

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
RICHARD J. LUEDERS

THE DETROIT EDISON COMPANY
QUALIFICATIONS OF RICHARD J. LUEDERS

Line
No.

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

2 A. My name is Richard J. Lueders. My business address is The Detroit Edison
3 Company ("Detroit Edison"), 2000 Second Avenue, Detroit, Michigan 48226.

4

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

6 A. I graduated from Holy Cross College with a degree in economics and
7 accounting. I also have a Masters in business administration from the
8 University of Connecticut. In addition, I am a Certified Public Accountant.

9

10 **Q. What is your current position and previous work experience?**

11 A. My current position is Director, Human Resources, Compensation, Benefits
12 and Human Resources Process and Technology (HRPT) with DTE Energy
13 Company. I have more than 30 years experience in finance and human
14 resources with companies including Pepsico, Inc. and United Technologies
15 Inc., as well as human resources consulting firms including Hewitt
16 Associates LLC.

17

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

19 A. I am a member of the American Institute of Certified Public Accountants and
20 the Human Resource Policy Association.

21

THE DETROIT EDISON COMPANY
DIRECT TESTIMONY OF RICHARD J. LUEDERS

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

2 A. My testimony will present an overview of actual and projected benefit
3 expense for The Detroit Edison Company for the period 2005 through 2011.
4 I will provide support related to the Company's pension expense, employee
5 benefits and health care costs. I will describe the key drivers of Edison's
6 actual and projected pension costs, other post employment benefits
7 ("OPEB"), active employee health care, and other labor related benefits for
8 the years 2005 through 2011. I will provide an overview of Edison's
9 compensation philosophy for non-represented employees. In addition, I will
10 discuss the Performance Excellence Process ("PEP"), the related cost-to-
11 achieve, and their projected impact on these costs in 2006 and beyond.

12

13 **Q. Mr. Lueders, are you sponsoring any exhibits?**

14 A. Yes, I am supporting information on the following Exhibits:

15 Exhibit DE-16

16 Schedule F5-8 Employee Benefit Cost Summary

17 Schedule F5-9 Pension Cost

18 Schedule F5-10 Other Post Employment Benefits (OPEB)

19 Schedule F5-14 Summary of Cost to Achieve

20 (Co-sponsored with Mr. Brudzynski)

21

22 **Q. Were these schedules prepared by you or under your direction?**

23 A. Yes, they were.

24

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1 **Q. Do any of these exhibits reflect the expected impact of the Performance**
2 **Excellence Process (PEP) which is currently in progress?**

3 A. Schedules F5-8, F5-9, and F5-10 do not reflect any PEP activity in the base
4 cost projections. Incremental PEP costs or savings are summarized as
5 separate line items. Schedule F5-14 includes the Costs to Achieve for the
6 benefit related items impacted by the PEP program.

7

8 **Employee Pension Costs**

9

10 **Q. What are the components of pension costs?**

11 A. Under the Statement of Financial Accounting Standards 87, *Employer's*
12 *Accounting for Pensions* ("SFAS 87"), there are four components of pension
13 costs.

14

15 Service costs: Service costs represent the pension benefits earned by
16 active employees during the current period on a present value basis. It is
17 based on current and projected salaries, expected employee turnover and
18 expected benefits to be paid based on actuarial assumptions of life
19 expectancy.

20

21 Expected return on assets: Expected return on assets is an estimate of the
22 expected investment return on assets invested in the pension trusts. While
23 actual year-to-year investment returns can vary significantly in the short run,
24 the expected return is determined based on long-term financial market

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1 expectations in order to avoid large swings in pension costs based on short-
2 term investment performance. Edison's estimated annual return was 9.0%
3 for 2005 and is 8.75% for 2006 and beyond.

4

5 Interest cost: Interest cost recognized in the current period is the increase in
6 the Projected Benefit Obligation ("PBO") due to the passage of time. The
7 PBO is the actuarial present value of benefits attributable to the pension
8 benefit formula discounted back to current dollars at a 6.00% discount rate
9 for 2005 and 5.90% discount rate for 2006 and beyond. Measuring the PBO
10 as a present value at the beginning of the period requires the accrual of an
11 interest cost for the current period at a rate equal to the discount rate. The
12 estimated discount rates of 6.00% for 2005 and 5.90% for 2006 and beyond
13 used in the projections are based on a number of external benchmarks,
14 such as the cost of high quality debt, as well as data from our independent
15 actuarial firm, Hewitt Associates, LLC.

16

17 Amortizations: In addition to these current period costs, pension costs also
18 include the effect of the delayed recognition of prior costs. This includes
19 prior service costs and unrecognized gains and losses. Prior service costs
20 arise from pension plan changes that will provide the employees an
21 increase in economic benefits in the future. When a plan provision is
22 changed that will impact future benefit payments for existing employees, the
23 incremental change in the PBO liability is amortized equally over the
24 average remaining years of service of the employees impacted.

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1 Unrecognized gains and losses are changes in the amount of either the
2 PBO or plan assets resulting from experience different from that assumed in
3 the actuarial assumptions. Most notably, since discount rates and return on
4 assets assumptions are based on estimates, differences arise in the levels
5 of estimated versus actual returns on assets invested, as well as changes in
6 the PBO arising from changes in discount rates when these gains or losses
7 exceed certain materiality thresholds. Unrecognized gains and losses,
8 outside a corridor equal to 10% of the greater of the PBO and the market
9 related value of assets, are amortized based on a period equal to the
10 average remaining service life of employees covered by the plan.

11

12 **Q. How are the assumptions developed for retirement plan cost**
13 **purposes?**

14 A. The process by which the actuarial assumptions are evaluated and
15 determined depends on the particular valuation being performed: pension
16 funding, pension expense, OPEB funding, or OPEB expense. In general,
17 each assumption is set as the best estimate of anticipated future experience
18 under the plan based on input and advice from our actuaries in accordance
19 with applicable Actuarial Standards of Practice.

20

21 The assumptions are set utilizing historical data provided by Detroit Edison,
22 input and analysis from our actuaries (Hewitt Associates) and our
23 investment advisors (Callan Associates), and reviewed by our auditors
24 (Deloitte and Touche). Hewitt Associates performs an annual review of the

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1 economic and demographic assumptions. The demographic assumptions
2 are reviewed based on both recent plan experience and considering
3 whether future experience is anticipated to be different. The economic
4 assumptions are also reviewed to ensure that the individual assumptions
5 are based on the same expected economic model. For example, the
6 interest rate, the salary increase rate, and the cash balance interest
7 crediting rate are reviewed to ensure that all three assumptions incorporate
8 the same underlying assumption of inflation. Depending upon the valuation,
9 the underlying rate of inflation maybe different, resulting in somewhat
10 different economic assumptions.

11

12 For retirement plan expense purposes, FAS 87 and 106 require that the
13 discount rate assumption be updated each year to reflect the rate of return
14 on high quality fixed income investments as of the measurement date
15 (Detroit Edison uses a November 30 measurement date). The discount rate
16 is selected based on information from Hewitt Associates about the current
17 interest rate environment as well a Hewitt analysis that matches projected
18 benefit payments with payouts from a hypothetical portfolio of high quality
19 (Aa or higher) corporate bonds. A yield-curve supported discount rate is
20 then developed. As a result the economic assumptions for FAS 87 and 106
21 will generally change from year to year.

22

23 For funding purposes, a longer-term perspective is taken reflecting the long-
24 term nature of the liabilities. Year-by-year changes in the interest rate

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1 environment therefore do not usually result in changes to the funding
2 valuation assumptions. Rather these are set based on the actuary's best
3 estimate of future experience, in accordance with applicable Actuarial
4 Standards of Practice.

5

6 **Q. How are these pension cost components projected to change between**
7 **2005 and 2011?**

8 A. Pension costs are projected to decrease from \$106.7 million in 2005 to
9 \$100.6 million in 2006, increase to \$106.0 million in 2007, and then
10 decrease to \$74.6 million in 2011. The impact of a relatively stable interest
11 rate environment, actual investment returns approximately equal to
12 assumptions, and a reduction in the amortization of actuarial losses led to
13 the decrease in pension cost between 2005 and 2006. The increase
14 between 2006 and 2007 is due largely to an anticipated change in the
15 participant mortality assumption. The change reflects recent and
16 anticipated mortality improvements resulting in longer life expectancies
17 producing a corresponding increase in pension expense. The projected
18 reduction in pension cost between 2007 and 2011 is due to assumed future
19 pension funding and the stabilized interest rates and investment returns.
20 Exhibit DE-16, Schedule F5-9 details these components for 2005 through
21 2011.

22

23 The service cost component earned in 2005 is expected to decrease in
24 2006 due to lower than anticipated salary increases and fewer active

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1 participants earning pension benefits, somewhat offset by the impact of
2 lower discount rate assumption (6.00% in 2005 vs. 5.90% in 2006). The
3 service cost component post-2006 is projected to increase due to
4 anticipated aging of the participant population, projected salary increases,
5 and the updated mortality assumption that will be reflected in Fiscal 2007
6 expense.

7

8 Interest costs are anticipated to increase due to the increase in PBO, as a
9 result of lower discount rates and the updated mortality assumption, as well
10 as the addition of another year of accumulated benefits.

11

12 Expected returns on plan assets were relatively level between 2005 and
13 2006 with a small increase in 2007 and larger increases in 2008 and later.
14 The leveling of expected returns between 2005 and 2006 were the result of
15 an increase in the market related value of plan assets offset by a reduction
16 in the expected return on assets from 9.00% during 2005 to 8.75% during
17 2006 and beyond. Projected pension contributions of approximately \$585
18 million between 2007 and 2011, as well as anticipated investment return,
19 produce larger asset values and a larger expected return on assets. The
20 market related value of plan assets as used in the development of service
21 cost differs from the actual value of plan assets because it spreads the
22 effects of variances in actual asset returns relative to expected assets over
23 a three-year period. For example, as of November 30, 2005, the
24 measurement date for the market related value used in deriving the

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1 expected return on assets for 2006, one third of the difference between the
2 actual expected asset return for the 2005 measurement period (December
3 1, 2004 to November 30, 2005) is included in the market related value.
4 Similarly, the November 30, 2005 market related value includes two thirds of
5 the difference between actual and expected asset returns for 2004 and all of
6 the difference between the actual and expected asset return for 2003.

7

8 **Q. Do amortized costs change between 2005 and 2011?**

9 A. Yes. The prior service cost amortization decreases from \$8.5 million in
10 2005 to \$3.6 million in 2011 as amortization bases for prior plan changes
11 become fully amortized. The amortization of gains and losses decreases
12 from \$50.0 million in 2005 to \$37.7 million in 2011, as the amount subject to
13 amortization is reduced by each prior year's. As of November 30, 2005 the
14 measurement date for year-end 2005 footnote disclosure purposes, Detroit
15 Edison had \$748 million in accumulated unrecognized losses.

16

17 **Other Post Employment Benefits (OPEB)**

18

19 **Q. Are you sponsoring projections related to Other Post Employment**
20 **Benefits ("OPEB")?**

21 A. Yes. I am sponsoring a projected increase to OPEB from \$120.4 million in
22 2005, to \$151.8 million in 2011, as referenced in Exhibit DE-16, Schedule
23 F5-10.

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1 **Q. What are OPEB Costs?**

2 A. For Detroit Edison, OPEB costs are those related to the provision of retiree
3 medical, dental, prescription drug and life insurance benefits. OPEB is a
4 cost recognized pursuant to Statement of Financial Accounting Standards
5 No. 106, *Employers' Accounting for Postretirement Benefits Other Than*
6 *Pensions* ("SFAS 106").

7

8 **Q. What are the cost components of OPEB?**

9 A. OPEB has the same basic cost components as I described for pension
10 costs. They are:

11 Service cost: Service costs are the portion of the expected post retirement
12 benefit obligation attributable to employee participation service during the
13 period on a present value basis. This cost reflects actuarial assumptions of
14 employee turnover, age at retirement and expected longevity. This cost is
15 also dependent on the estimated costs of providing these benefits
16 subsequent to retirement and thus are impacted by both current medical
17 cost levels and expected medical cost inflation.

18

19 Expected return on assets: The expected return on assets is an offset to the
20 costs of the OPEB, based on the expected long-term return on assets
21 invested in qualified trusts. The assumed return was 9.0% for 2005 and
22 8.75% for 2006 and beyond.

23

24 Interest cost: Interest costs are the costs arising from the current period

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1 interest on the discounted Accumulated Post-Retirement Benefit Obligation
2 (“APBO”). Like pensions, the accumulated liability was discounted to
3 today’s dollars based on the discount rate of 6.00% discount rate for 2005
4 and 5.90% for 2006 and beyond.

5

6 Amortizations: This cost component includes the amortizations related to
7 prior service costs and unrecognized gains and losses. Prior service costs
8 are amortized over the estimated remaining service lives of active
9 participants at the time of the last plan change. Gains and losses, outside a
10 similar 10% corridor described for pension expense, are amortized over the
11 current estimated remaining service lives of active participants. As of
12 November 30, 2005 the measurement date used for year-end 2005 footnote
13 disclosure purposes, Detroit Edison had unrecognized losses of \$669.7
14 million stemming from differences between the estimated and actual returns
15 on assets, increases in the APBO arising from the reduction in discount
16 rates as well as revised medical cost inflation estimates.

17

18 **Q. What changes in these OPEB costs components do you expect**
19 **between 2005 and 2011?**

20 A. OPEB costs are projected to increase from \$120.4 million in 2005 to \$149.4
21 million in 2006, \$160.9 million in 2007, and then decline to \$151.8 million in
22 2011. The increase between 2005 and 2006 is the result of actual historical
23 retiree health care claim experience, an increase in the assumed future
24 retiree health care inflation assumption, lower discount rate, and lower

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1 assumed long-term investment returns. The projected increase between
2 2006 and 2007 is largely due to the anticipated increase in the future health
3 care inflation assumption and updated mortality assumptions. A projected
4 reduction in OPEB cost between 2007 and 2011 is due to future OPEB
5 funding and the continued stabilization of interest rates, investment returns,
6 and retiree health care inflation. Exhibit DE-16, Schedule F5-8 details these
7 components for 2005 through 2011.

8

9 **Q. What are the underlying causes of the changes Edison projects in**
10 **OPEB costs between 2005 and 2011?**

11 A. The cost components for OPEB are reflected on Exhibit DE-16, Schedule
12 F5-10, for 2005 through 2011. These include:

13

14 Service costs are estimated to increase from \$43.8 million in 2005, to \$70.6
15 million in 2011 based on the current period discounted actuarial present
16 value of accumulated post-retirement benefit obligations, including the
17 projected medical cost escalations discounted to current dollars at 6.00%
18 during Fiscal 2005 at 5.90% during Fiscal 2006 and beyond. This increase
19 reflects the impact of higher medical cost inflation, a lower discount rate,
20 and updated mortality assumptions. The interest cost is expected to
21 increase from \$79.6 million in 2005, to \$117.4 million in 2011, due to the
22 increase in the accumulated post-retirement benefit obligation.

23

24 The expected return on assets is reduced from \$57.8 million in 2005, to

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1 \$48.0 million in 2006 and then increases to \$82.3 million in 2011. The
2 decrease between 2005 and 2006 reflects a reduction in the expected
3 return on assets from 9.00% in 2005, to 8.75% in 2006 and beyond, and the
4 recognition of the lower market value of the assets invested in the qualified
5 trusts. Future projected contributions work to increase the market value of
6 assets and the expected return on assets.

7

8 Amortization of prior service costs and transition obligation decrease from a
9 total of \$10.9 million in 2005 to \$10.3 million in 2006 through 2011.

10

11 Finally, the amortization of (gains)/losses increases from a cost of \$43.8
12 million in 2005, to a cost of \$51.9 million in 2006. The amortization cost
13 increases to \$52.6 million in 2007 before decreasing to a cost of \$35.8
14 million in 2011. The increase in cost between 2005 and 2006 reflects the
15 impact of the lower discount rate and higher actual and assumed future
16 retiree health care inflation. The increase between 2006 and 2007 reflects
17 amortization increases due to the anticipated updated mortality assumption
18 and health care trend assumption offset by a lower amount subject to
19 amortization due to the prior year amortization amount. The decline in the
20 loss amortization between 2007 and 2011 reflects the reduction in the
21 amount subject to amortization arising from each prior year's amortization.
22 The unrecognized loss is being amortized over approximately 10 years.

23

24 **Q. What medical cost escalation assumptions are reflected in projected**

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1 **OPEB costs?**

2 A. Fiscal 2005 expense assumed 9% escalation in medical costs for retirees
3 less than 65 years old in 2005 with annual increases trending down to 5%
4 by 2011. Because of the impact of Medicare, cost trends for retirees 65
5 years old and over are assumed to escalate by 8% in 2005, with the annual
6 increase trending down to 5% by 2010. Medical costs are assumed to
7 escalate by 5% annually thereafter for all ages. Expense for Fiscal 2006
8 and beyond were based on the same pattern, but assumed the initial 9%
9 and 8% escalation applied to 2006 (in addition to 2005) and then trended
10 down to 5% by 2011 rather than 2010.

11

12 **Q. What is the basis for these medical cost trend assumptions?**

13 A. During most of the 1990's, annual health care cost increases experienced
14 by Detroit Edison were relatively modest. However, beginning in 2000,
15 trend rates jumped substantially, reflecting higher prescription drug prices,
16 increased service utilization, and to a degree, higher costs due to the
17 increasing use of technology for increasing life expectancy. The cost trends
18 used in the determination of the OPEB cost reflect this recent experience,
19 but with the potentially optimistic presumption that double digit annual
20 escalations in medical costs are not sustainable over the long-term. Thus,
21 the annual escalation is assumed to trend down to a 5% annual escalation
22 by 2010 and 2011.

23

24 **Q. How do the cost trends assumed in Edison's OPEB costs projections**

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1 **compare to other companies?**

2 A. The medical cost escalation assumptions are consistent with other
3 companies, since the issues impacting health care costs are endemic to
4 virtually all companies that provide comprehensive retiree health benefits.
5 In a 2005 survey of 78 large companies by Hewitt Associates, for example,
6 the average initial cost trend rate was about 10%, with more than half of the
7 respondents using a rate between 9% and 11%. The ultimate long-term
8 cost trend averaged over 5% with the vast majority assuming a rate
9 between 5% and 5.5%. The assumptions used in Detroit Edison's OPEB
10 cost projections fall in the range of these values.

11

12 **Q. Has Detroit Edison externally funded its OPEB costs?**

13 A. Yes, it has. Detroit Edison has externally funded the incremental costs
14 resulting from the adoption of SFAS 106. Specifically, Detroit Edison has
15 established and made contributions to Voluntary Employee Benefits
16 Associations ("VEBA") of over \$100 million since 2001 and over \$63 million
17 to a 401(h) account since 2001

18

19 **Q. Please describe the reduction to OPEB expense related to the**
20 **securitization of the Transition Obligation.**

21 A. The total OPEB expense determined by Hewitt Associates, LLC for each
22 year is reduced by \$7 million for the amortization of the Transition Obligation
23 costs that were securitized in 2001. The Transition Obligation associated
24 with Detroit Edison employees of \$84 million was part of the regulatory

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1 assets securitized. As the securitization of the Transition Obligation
2 resulted in immediate recognition of the liability in 2001, it eliminated the
3 need for any future amortization of such obligation.

4

5 **Q. What external funding of OPEB related expenses is assumed in these**
6 **projections?**

7 A. Consistent with the Commission's requirement in its Order in Case No. U-
8 10040 that utilities externally fund the OPEB expense included in rates, the
9 OPEB expense projections reflect the assumption that \$75 million is funded
10 in 2006 (the net OPEB expense adopted in the rates approved in Case No.
11 U-13808) and each year's projected net OPEB expense for 2007 and
12 beyond. The assumption that the Company will fund its net OPEB expense
13 in 2007 and beyond is premised on the Commission's adoption of the OPEB
14 Equalization Mechanism proposed by Mr. Brudzynski. These levels of
15 OPEB external funding is further premised on the assumption that the
16 Company will be able to take full advantage of these contributions as
17 deductions in its Federal income tax returns. If the Company is unable to
18 claim a deduction for this external funding, the amounts funded will be
19 reduced by the tax effects of the loss of such deductions.

20

21 The OPEB cost projections reflected in Schedule F5-10 reflect the following
22 funding amounts which total \$597 million:

23 2006: \$75 million

24 2007: \$100 million

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1 2008: \$108 million

2 2009: \$106 million

3 2010: \$105 million

4 2011: \$103 million

5

6 **Active Employee Benefits**

7

8 **Q. Are there employee benefits provided by Detroit Edison other than**
9 **pension and OPEB for which you are projecting cost increases**
10 **between 2005 and 2011?**

11 A. Yes. The Company offers a competitive active employee benefits package
12 for the attraction and retention of a skilled workforce. Aside from pension
13 and retiree medical, the other major components of the benefit package
14 include a choice between several Health Care plans, Life Insurance, Long
15 Term Disability coverage, and a 401(k) Savings and Investment Plan. The
16 components of these benefits are summarized on lines 5 through 8 on
17 Exhibit DE-16, Schedule F5-8. These costs are projected to increase from
18 \$167 million in 2005, to \$186 million in 2006, \$199 million in 2007,
19 increasing to \$252 million in 2011. The largest component in this category
20 is the cost of medical and related benefits for active employees. The cost of
21 Life Insurance is projected to increase from \$7 million in 2005, to \$8.2
22 million in 2006, to \$8.5 million in 2007, to almost \$10 million in 2011, based
23 on the projected insurance coverage increase resulting from higher labor
24 costs. Similarly, Savings Plan costs are projected to increase from \$22

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1 million in 2005, to \$23 million in 2006, to almost \$24 million in 2007, to over
2 \$27 million in 2011, based on the projected increase in labor costs.

3

4 **Q. What actions has Detroit Edison taken to manage its cost of benefits**
5 **for active employees and retirees?**

6 A. While managing benefit costs has been a matter of great concern over the
7 years, growth in costs since 2000 has led the company to take dramatic
8 action. In 2001, the company initiated an aggressive campaign to manage
9 its benefits costs for both non-represented active employees and retirees.
10 Substantial increases in cost sharing and significant plan design changes
11 across the entire DTE enterprise for active non-represented employees
12 decreased the cost of benefits \$2.5 million. Program and administrative
13 costs were reduced \$2.7 million by aggressively renegotiating provider and
14 carrier contracts. The changes introduced in 2003 are projected to provide
15 savings of \$5 million on an ongoing basis to the enterprise. These changes
16 included increases in the non-represented retiree cost-sharing responsibility
17 for health care costs from 3% in 2003, to 8% in 2004. In addition, the
18 eligibility requirements for current employees to receive post-employment
19 health care benefits were changed from 15 years of service acquired after
20 age 40, to 10 years of service acquired after age 45. Another series of
21 benefit design changes were introduced in 2005, primarily impacting non-
22 represented retirees. These changes included targeting cost sharing at
23 10% for those who retire between 2002 and 2007, increasing to 25% for
24 those who retire after 2020. Other plan design features such as co-

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1 insurance, deductibles and co-pays were adjusted to be more competitive
2 and comparable with market norms. The impact of these changes produced
3 a savings of approximately \$11 million in 2005, projected to increase in the
4 years going forward.

5

6 During 2004 and 2005, the Company completed contract negotiations with
7 all of the Union groups representing over 50% of DTE Energy employees in
8 the regulated entities. The effect of the negotiations was that near-cost
9 neutral contracts were negotiated that in some instances are effective into
10 2009. The negotiated reduction in the benefit levels substantially offset
11 corresponding increases to base pay for the duration of the agreements. A
12 provision of the U.W.U.A. Local 223 contract, which covers over 50% of the
13 active employee workforce, included retiree cost sharing for employees
14 retiring after December 31, 2004 along with new hires after June 7, 2007
15 being responsible for 50% of the cost of post-retirement healthcare. Prior to
16 those dates, members of U.W.U.A. Local 223 had no retiree healthcare
17 cost sharing requirements. In 2005, the Company negotiated an agreement
18 with I.B.E.W. Local 17 that includes the provision of 10% co-insurance and
19 corresponding deductibles for in and out-of-network services. Cost sharing,
20 co-pays and other plan design features were also directionally adjusted to
21 be more competitive.

22

23 **Q. What actions does Detroit Edison expect to take in the future to**
24 **manage active employee and retiree benefit expense?**

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1 A. The company plans to continue its aggressive efforts to manage benefit
2 costs while still providing a competitive benefits array for attraction and
3 retention purposes. Expected actions to be implemented in 2007 include
4 vendor changes to reduce costs as well as additional plan design changes
5 to further reduce the Company's cost of benefits. A significant effort in 2007
6 will be to expand enrollment in the Consumer Driven Health Plan(s) offered
7 by the Company. In addition, the company plans to continue its array of
8 aggressive disease management and wellness programs. These programs
9 provide specific tools for employees, pre-65 retirees and eligible dependents
10 to effectively manage their chronic health care conditions while supporting
11 healthy lifestyles. Components of the programs include smoking cessation,
12 weight loss and other healthy life style initiatives all designed to help
13 mitigate the expected national long-term health care trend rates.

14

15 **EMPLOYEE COMPENSATION**

16

17 **Q. What is Detroit Edison's compensation philosophy and framework for**
18 **non-represented employees?**

19 Edison's compensation philosophy is designed to: a) provide pay programs
20 that attract, retain and motivate employees; b) assure that pay is externally
21 competitive (paid near the market median) and internally equitable; and c)
22 differentiate total rewards based on individual contributions and results.

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1 At Edison, the compensation framework for non-represented employees has
2 two primary components: base and variable pay. Employee base pay is
3 reviewed annually and adjusted (if appropriate) based on position relative to
4 the external market and individual performance. Variable pay is based on
5 the achievement of customer, company, organizational and individual
6 results. In tandem, Edison's base and variable pay plans provide a
7 framework of market median pay opportunities for non-represented
8 employees.

9

10 **Q. How does Edison's non-represented compensation philosophy and**
11 **framework provide benefits to customers as well as shareholders?**

12 A. Edison's compensation philosophy and framework provides a benefit to
13 customers and shareholders by attracting and retaining employees with the
14 requisite skills and experience to ensure quality customer service delivery,
15 and by recognizing and rewarding effective and efficient performance. This
16 directly benefits all customers by providing a high level of service at a
17 competitive cost, and provides incentives to focus future job performance on
18 those activities that provide the most benefit to customers and shareholders.

19

20 Further, based on input from the Commission in other rate cases, the
21 Company is aware of a desire on the part of the Commission to more
22 closely link incentive plans to customer related issues. For 2006, the
23 incentive plans include approximately 70% of the metrics that are customer
24 focused (operationally and financially), spread across a variety of Edison-

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1 specific measures, including; customer satisfaction, safety, workplace
2 diversity (demographics representative of our service territory), success in
3 achieving Performance Excellence goals (thereby mitigating future rate
4 increases), and Edison overall performance (working to remain financially
5 sound to meet future customer reliability and generation needs). The
6 remaining 30% component is shareholder related and contains DTE Energy
7 Company metrics.

8

9 **PERFORMANCE EXCELLENCE PROCESS**

10

11 **Q. Are there any expense reduction initiatives currently in progress with**
12 **Detroit Edison?**

13 A. Yes, DTE Energy, including Detroit Edison, is currently engaged in the
14 Performance Excellence Process (PEP).

15

16 **Q. What is the Performance Excellence Process?**

17 A. The broad description of the Performance Excellence Process is included in
18 Mr. Brudzynski's testimony and also discussed from an industry perspective
19 in Mr. Buckler's testimony.

20

21 **Q. How will PEP achieve these objectives?**

22 A. When fully implemented, PEP will result in an optimal Detroit Edison
23 workforce that is more focused on system integrity and customer service. In
24 order to achieve this result, the Company has designed a market based

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1 voluntary exit program for non-represented employees within the framework
2 of Edison's core values of integrity and respect. This program is called the
3 Voluntary Separation Incentive Program (VSIP). It provides an enhanced
4 pension or cash separation benefit along with retiree health and life
5 eligibility, outplacement and financial counseling. The VSIP has been
6 offered to targeted business unit and organizational groups that are
7 expected to be decreased in size through voluntary and/or involuntary
8 initiatives. Discussions have also taken place with the leadership of Local
9 223 which represents approximately half of Edison's workforce. An
10 involuntary exit program may be required to achieve the Company's
11 operating performance and customer service objectives.

12

13 **Q. Does the PEP initiative have any impact on pension or benefit costs?**

14 A. Yes

15

16 **Q. What is the potential impact of the Performance Excellence Process**
17 **on the costs associated with employee pensions and benefits?**

18 A. The PEP process is projected to generate an employee benefit savings of
19 approximately \$3 million in 2006, growing to approximately \$20 million in
20 annual savings by 2008 and beyond. These savings are primarily
21 generated by lowered pension and OPEB expenses along with lower active
22 employee expenses resulting from an optimized Edison workforce. PEP
23 employee benefit savings alone are projected to be approximately \$100
24 million over this time period. From a PEP perspective, these savings are

Line
No.

1 expected to result in a relatively flat O&M employee benefit expense from
2 2006 through 2011.

3

4 **Q. Are there any unusual Cost to Achieve (CTA) items impacting the**
5 **employee benefit savings?**

6 A. Yes there are. In certain circumstances significant reductions in employee
7 levels may lead to the requirement to recognize a curtailment cost. A
8 curtailment cost is one that accelerates the recognition of previously
9 unrecognized service costs as well as additional costs or savings related to
10 employees terminating employment earlier than anticipated by the actuarial
11 assumptions used to develop the pension and OPEB costs. The prior
12 service cost portion of curtailment accounting is merely an acceleration of
13 costs previously subject to delayed recognition under SFAS 87 and SFAS
14 106, which would have been recognized through the normal systematic
15 amortization of these costs when viewed over the long term.

16

17 The complete details regarding CTA can be found in Mr. Brudzynski's
18 testimony.

19

20 **Q. Exhibit DE-16, Schedule F5-14, "Summary of Cost to Achieve" details**
21 **the separation and curtailment costs that are anticipated as part of the**
22 **CTA. Would you please describe these separation and curtailment**
23 **costs?**

Line
No.

1 A. Yes. Lines 16 thru 19 on Exhibit DE-16, Schedule F5-14 show projected
2 separation, curtailment and other transitional costs of \$23.4 million, \$77.4
3 million and \$7.8 million respectively. Separation costs are estimated costs
4 for providing severance payments, based on years of service for terminated
5 employees; the definition of curtailment costs has been previously
6 discussed in my testimony as well as Mr. Brudzynski's; other transitional
7 costs are related to additional payroll taxes, COBRA costs and
8 outplacement services all for the projected terminated employee group.

9

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

11 A. Yes, it does.

12