reasons given by the Commission for ordering this**  
6 **case?**

7 A. The Commission cited concerns about rising energy costs. It also  
8 expressed concern that Edison could exceed its authorized rate of return  
9 during 2006. The Commission indicated that recent reductions in Electric  
10 Choice levels below those reflected in rates, the expiration of the residential  
11 rate caps, along with a publicly announced Performance Excellence  
12 Process ("PEP") and anticipated cost reductions, could result in Edison  
13 being in an over-earning position in the near future.

14

15 **Q. Do you agree with the Commission's preliminary assessment of**  
16 **Edison's financial situation?**

17 A. No, I do not. While I agree that Edison's customers should pay electric  
18 rates that are just and reasonable, I do not believe that Edison's current rate  
19 levels are too high. As summarized by witness Horgan, based on current  
20 rates, Edison experienced a revenue deficiency of \$51 million in 2005,  
21 anticipates a sufficiency in 2006 of \$5 million, and projects a deficiency in  
22 2007 of \$45 million and larger revenue deficiencies in subsequent years.  
23 Earning our authorized return for only one year out of the past several, is  
24 hardly a "windfall" as described by one intervening party in this case.

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2 Although some financial and/or sales projections may have changed since  
3 Edison's previous rate case (as the Commission states in its initiating  
4 order), thereby giving the impression that the Company may have excess  
5 earnings, Edison has also experienced a number of cost increases above  
6 those levels approved in U-13808, some of which are beyond its control.  
7 Also, from a sales perspective, although a portion of the Choice load  
8 migrated back to bundled service during the past two years, total service  
9 territory sales projected for 2007 on a temperature normalized basis are well  
10 below the levels used for 2004 to establish rates in Case No. U-13808, and  
11 even further below historical trends because of the lagging Southeastern  
12 Michigan economy.

13

14 When revenues and costs are looked at in totality, Edison's rates are clearly  
15 not excessive, in fact, beginning in 2007, Edison's rates are insufficient to  
16 recover its cost of service. Edison will need additional rate relief beginning  
17 in 2007 to provide the revenues necessary in light of the cost pressures  
18 facing us now and in the future. Edison's evidentiary filing in this case sets  
19 forth this revenue deficiency.

20

21 **Part II – Major Issues and Challenges**

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1     **Q. Describe the cost pressures being experienced by Edison today,**  
2           **compared to those that existed when the Commission issued its order**  
3           **in Case No. U-13808.**

4     A. Unfortunately, Edison has experienced an increase in several cost  
5       categories above those assumed in its last general rate case. It should be  
6       noted that in Edison's last rate case, the Commission utilized a 2002  
7       historical test period, adjusted for inflation, with known and measurable  
8       changes to selected items for 2004. The cost increases, for the most part,  
9       can be attributed to costs that are very difficult for Edison to fully control  
10      such as increases in environmental compliance requirements, raw material  
11      commodity price increases, uncollectible expense, medical spending for  
12      both active employees and retirees, as well as certain maintenance on our  
13      distribution system and at our generation plants required for plant and  
14      customer reliability. Later in my testimony I will provide a high level  
15      summary of the programs we have and are undertaking to address these  
16      cost pressures. Witnesses Brudzynski, Colonnello, Lueders, Harris,  
17      Lapplander, Dow and Broome will provide detailed discussions of Edison's  
18      capital and O&M expense for the test period covered in this case.

19

20    **Q. Briefly summarize how the passage of Public Act 141 has affected**  
21       **Michigan's electric utility industry.**

22    A. Public Act 141 was enacted in June 2000 and among other things  
23       mandated that electric choice be made available to all electric customers in  
24       the State of Michigan. Michigan's approach to electric restructuring is

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1 unique when compared with the other states that have restructured their  
2 electric industries. Michigan is the only state to grant full customer choice,  
3 and not deregulate generation. Michigan's regulatory structure is often  
4 referred to as a "hybrid". As a result of this structure, Edison continues to  
5 be obligated to provide electric supply at cost-based rates, and customers  
6 are free to switch suppliers and subsequently return to Edison's regulated  
7 cost-based generation rates, with only limited restrictions, to capture the  
8 lower of cost or market pricing. Although Electric Choice sales levels have  
9 recently declined from their historical highs largely due to very high market  
10 prices, the Public Act 141 structure remains the largest and most significant  
11 business and regulatory risk facing Edison today. Changes in Electric  
12 Choice sales, as evidenced by actual choice data from 2001 through 2005  
13 (Exhibit DE-21, Schedule RJB-1), dwarf normal year-to-year sales changes  
14 due to weather and economic conditions.

15

16 **Q. How does the Electric Choice program affect Edison?**

17 A. Generally, increased Choice participation reduces Edison's earnings while  
18 decreased choice participation increases Edison's earnings, all other things  
19 being equal, until such time as base rates are reset. Similarly, more Choice  
20 participation generally reduces fuel and net purchase power costs while less  
21 Choice participation increases fuel and net purchased power costs as  
22 reflected in our PSCR mechanism. Thus, Edison's challenge in this  
23 environment is to manage total costs, including power supply, with an  
24 unknown customer load requirement each and every year.

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Public Act 141 fundamentally altered the traditional utility obligation to serve compact wherein a utility's obligation to serve was matched by customers' corresponding obligation to purchase from the utility at regulated rates. In the past, the obligation to serve compact (which included the reasonable opportunity for recovery of a utility's costs from customers) was the foundation upon which all utility investments were made. The ability of customers to choose the lower of market or cost-based power supply precludes a utility from recovering its full generation cost-of-service, particularly during periods of lower electric market prices. In contrast, during periods of high market prices, utilities are required to sell at cost rather than at market prices. Thus, utilities lose revenue during periods of low market prices but are precluded from making up that loss during periods of high market prices.

15

16

Additionally, lack of a predictable customer base creates sales volatility, which makes it extremely difficult, if not impossible, under the current rules, to build and pay for new base load generation. This last fact was recently recognized by the Commission Staff in its January 3, 2006 report submitted in the Capacity Needs Forum, Case No. U-14231. In its report, the Staff stated that it is unlikely major capacity additions will be constructed in Michigan in the foreseeable future without some change in the Commission's current rate making policies.

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1 Exhibit DE-21, Schedule RJB-1, reflects the volatility in choice sales since  
2 2001 and underscores the difficulty facing Edison with respect to generation  
3 planning and recovery of costs.

4

5 **Q. How does Michigan's hybrid electric regulatory structure and the**  
6 **impact of energy prices impact Edison's earnings stability?**

7 A. The relationship between regulated, cost-based rates and electric market  
8 prices is critical and determines whether customers leave or return to utility  
9 generation supply. As I stated previously, customer switching is one of the  
10 major risks and challenges facing Edison today.

11

12 The difference between regulated and competitive market prices does not  
13 reflect differences in the relative cost efficiencies of utility generation versus  
14 market generation. Rather, the differences in price reflect the fact that these  
15 are two fundamentally different and incompatible pricing systems that do not  
16 operate in tandem.

17

18 A consequence of Michigan's hybrid regulatory structure is that it fails to  
19 provide a stable customer base and hence creates an uncertain customer  
20 revenue stream since customers are free to switch to an alternative electric  
21 supplier and return to regulated generation cost-of-service rates.

22

23 The high volatility in electric market prices, driven primarily by natural gas  
24 prices, has been the impetus for customer switching back and forth between

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1 market based supply and utility generation. For example, in 2005,  
2 wholesale round-the-clock market prices steadily increased from  
3 approximately \$40 MWh to close to \$70 MWh. During 2006, as natural gas  
4 prices have declined, market prices have followed and now, as addressed  
5 by witness Byron, approximate \$50 MWh on average for 2006. Absent  
6 regulatory fixes to this hybrid structure, the risk of customer switching due to  
7 extremely volatile market prices makes it very difficult, if not impossible, for  
8 a utility to consistently earn a fair and stable return on its current investment.  
9 If and when market prices retreat, Edison will most likely lose customers  
10 quicker than in the past due to the level of experience and sophistication  
11 being exhibited in the marketplace by both AES' and our customers.

12

13 **Q. Are there any efforts being undertaken at the State level to address**  
14 **this generation investment dilemma?**

15 A. Yes. On January 3, 2006, The MPSC Staff issued a report as part of the  
16 Capacity Needs Forum ("CNF") to address future supply adequacy and  
17 reliability for the State of Michigan. The Staff's report addressed concerns  
18 with current Commission policy that, absent resolution, will impede  
19 development of new baseload generation in the State due to significant  
20 financial risk resulting from the current hybrid structure. While the CNF  
21 Report has proposed constructive modifications to the Commission's  
22 resource addition policy to remove some of the risks, these  
23 recommendations, by themselves, do not adequately reduce the risks that

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1 Michigan's electric utilities would continue to bear if they were to make  
2 multi-billion dollar investments in long-lived base load generation assets.

3

4 **Q. Have there been any more recent developments with respect to state**  
5 **energy planning?**

6 A. Yes. In April, 2006, Governor Granholm issued an Executive Directive  
7 calling for the Chairman of the MPSC to develop a comprehensive energy  
8 plan (with consultation among various stakeholders) to meet the future  
9 electric power needs of the State. The plan (called the "21<sup>st</sup> Century Energy  
10 Plan") will investigate and encourage the use of new alternative and  
11 renewable technologies, as well as the potential for conservation and  
12 demand response in addition to conventional power supply resources such  
13 coal and nuclear. Edison is participating in these discussions.

14

15 **Q. What sort of challenges does the economic climate in Michigan**  
16 **present?**

17 A. The Michigan economy is undergoing a fundamental change. As part of a  
18 global economy, we are seeing hundreds of thousands of good-paying  
19 manufacturing jobs leaving the state. Global competition is affecting not  
20 only the automobile manufacturers and auto parts suppliers, but also the  
21 entire small manufacturing base that has been the life blood of  
22 Southeastern Michigan.

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1 Throughout the 1990's, Edison's sales grew at approximately 2% per year  
2 and provided an additional revenue stream to offset inflationary cost  
3 pressures. However, as supported by witness Colandrea, on a  
4 temperature-normalized basis, service area sales have remained basically  
5 flat since 2000. The testimony in this case projects sales growth over the  
6 next several years, but at a pace slower than experienced in previous years.  
7 While this is our base projection, there is a risk that sales over the short-  
8 term may be less due to the lagging Michigan economy.

9  
10 With this recent lack of sales growth, Edison has had to offset inflationary  
11 cost increases with cost reductions and improved efficiencies. I will discuss  
12 the specific steps Edison has undertaken to control costs later in my  
13 testimony.

14  
15 The impact of Michigan's lagging economy adversely affects Edison not  
16 only with respect to growth in territory sales but also higher uncollectibles  
17 and collection related expenses.

18

19 **Q. How has the economy in Michigan affected the Company's**  
20 **uncollectible accounts?**

21 A. Both of our utilities (Edison and Michigan Consolidated Gas Company) have  
22 experienced over 50% increases in uncollectibles since 2002. The  
23 increases are attributable to Michigan's economic condition, as well as the  
24 increase in the price of energy, particularly natural gas. Edison has taken

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1 aggressive action to reduce the levels of past due accounts (as discussed  
2 by witness Broome), including increasing customer disconnections,  
3 contracting with collection agencies and working with the State to increase  
4 low-income funding. However, given the outlook for Michigan's economy  
5 and increasing energy prices, uncollectibles will continue to be a challenge  
6 for the Company. Although actions to shore-up the uncollectible situation  
7 negatively impacts customer satisfaction levels, these actions are important  
8 to contain the level of uncollectibles.

9

10 **Q. Earlier you stated that environmental compliance costs were one of**  
11 **the major issues facing Edison. What is Edison's situation with**  
12 **respect to environmental protection?**

13 A. The Company has a long and proud history of reducing the adverse  
14 environmental impact of its operations. As early as 1928, Edison installed  
15 electrostatic precipitators to reduce particulate emissions at the Trenton  
16 Channel Plant. We were also one of the first U.S based electric utilities to  
17 use cleaner low-sulfur western coal to reduce sulfur dioxide emissions.  
18 Environmental investments are very important as they not only address the  
19 health and well-being of our citizens, but are also necessary to meet federal  
20 laws in order to keep Edison's fossil generation fleet running and providing  
21 reliable low cost base load electric generation.

22

23 **Q. Please provide an overview of recent environmental investments to**  
24 **address air quality concerns.**

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1 A. In addition to our normal capital spending requirements, Edison has  
2 invested substantially (approximately \$550 million) since 1999 to comply  
3 with federal, state, and local rules related to environmental compliance at  
4 our fossil fuel plants. These investments were included in Edison's last rate  
5 case. As witness Boyd describes, the Company is required to spend  
6 approximately \$250 million in 2006 and an estimated \$1.1 billion in future  
7 capital expenditures through 2011 to meet existing emission reduction  
8 requirements. We will continue to make prudent investments that balance  
9 environmental and economic concerns.

10

11 Given that these large expenditures (capital and O&M) for environmental  
12 compliance will be ongoing, an annual recovery mechanism, although not  
13 proposed in this proceeding, would seem to be more appropriate than  
14 recovery via a traditional rate case approach which has considerable  
15 regulatory lag. Other states have adopted similar cost recovery  
16 mechanisms for recovery of environmental compliance costs.

17

18 **Q. To what extent have costs for environmental compliance changed**  
19 **since Edison's previous general rate case?**

20 A. They continue to rise. As witness Boyd describes, Edison's air emissions  
21 compliance strategy utilizes both the installation of new control equipment  
22 and the purchase of emission allowances. The goal of the program is to  
23 minimize long-term compliance cost while achieving the reductions required.  
24 There is a very delicate balancing act between installation of new control

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1 technology verses utilization of emission allowances with their volatile  
2 market prices. Also, both the federal and state governments are looking to  
3 establish additional rules for air emissions, and thus future cost increases  
4 above those included in this case are likely. For example, Governor  
5 Jennifer Granholm recently directed the Department of Environmental  
6 Quality to develop a rule to reduce mercury emissions from Michigan's  
7 power plants by 90 percent by 2015 which exceeds the federal standard of  
8 mercury emission reductions of 70 percent by 2018.

9

10 **Q. Please discuss the increases experienced by Edison related to health**  
11 **care spending.**

12 A. As explained by witness Lueders, health care costs are projected to  
13 increase 6% to 9% annually between 2006 and 2011. This is in addition to  
14 the double digit increases experienced over the past several years.  
15 Increasing health care costs for both active and retired employees is not a  
16 localized problem and is being experienced by companies all around the  
17 country. Therefore, increasing the Company's active health care costs by  
18 the rate of inflation (as was adopted by the Commission in Edison's  
19 previous rate case) is no longer sufficient. The Commission acknowledged  
20 this rapid increase in medical costs in its April 2005 order in MichCon's rate  
21 case when they adopted health care cost increases which exceeded the  
22 level of inflation. As discussed by witness Lueders, Edison continues to  
23 aggressively manage its benefits costs for both active and retired  
24 employees. We have increased cost sharing and adjusted plan designs,

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1 while still providing a competitive benefits portfolio for attraction and  
2 retention of our workforce. While these efforts have somewhat mitigated the  
3 cost increases, health care costs continue to increase above the rate of  
4 inflation.

5

6 **Q. Please describe other cost pressures facing Edison.**

7 A. The average age of Detroit Edison's fossil steam fleet is over 30 years,  
8 which is at, or nearing, the design life of major components. This results in  
9 increased unscheduled and more costly reactive maintenance. Above and  
10 beyond the environmental compliance expenditures discussed above,  
11 maintaining capacity and reliability also requires significant capital  
12 improvements associated with planned periodic maintenance activity, which  
13 adds to Edison's cost pressures. In his testimony, witness Harris elaborates  
14 more fully on these types of expenditures.

15

16 Edison is also undertaking needed improvements to its distribution system.  
17 In 2004 and 2005, hurricane restoration efforts by our contractors in the  
18 southern states impacted the regionally available resources to support line  
19 clearance, maintenance and construction and reduced the work completed  
20 locally. One of the most effective ways of reducing outages and maintaining  
21 reliability is line clearance. Other significant initiatives that improve reliability  
22 include pole top maintenance and other line construction projects. In 2006,  
23 the Company plans to increase both its line clearance and line construction  
24 programs. This work must be completed on an ongoing basis to avoid

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1 negative service level impacts. As further explained by witness Dow, the  
2 Company has increased its reliability improvement program which includes  
3 this increase in line clearance as well as expanded distribution maintenance  
4 and additional capital projects. Examples of these projects include; pole top  
5 maintenance, replacement of such items as poles, crossarms, insulators,  
6 lightning arrestors, conductors, transformers, regulators and replacement of  
7 obsolete equipment at our substations that have reached "end of life".  
8 Customers will benefit from these investments via reduced outages, quicker  
9 restoration and the related cost reductions primarily associated with day-to-  
10 day outage and storm restoration.

11

12 **Q. What steps have been made by Edison since 2002 to improve**  
13 **customer service and satisfaction?**

14 A. Improving service quality is one of the key priorities for Edison. Our on-  
15 going strategy encompasses both lowering costs and continuous  
16 improvement in service levels. As discussed by witness Broome, as a result  
17 of this focus, customer service quality continues to improve. In 2005,  
18 Edison exceeded all the MPSC standards of performance for customer  
19 service measures.

20

21 In addition to service quality, several reliability programs are in place to  
22 improve reliability and reduce day-to-day outages and storm expenses.  
23 One measure of reliability is restoration time. The average amount of time it  
24 takes to restore service is impacted by storm activity for any given month.

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1 The MPSC standard is that 9 out of 10 customers (90%) should be restored  
2 in an eight-hour period. For the year 2005, Edison's customer service  
3 restoration was 88% which fell just short of meeting the 90% threshold  
4 because of four large storms which effected between 129,000 and 190,000  
5 customers.

6  
7 Overall, the satisfaction of Edison's customers is at the median of the  
8 industry.

9  
10 As discussed briefly above, investments being made by the Company will  
11 continue to improve both service quality and reliability. In addition, as a  
12 means to provide increased understanding for our employees around  
13 customer service issues, Edison's incentive compensation plans have been  
14 realigned in 2006 and beyond, to focus more of its plan metrics on customer  
15 and reliability related targets.

16

17 **Q. Can you summarize the cost pressures facing the Company over the**  
18 **near-term?**

19 A. As I have just described, the Company faces many cost increases over and  
20 above the cost level incorporated in its current rates, and many of these  
21 costs will continue to rise for several years. Most of these cost increases  
22 are due to circumstances beyond Edison's control, such as record high raw  
23 material commodity and fuel prices. Edison will offset these cost increases

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1 in large part by implementing its Performance Excellence Process, which I  
2 will now discuss.

3

4 **Part III – Major Initiatives and Cost Trends**

5

6 **Q. What are some of the major initiatives undertaken by Edison since**  
7 **2002 to control its cost of service?**

8 A. Edison has undertaken several company-wide programs over the last  
9 several years to control costs. These include our DTE Operating System,  
10 the new Enterprise Business System (“EBS”) and our current Performance  
11 Excellence Process (“PEP”). The DTE Operating System, as detailed in  
12 Edison’s previous rate case, is a framework of tools, methodologies and  
13 processes focused on continuous improvement of corporate processes and  
14 on attainment of operational excellence.

15

16 **Q. Please describe the Enterprise Business System.**

17 A. In 2003 we began the development of the EBS. This is a company wide  
18 initiative to improve processes by implementing new core information  
19 systems, including finance, human resources, supply chain and work  
20 management. EBS will replace our legacy systems that have reached the  
21 end of their life cycle. The EBS implementation will complete its launch in  
22 2007. Witness Brudzynski provides details related to costs, benefits and  
23 savings related to EBS.

24

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1 **Q. Please describe why the Company has begun the PEP initiative.**

2 A. The Company needs to successfully make continuous improvements and  
3 achieve best-in-class operational performance, while adhering to strict cost  
4 controls. PEP is an integral part of achieving these goals. We need to  
5 reduce our cost structure to help the residential and business customers we  
6 serve, recognizing that we still have large environmental construction  
7 projects to pay for and recognizing that some customers are already having  
8 difficulty paying their energy bills. We have a competitive price  
9 responsibility to our customers and a fiduciary responsibility to our  
10 shareholders.

11

12 **Q. Why is Edison undertaking these changes now?**

13 A. We are facing one of the most difficult times I have seen in my 30-plus  
14 years of service with Edison. Because of the weak local economy, we see  
15 customers having a tough time paying their energy bills. As I described  
16 earlier, from 2006 through 2011, Edison is facing over \$1.3 billion alone in  
17 construction programs resulting from environmental regulations that will  
18 drive electricity costs up. Edison does not aspire to be an average  
19 company. Rather, we aspire to sustain a level of operational excellence as  
20 well as top quartile cost and customer satisfaction.

21

22 **Q. How is Edison implementing these changes?**

23 A. The PEP process began in late 2005 when we engaged our workforce in  
24 providing ideas for cost savings and process improvements. Over 12,000

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1 ideas were generated and ultimately over 1,000 ideas were approved for  
2 implementation. As discussed in more detail by witness Brudzynski, the  
3 PEP will focus on all areas of both Edison and MichCon, however,  
4 approximately 1/3 of the savings are anticipated to come from Edison's  
5 corporate support organization. PEP involves redesigning and restructuring  
6 processes and our organizations; removing non-value added work;  
7 continuing to invest in power plants and distribution systems to improve  
8 reliability; and investing in technology and services to improve overall  
9 customer satisfaction. Most of these initiatives will be incorporated over a  
10 two to three-year period to ensure sustainability and minimize the potential  
11 impacts on our customers and some, such as automated meter reading  
12 ("AMR"), will be accomplished over an even longer period.

13

14 As will be further described by witnesses Dow and Broome, as part of the  
15 PEP, Edison is undertaking an investment in AMR. This program, which  
16 provides tremendous customer benefits including increased meter reading  
17 accuracy, improved quality and reliability of energy delivery, and more  
18 effective customer care, will begin in 2007 and run for approximately six  
19 years with about \$50 million invested per year. The cost savings generated  
20 by this program over time will lower customer rates as well as result in an  
21 increase in customer satisfaction.

22

23 The expected collective annual O&M, capital and PSCR PEP savings for  
24 Edison approximates \$50 million for 2006, \$170 million for 2007, and \$240

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1 million per year thereafter. However, since the Company is in the early  
2 stages of the PEP process, there remains risk and uncertainty with respect  
3 to the timing and level of these savings projections. The timing of these  
4 cost savings is not immediate, and as witness Brudzynski states, there will  
5 be costs, such as severance and separation related costs, potential  
6 curtailment (pension, OPEB) costs, etc. in order to achieve these savings as  
7 well.

8

9 **Q. You mentioned a cost savings associated with the PEP. Are there**  
10 **costs to achieve these savings also?**

11 A. Yes. As discussed by witness Brudzynski, Edison is seeking to defer and  
12 amortize the costs to achieve these PEP savings over a 5-year period to  
13 provide for a better matching of costs and savings. An application has been  
14 filed with the Commission requesting such accounting treatment. The 2007  
15 cost of service reflected in this case incorporates Edison's accounting  
16 treatment.

17

18 **Q. What do you anticipate the results of the PEP will have on Edison and**  
19 **its customers?**

20 A. We have a substantial need to make investments in our generation and  
21 distribution systems over the next several years to comply with  
22 environmental rules, improve safety, service quality and reliability. Thus,  
23 most importantly, the savings generated from PEP will minimize the need  
24 for rate increases. We'll also have improved plant reliability and customer

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1 satisfaction. As stated earlier, we are also making a large investment in  
2 AMR which will have a significant impact on improving customer satisfaction  
3 and in reducing costs. As supported by witness Brudzynski, the PEP  
4 savings will exceed the costs to achieve these savings and help to mitigate  
5 cost increases related to environmental investments.

6

7 **Part IV – Edison Financial Situation**

8

9 **Q. Can you describe Edison's recent financial performance?**

10 A. Edison's financial health deteriorated substantially from 2002 to 2004 due  
11 almost entirely to customer migration to alternative suppliers. Return on  
12 equity dropped from 14.4% in 2002 to 5.4% in 2004. Moreover, an  
13 increasing portion of our earnings in this time frame were provided by non-  
14 cash regulatory deferrals. This was one of the most precipitous financial  
15 downturns the company has ever faced.

16

17 **Q. Has the Company's financial performance improved since 2004?**

18 A. Yes. Detroit Edison's financial health improved in 2005 and is expected to  
19 do so further in 2006. Rate relief granted in Case No. U-13808 combined  
20 with leveling off of electric choice sales loss have resulted in improved  
21 financial performance. Return on equity increased to 9.4%, which was still  
22 less than authorized. However, in spite of the improved earnings picture,  
23 Edison's cash flow remains weak which causes concern with the credit  
24 rating agencies as will be discussed shortly.

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2     **Q.   Would Edison have earned its authorized return on equity in 2005**  
3         **absent the residential rate cap?**

4     A.   No, it would not have.  As supported by witness Horgan, Edison's 2005  
5         revenue deficiency was approximately \$51 million after normalizing for the  
6         residential rate cap and normal weather.

7

8     **Q.   Why did Edison experience a revenue deficiency for 2005?**

9     A.   The reasons for this deficiency are two-fold: first, territory electric sales were  
10         substantially below the level utilized in Edison's last rate case to establish  
11         rates, and second, we experienced significant increases in expenses that  
12         are largely beyond our control, such as raw material commodity prices (i.e.  
13         steel, copper, aluminum) that are critical components of our generation  
14         plants and distribution system, benefits costs and increased maintenance  
15         on our aging distribution system and generation plants.  Returning choice  
16         sales were modest and largely offset the lower service territory sales level.

17

18     **Q.   Does Edison project the financial situation in 2006 will continue to**  
19         **improve?**

20     A.   Yes.  Edison expects to earn its allowed return on equity in 2006, due in part  
21         to the return of more electric choice sales which offsets the continuing cost  
22         escalation and flat service territory electric sales growth.

23

24

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1 **Q. Do you expect the improvement in financial performance to continue?**

2 A. No, not without additional rate relief. Territory electric sales are projected to  
3 remain relatively flat. Also, electric choice sales levels have stabilized and  
4 thus are not expected to continue to make up for the lack of growth in  
5 territory sales. As discussed earlier in my testimony, the high volatility in  
6 electric market prices is the main driver causing customer switching back  
7 and forth between market based supply and utility generation. Although not  
8 reflected in our base sales forecast, as a result of the potential for falling  
9 market prices, electric choice sales may increase again causing another  
10 erosion in revenues.

11

12 In addition to the general inflationary cost increases since 2004, the  
13 Company has experienced more significant increases in raw material  
14 commodity prices, benefits and uncollectible expenses. Edison also  
15 continues to invest in both capital and O&M above levels approved in the  
16 last rate case for system reliability and safety.

17

18 These cost increases are driven by the ongoing reliability challenges caused  
19 by the age of our generation fleet and distribution system and by an  
20 expanded maintenance plan to target critical reliability issues. Our aim is to  
21 address these reliability issues on our system via prudent but aggressive  
22 maintenance of our system. The Company recognizes that as our  
23 equipment ages, our ability to achieve the system reliability levels that our  
24 customers expect and deserve, will continue to be a challenge.

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2     **Q. How does Edison's recent financial performances impact those**  
3     **agencies that rate your bonds and investment risk?**

4     A. The rating agencies don't expect Edison to earn above its allowed rate of  
5     return on a regular basis. Unfortunately, as I have previously discussed,  
6     this has not been the case in the recent past due in large part to electric  
7     choice sales volatility. In addition, as further explained by witness  
8     Stadnikia, Edison has already been impacted by the investment  
9     community's view of a struggling Michigan economy. Although the  
10    Commission's actions with respect to Edison's last rate case and  
11    unbundling order have resulted in recent improved financial performance,  
12    the rating agencies and investors see many economic and regulatory  
13    challenges ahead and most are continuing to take a very cautious view.

14

15    Cash flow is also an important measure for rating agencies and investors.  
16    Edison also requires a strong cash flow in order to support its ongoing  
17    capital investment requirements. Maintaining a strong cash flow position  
18    provides access to capital markets on favorable terms, which is essential for  
19    Edison to finance, at reasonable costs, its critical capital projects in the  
20    near-term, (environmental retrofits, reliability upgrades, etc), and in the  
21    future with the potential for new baseload generation capacity. New  
22    baseload generation assets are multi-billion dollar investments, and require  
23    financially strong utilities with access to capital markets to undertake their  
24    development on reasonable financial terms.

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2     **Q.   Why are the opinions of these rating agencies important?**

3     A.   Given our large environmental expenditures, the AMR program, the  
4           potential for investment in baseload capacity and our normal annual capital  
5           expenditures of approximately \$600 million, over the next five years Edison  
6           will have to access capital markets frequently as it increases its invested  
7           capital base by approximately \$2.0 billion. The condition of Edison's capital  
8           structure, balance sheet and cash flows, together with the rating agencies'  
9           assessment of Edison's business and regulatory risks, collectively  
10          determine our credit ratings and will impact the price we pay to issue new  
11          and refinance existing debt. A negative outlook could very likely make it  
12          more expensive and more difficult to obtain the required financing on  
13          favorable terms.

14

15           **Part V: Summary of Edison's Rate Relief Request**

16

17     **Q.   Is Edison requesting a rate increase as part of this case?**

18     A.   Yes. As witness Horgan summarizes, Edison is facing a revenue deficiency  
19          in 2007 of \$45 million. Current electric rates were established in the last  
20          rate case on a 2002 test year with known and measurable changes to 2004.  
21          During the intervening three year period, Edison's cost of service has  
22          increased. As summarized on Exhibit DE-21, Schedule RJB-2, the major  
23          reasons for the revenue deficiency since Case No. U-13808 are: 1)  
24          Increased economic cost pressures over the past 3 years in areas such as

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1 raw materials, fuel, labor, healthcare and uncollectible expenses; 2) higher  
2 levels of generation plant and distribution system maintenance as previously  
3 discussed; 3) investments in our asset and technology infrastructure; and 4)  
4 lower service territory electric sales levels. Historically, territory electric  
5 sales growth served to mitigate inflationary cost pressures.

6  
7 Offsetting these factors are the increase in revenues from choice customers  
8 returning to bundled electric service and the expected cost savings from  
9 Edison's PEP effort. While these items will substantially reduce Edison's  
10 revenue deficiency, they will not completely alleviate the revenue deficiency  
11 given the magnitude of the expenditures the Company faces in 2007.  
12 Absent a base rate increase effective January 1, 2007, Edison will not be  
13 able to earn its authorized rate of return in 2007.

14

15 **Q. As discussed earlier in your testimony, under the hybrid regulatory**  
16 **model, customer switching to and from electric choice is one of the**  
17 **major challenges confronting Edison. How does Edison propose to**  
18 **"level the playing field" with respect to Electric Choice?**

19 **A.** As discussed by witness Falletich, Edison proposes to establish that for  
20 similarly situated customers, bundled and electric choice, commercial and  
21 industrial ("C&I") customers will pay the same distribution rates. As I stated  
22 earlier, the Commission, by issuance of its order in Edison's unbundling  
23 case, has taken the initial positive steps to require each customer class to  
24 pay their fair and proportionate share of each element of service. This

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1 additional step would preserve the C&I rate subsidy of residential rates, but  
2 provide for a sharing of the subsidy equally between both choice and  
3 bundled customers.

4

5 **Q. Is the Company proposing any changes that would address the**  
6 **concern the Commission expressed in this case with respect to**  
7 **changing levels of customer choice and its impact on Edison's**  
8 **earnings?**

9 A. Yes. Edison is proposing a choice tracker mechanism as detailed in  
10 witness Falletich's testimony. The purpose of the choice tracker mechanism  
11 is to track any changes in choice sales, up or down, from the choice sales  
12 level assumed in setting the base rates in this proceeding. Edison would  
13 then implement a surcharge, or credit to full-service customer rates for any  
14 increase or decrease in non-fuel power supply revenues as a result of a  
15 change in choice sales. Under this proposal, customers would benefit from  
16 swings in PSCR costs resulting from the changing level of choice sales. For  
17 example, if choice sales were to decline, full-service customers would  
18 receive a base rate credit to help defray any increases in PSCR costs  
19 resulting from the increase in full-service service load. The choice tracker  
20 mechanism is designed to levelize and smooth out full-service customer  
21 overall rates (base and PSCR) and utility revenue changes associated with  
22 changes in electric choice sales.

23

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1 **Q. Is Edison proposing any other trackers in this proceeding?**

2 A. Yes. Witness Brudzynski is proposing a cost tracker related to expenses for  
3 other post employment benefits ("OPEB"). OPEB relates to healthcare  
4 costs (medical and prescription drugs), life insurance and any other non-  
5 pension related benefits for retirees. Due to the volatile nature of these  
6 costs from year to year, Edison is proposing to either surcharge or credit to  
7 customers the difference between actual OPEB costs and costs for OPEB  
8 included in the Company's approved rates. Customers will have the benefit  
9 of lower rates if changes in assumptions and experience lead to lower  
10 OPEB expense. Similarly, the Company will be less likely to file  
11 comprehensive general rate cases to seek recovery of any higher overall  
12 expense, including increased OPEB expense.

13

14 **Q. What should the Commission conclude from the evidence presented**  
15 **by Edison in this rate case?**

16 A. The Company has demonstrated a revenue deficiency of \$45 million for  
17 2007 and larger revenue deficiencies in subsequent years. Through the  
18 various process improvement programs currently in place, although inherent  
19 uncertainties remain, Edison is able to partially offset future revenue  
20 deficiencies resulting from capital and O&M increases required to meet  
21 environmental compliance, healthcare costs, raw material commodity price  
22 increases and ongoing maintenance of our aging utility infrastructure.  
23 Edison therefore, seeks Commission approval for new rates to recover the  
24 2007 revenue deficiency.

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2 Having stable electric rates that provide a reasonable, yet realistic,  
3 opportunity to earn a fair return on a continuing basis is essential for Edison  
4 to be a financially sound utility. Utilities should not be placed in the position  
5 of taking all the downside risk associated with regulatory lag, particularly  
6 when that risk has been exacerbated by electric choice switching. The  
7 prospect of having electric rates reduced even before Edison actually earns  
8 its authorized rate of return creates a regulatory system where a utility  
9 would always under-perform financially. There would not be any realistic or  
10 reasonable opportunity to earn the authorized return on a continuing basis.

11

12 Our customers should pay electric rates that are fair and reasonable.  
13 Edison is committed to doing everything we can to operate as efficiently as  
14 possible in this challenging and ever-changing environment. Customers  
15 and shareholders benefit from a utility that is financially healthy. Access to  
16 the capital markets at favorable costs and terms is of paramount  
17 importance, in order for Edison to make the required capital investments to  
18 ensure reliable and affordable electric service.

19

20 **Part VI: Introduction of Other Witnesses**

21

22 **Q. How does the Company propose to present evidence in support of its**  
23 **positions in this case?**

24 **A.** We propose to present our case through 19 witnesses, in addition to myself.

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2

Mr. Skiles W. Boyd, Vice President of Environmental Management and Resources, will discuss the Company's plans and the associated costs of compliance with clean air environmental laws and regulations.

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6

Mr. David G. Broome, Director of Customer Service Processes, will discuss customer service quality and costs.

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Dr. Aldo F. Colandrea, Manager, Corporate Energy Forecasting, will discuss the forecasts of energy requirements and peak loads.

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1 Mr. Wayne A. Colonnello, Manager of Nuclear Strategic Planning, will  
2 discuss nuclear capital expenditures, nuclear fuel expenses and operation  
3 and maintenance expenses.

4

5 Mr. Vince G. Dow, Vice President of Distribution Operations, will discuss  
6 energy delivery investments and costs.

7

8 Mr. Edward L. Falletich, Manager, Pricing, will present the billing  
9 determinants for 2007; the proposed power supply and distribution  
10 surcharges necessary to recover Edison's overall revenue deficiency for  
11 2007; the proposed Choice Tracker Mechanism; and proposed changes to  
12 prices and tariffs affecting all of the Company's retail customers.

13

14 Mr. Guy Harris, Director of Fossil Generation, will present the non-nuclear  
15 forecasted capital expenditures, production, operation and maintenance,  
16 fuel handling expenses, and plant availability.

17

18 Mr. Marty L. Heiser, Regulatory Expert, Pricing, will present Edison's Cost of  
19 Service for 2005 historic and 2007 test years and support the jurisdictional  
20 separation of costs.

21

22 Mr. Paul G. Horgan, Manager, Revenue Requirements, will present the rate  
23 base, including working capital, overall rate of return and the revenue  
24 requirement.

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2

Mr. Gary E. Lapplander, Director, Fuel Supply, will discuss the forecast of fossil fuel prices and major fossil fuel sources.

4

5

Mr. Richard J. Lueders, Director, Compensation and Benefits, will present an overview of pension expense, employee benefits and health care costs.

6

7

8

Dr. Roger A. Morin, Professor of Finance, College of Business, Georgia State University, will assess the financial risk of the Company, and support a recommended return on common equity.

9

10

11

12

Mr. William J. Newbold, Manager, Electric Choice Program, will present the results of the collaborative on electric choice metering issues and will support the adoption by the Commission of the near-consensus proposal resulting from that effort.

13

14

15

16

17

Mr. Michael W. Shields, Manager, Long Term Sourcing, Generation Optimization, will present Edison's projected expenses associated with being a network transmission customer of the International Transmission Company and with being a Market Participant of the Midwest Independent Transmission System Operator.

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23

Mr. Paul A. Stadnikia, Assistant Treasurer, will testify with respect to capital structure and cost of long and short-term debt.

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Mr. Michael G. VanHaerents, Director of Corporate Financial Planning, will describe the assumptions used for the forecast years and discuss the output from the financial forecasting models on a total Company basis. He will also discuss historic information for the rate of return, income statement, balance sheet, and adjustments of net operating income.

7

8

Mr. Mark R. Williamson, Manager, Load Research, will support the development of the 2005 historic and 2007 forecast load Allocation Schedules.

10

11

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

13 A. Yes, it does.

14