

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
THE DETROIT EDISON COMPANY)
for determination of net stranded costs)
and for approval of net stranded cost)
recovery charges.)
_____)

Case No. U-13350

QUALIFICATIONS AND DIRECT TESTIMONY OF RICHARD A. POLICH

ON BEHALF OF ENERGY MICHIGAN

- 1 Q. Please state your name and business address.
- 2 A. My name is Richard A. Polich. My business address is 2010 Hogback Road, Ann Arbor,
- 3 MI 48105.
- 4 Q. By whom are you employed and what is your present position?
- 5 A. I am employed by Nordic Marketing L.L.C. as a Vice President.
- 6 Q. Please state your educational background.
- 7 A. I graduated from the University of Michigan in Ann Arbor in August of 1979 with a
- 8 Bachelor of Science Engineering Degree in Nuclear Engineering and a Bachelor of Science
- 9 Engineering Degree in Mechanical Engineering. In May 1990, I received a Masters of
- 10 Business Administration from the University of Michigan in Ann Arbor.
- 11 Q. Please describe your work experience.
- 12 A. In May of 1978 I joined Commonwealth Associates as a Graduate Engineer and worked on
- 13 several plant modification and new plant construction projects. In May 1979 I joined
- 14 Consumers Power Company as an Associate Engineer in the Plant Engineering Services

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1 Department. In April of 1980 I transferred to the Midland Nuclear Project and progressed
2 through various job classifications to Senior Engineer. I participated in the initial design
3 evaluation of the Midland Cogeneration Plant. In July 1987 I transferred to the Market
4 Services Department as a Senior Engineer and reached the level of Senior Market
5 Representative. While in this department I analyzed the economic and engineering
6 feasibility of customer cogeneration projects. In July of 1992 I transferred to the Rates and
7 Regulatory Affairs Department of Consumers Energy as a Principal Rate Analyst. In that
8 capacity I performed studies relating to all facets of development and design of the
9 Consumers' gas, retail, electric and electric wholesale rates. During this period, I was
10 heavily involved in the development of Consumers Direct Access program and in the
11 development of Retail Open Access program. I also participated in the development of the
12 Consumers' revenue forecast.

13 In March 1998, I joined Nordic Electric as Vice President in charge of marketing and
14 sales. My responsibilities included all aspects of obtaining new customers and enabling
15 Nordic to supply electricity to those customers. In May 2000, my responsibilities shifted
16 to Operations and Regulatory Affairs. My responsibilities include management of supply
17 purchases; transmission services, and development of new power projects. Regulatory
18 Affairs responsibilities include over seeing regulatory and legislation issues.

19 Q. Are you a registered professional engineer in the State of Michigan?

20 A. Yes I am.

21 Q. Have you previously testified before this Commission?

22 A. Yes. I presented testimony on five occasions on behalf of Consumers Energy. In the
23 remand phase of retail wheeling Case U-10143/U-10176 presenting the Consumers' method

1 for design of future retail wheeling rates, the Consumers proposed Special Contract Rate
 2 Case U-10625 presenting methods to identify and qualify customers. I presented testimony
 3 in the Consumers' Electric Rate Case proceeding U-10335. I presented testimony in the
 4 initial phase of retail wheeling Case U-10143/U-10176 on the proposed cost and rate of retail
 5 wheeling and in Case U-10685 the Consumers Energy Electric Rate Case in November
 6 1994. I presented testimony for Energy Michigan in Cases U-11915 (Supplier Licensing)
 7 and U-11956 (Edison True Up Case), U-12478 and U-12505 (Edison and Consumers Energy
 8 Securitization Cases), U-12639 (Stranded Cost Methodology Case) and U-13380
 9 (Consumers Energy Determination of Stranded Costs).

10 **PURPOSE OF TESTIMONY**

- 11 Q. Mr. Polich, please describe the purpose of your testimony in this proceeding.
- 12 A. I will address Detroit Edison Company's (DECo) assertion that they incurred stranded costs
 13 during the calendar years 2000 and 2001, and the premise that DECo shall incur additional
 14 Stranded Cost of 2002 and 2003. My testimony will show that the MPSC should ignore all
 15 projections of Stranded Cost of 2002 and 2003 because the information necessary to
 16 accurately project Stranded Costs is inaccurate, speculative and one sided. The potential for
 17 the Customer Choice Program to be scuttled by establishing high Stranded Cost Charges
 18 based upon projected Stranded Costs dictates that only actual Stranded Cost data should be
 19 used in this case. Our analysis will show that DECo actually collected sufficient excess
 20 revenues to create over \$554 million in Stranded Benefits during calender years 2000 and
 21 2001. It is also our position that the Stranded Benefits from 2000 and 2001 should be carried
 22 forward to offset any potential future Stranded Costs.
- 23 Q. What is the basis for your position on using excess Stranded Benefits to offset future

1 Stranded Costs?

2 A. We feel Stranded Benefits should be treated in the same manner as Stranded Costs. Utilities
3 have continually claimed the right to include unrecovered Stranded Costs from previous
4 years in the Stranded Cost amount to be recovered in this proceeding. In addition, they
5 claim the right to carry forward any unrecovered Stranded Costs into future recovery
6 periods. The principles associated with the recovery of Stranded Costs should apply equally
7 to the application of Stranded Benefits. DECo through its filed testimony, is requesting
8 recovery of perceived unrecovered Stranded Costs from prior years and proposing to carry
9 forward any unrecovered Stranded Costs for recovery in future years. If DECo can apply
10 this philosophy to Stranded Costs then they should also be required to apply it to Stranded
11 Benefits. Thus, the MPSC needs to first, establish the amount of Stranded Benefits from
12 calendar years 2000 and 2001 then allow the use of these Stranded Benefits to offset any
13 potential future real Stranded Costs that DECo may occur over the next several years. In
14 addition, these Stranded Benefits should be used to offset the Securitization Charge amounts
15 applied to those customers participating in Customer Choice for 2003.

16 Q. What are the other critical issues are being addressed in your testimony?

17 A. First, DECo should not be allowed to introduce revisions to their last cost of service study
18 which have not been proven to be prudent or for which Edison has not obtained MPSC
19 approval. Second, DECo has chosen to ignore or failed to properly account for several items
20 which significantly alter the stranded cost calculation. Third, it appears DECo is attempting
21 to claim that revenues from third party sales, should be excluded, even though DECo used
22 jurisdictional resources to enable DECo to make the sales. Finally, the Michigan Public
23 Service Commission (MPSC) should continue its policy of offsetting the Securitization

1 Charge by establishing a negative Transition Charge equal to the Securitization Charge and
2 funding the rate equalization credit with excess securitization savings.

3 Q. What is the fundamental problem with DECo's filed testimony in this case?

4 A. The case filed by DECo suffers from the similar problems encountered in Consumers Energy
5 Company's filing in Case U-13380. Both companies have developed their case around cost
6 analyses which were not based upon the last Commission approved cost of service study.
7 Both companies have altered the capital cost structure, adding additional capital costs not
8 approved by the MPSC, changed rates of returns and introduced different accounting. Both
9 companies are using different allocation factors for production plant based upon their own
10 interpretation of the rules. Both companies altered previously approved rates of recovery.
11 The result is complete confusion as to what are the real cost of service and revenue numbers
12 on which to base Stranded Cost Calculations. This leaves the parties participating in this
13 case with the task of scrambling to figure out what are the real costs and revenues on which
14 to calculate stranded costs. The MPSC needs to establish a standard procedure which
15 includes specifications on how data and calculations are to be made to determine stranded
16 cost. The case filed by DECo in this proceeding is appalling in its attempt to create the
17 appearance that DECo has incurred stranded costs as a result of Customer Choice Service.

18 Q. Are you sponsoring any Exhibits?

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

20 Exhibit ~~EM-~~^I 32 (RAP-1) Calculation of 2000 and 2001 Stranded Cost/(Benefit)

21 Exhibit ~~EM-~~^I 33 (RAP-2) 2001 Fuel Revenue

22 Exhibit ~~EM-~~^I 34 (RAP-3) 2001 Production Related Revenues

23 Exhibit ~~EM-~~^I 35 (RAP-4) Special Contract Revenue Discount

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STRANDED COST CALCULATION TIME PERIOD

Q. Over what time period has DECo attempted to calculate stranded costs for purposes of developing the Transition Charge?

A. The Transition Charge developed by DECo is based upon stranded cost calculated over calendar years 2000 through 2003. They have justified this calculation on the basis that the Transition Charge will not be implemented until early 2003. The estimated Stranded Costs contained in Mr. Edward L Falletich's testimony for 2000 and 2001 are based upon supposed "actual" revenues and costs. The calculation of stranded costs for 2002 and 2003 are based upon "projected" revenues and costs developed by DECo.

Q. Should the Transition Charge include projected stranded costs for 2002 and 2003?

A. No. As proven by DECo in this case, it is difficult enough for them to accurately calculate stranded costs based upon actual 2000 and 2001 historical results. They even failed to introduce a case for 2001 based upon actual revenues and costs, even though it has been nine months since the end of the year and five months since the 2001 earnings were reported. As will be shown later in this testimony, DECo has not properly allocated costs, improperly billed revenues, and incorrectly adjusted rates of return in order to calculate stranded costs for calendar years 2000 and 2001. With these kind of adjustments to actual results, there is no assurance that DECo can properly project revenues and costs for 2002 and 2003 with any degree of reliability. In addition, today's power markets are in such flux that it creates additional uncertainty, making it difficult for anyone to predict tomorrow's conditions. Stranded costs are highly dependent on the amount of bundled load served by DECo, the amount of load served by power marketers, the market price of power, the amount of real

1 load growth, the economy, and other factors. Using highly subjective projections to
 2 calculate and establish a Transition Charge could result in a Transition Charge which is too
 3 high and kills the program. DECo should be required to use a process similar to PSCR
 4 reconciliation to determine the stranded costs, using actual revenues and costs authorized by
 5 the MPSC. This can be filed by DECo annually once the actual figures are known. In
 6 addition, the MPSC needs to establish a formula and process that eliminates subjective
 7 adjustments not authorized by the MPSC. This should include a requirement to file their
 8 cases within 4 months of the end of the calendar year. This will result in Stranded Cost
 9 cases which are easier to assess, process, and compile decisions.

10 Q. What time period should be used to calculate stranded costs and the associated transition
 11 Charge in this Case?

12 A. Only the stranded costs actually incurred by DECo during the calender years 2000 and 2001
 13 should be used to calculate the 2003 Transition Charge.

14 **DETROIT EDISON'S REVENUE DEFICIENCY CALCULATION**

15 Q. Has DECo requested the MPSC to approve change in DECo's capital expenditures,
 16 operating costs and rate of return in this case?

17 A. Yes. Any deviation from the amounts used to calculate Edison's Current Rates and
 18 surcharges, that are used to calculate Stranded Cost/Benefit, need MPSC approval. DECo
 19 has included in its calculation of Stranded Costs, several changes in Net Production Plant,
 20 Construction Work in Progress ("CWIP"), Depreciation Expense, Purchase and Interchange
 21 ("P&I") Capacity, R & PP Tax, Insurance, and rate of return. DECo's witness Martin L.
 22 Heiser admits that a new cost study was performed for this case. The costs contained in
 23 DECo's Exhibits supposedly reflect the costs DECo actually incurred versus the costs

1 contained in the last general rate case. Since rates are frozen, current rates do not reflect any
2 of these cost changes. As a result, any change in cost of service versus those authorized in
3 the last MPSC approve rate case, will impact the stranded costs calculation. This results in
4 the Electric Choice customers paying 100% of the increased costs.

5 Q. Does the calculation of Production Fixed Cost ("PFC") by DECo include other alterations
6 in the costs assigned to PFC?

7 A. Yes. Mr. Heiser has chosen to add to the PFC the following costs, some of which are
8 normally recovered as variable costs or under surcharges:

- 9 A. Nuclear Decommissioning
- 10 B. MPSC Assessment Fees
- 11 C. Washington DC Franchise Fee
- 12 D. Plant Materials & Supplies, Rents Receivable, Securitization Implementation
- 13 Costs and all Retail Access Costs

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14 Q. Does DECo use the correct Pre-Tax Rate of Return in its calculation of Revenue
15 Requirements?

16 A. No. DECo's revised testimony includes a calculation of a 10.68% Pre-Tax Rate of Return
17 (ROR), which is not based upon any previous MPSC orders. This is another example of
18 DECo attempting to obtain an increase in cost of service without going through full rate case
19 proceedings. It is also another example of DECo attempting to increase frozen rates and
20 applying the incremental revenues to justify stranded costs to be applied to Customer Choice
21 participants. The passage of PA141 froze rate levels and associated rates of return. Based
22 on the ROR of 7.66%, approved by the MPSC in U-10102, the before-tax ROR is 10.01%
23 as calculated by DECo in Case U-11956. Energy Michigan has applied this before-tax ROR

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1 in its calculation of Stranded Cost/(Benefits).

2 Q. Does the revenue calculation in Mr. Heiser's Exhibit No. A-¹⁷(MLH-1) properly reflect
3 the revenues that should be allocated to cover the PFC?

4 A. No. Mr. Heiser failed to include in the Revenue Deficiency Calculation, certain revenues
5 and/or applied allocators which reduced revenues that would offset expenses. These include:

- 6 A. Fuel Costs
- 7 B. O & M Revenues
- 8 C. Adjustments for Special Contracts
- 9 D. Direct Assignment Revenue

10 Q. Are there any further inappropriate changes in the revenue calculation made by DECo?

11 A. Yes. Mr. Michael G. VanHaerents removes the revenues associated with DECo's sales to
12 the Ford Motor Company/Rouge Steel Co. that occurred in 2000 and 2001. DECo removed
13 these revenues because "...the full service tariff sales to the Ford Rouge complex was a
14 temporary sale." In theory, every sale is a one time occurrence or temporary sale.
15 Customers can change load requirements by installing more efficient equipment, eliminating
16 a product line, moving business to another location, purchasing power from an alternative
17 supplier, etc. This does not change the fact that the sale did occur, DECo did earn a profit
18 from the sale and the sale offsets stranded costs. The removal of these revenues from the
19 stranded cost calculation is nothing more than an attempt by DECo to increase stranded
20 costs, resulting in fewer customers participating in Customer Choice, and increasing DECo
21 profits at the expense of Customer Choice customers.

22 Q. How does this affect the calculations of Stranded Cost and DECo's proposed Transition
23 Charge?

1 A. As will be shown below, the Stranded Cost and associated Transition Charge calculation
2 contained in Mr Edward L. Falletich's testimony has no basis in reality.

3 Q. Have you prepared a revised stranded cost calculation?

4 A. Yes. In Exhibit ~~EM-32~~^{F-32}(RAP-1) I have revised DECo's stranded cost calculation to reflect
5 the errors contained in their analysis. The stranded costs were calculated for calendar years
6 2000 and 2001. Because DECo did not include any data based upon the last MPSC
7 approved general rate case, I was forced to use their revised cost of service figures. Use of
8 DECo's figures in the calculation of Revenue Requirements, introduces the likely hood that
9 I have under estimated the amount of Stranded Benefit in my calculation.

10 Q. Why did you remove the Nuclear Decommissioning Expense?

11 A. I made adjustments to remove all impacts associated with Nuclear Decommissioning costs
12 and revenues from the Revenue Requirement calculation, because it is separately collected
13 and accounted for. It is collected under a separate surcharge, and paid by all customers,
14 including Customer Choice customers. In addition, any over or under collection are
15 periodically reviewed and adjusted. As such, any under or over collections should not be
16 factored into stranded costs calculations. This could cause confusion in future Nuclear
17 Decommissioning reconciliation proceedings and surcharge adjustments. DECo included
18 the Nuclear Decommissioning Expense in the Depreciation Expense Category.

19 Q. Why did you remove the MPSC assessment fees from the PFC expense?

20 A. These fees are part of the fixed cost of customer service and should be recovered through the
21 Customer Service Charge. DECo has not included any revenues from the Customer Service
22 Charge to offset these expenses.

23 Q. Why did you remove the expenses associated with the Washington DC Franchise Fee?

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1 A. This item was included as a tax item in DECo's expense allocation. Franchise fees are
2 associate with serving end use customers and should not be allocated to production plant in
3 service.

4 Q. Why were the fuel expenses changed?

5 A. Revenue of Edison's FERC Form 1 data showed the fossil fuel expense to be
6 \$608,196,788,000 for 2000 not the \$572,548,152,000 shown in Mr. Heiser's workpaper WP
7 MLH-2, page 19 line 1, column d.

8 REVENUE ADJUSTMENTS TO STRANDED COST CALCULATION

9 Q. Why were the revenues increased for special contracts?

10 A. In the past, DECo chose to enter into several Special Contracts in an effort to avoid losing
11 load to third parties or cogeneration. These discounts are a competitive choice to retain
12 customer load. These Special Contracts were discounts from DECo's bundled tariffs. The
13 revenue requirement derived from DECo's cost of service assumes the load served under the
14 Special Contracts was priced at full service rates. Thus, any revenue shortfall created by the
15 rate discounts is included in the actual revenues received during 2000 and 2001. If no
16 adjustment is made to DECo's actual revenues to remove the impact of the rate discounts,
17 the discounts effectively become stranded costs and are factored into the Transition Charge.
18 It is totally inappropriate to charge customers electing competitive supply alternatives for
19 the costs DECo incurs to compete against competitive suppliers. Based upon Discovery
20 Response EMDE 1.2/2 from DECo, (SMC and LCC Year 2000 Annual Reports to the
21 Commission filed December 2, 2001), the estimated amount of revenue discount associated
22 with Special Contracts for calendar years 2000 is \$56.9 million. This discount should be
23 credited in its entirety to PFC, because DECo can not discount transmission, distribution,

1 surcharges and/or customer charges. Thus, the discount must have come from PFC and
2 DECo's 2000 PFC revenues should be increased by \$56.897 million. In addition, since
3 DECo does not know the amount of 2001 Special Contracts Discounts, the 2000 amount of
4 \$56.897 million should be added to 2001 PFC Revenues.

5 Q. What other revenues were added to the calculation?

6 A. As explained earlier, the "one-time only" revenues associated with the 2000 and 2001 sales
7 to Ford Rouge complex has been added to the total revenues. This increases the combined
8 revenues for 2000 and 2001 by \$37.4 million.

9 Q. Why did you reverse the O&M adjustments made in the revenue deficiency/(sufficiency)
10 calculation made by Mr. Heiser in Exhibit No. ~~A-17~~^{F-17}(MLH-1)?

11 A. This proposed adjustment by DECo is another example of the game they are playing to
12 increase projected Stranded Costs. A calculation anomaly associated with an allocation
13 percentage results in almost \$14 million in PFC revenue in excess of PFC revenue
14 requirement being allocated to excess O&M Revenues. This anomaly can be seen in Column
15 B of Exhibit No. ~~A-17~~^{F-17} (MLH-1). According to DECo's calculations, they are bringing
16 in more revenue than they are spending for O & M. This occurs because a fixed percentage
17 allocator calculated by comparing O & M expense to total PFC Revenue Requirement, is
18 applied to the actual 2000 PFC Revenue. If DECo's O & M Expense is \$577 million, then
19 only \$577 million should be applied to the PFC Revenue. Thus, DECo's calculation method
20 reduces the PFC Revenue Sufficiency by \$14 million and increases Stranded Cost by \$14
21 million. This can easily be avoided by simply removing the O & M adjustment in Column
22 B of Exhibit No. ~~A-17~~^{F-17}(MLH-1).

23 Q. Should the total revenues be adjusted to include revenues for third party sales?

1 A. The response to this question is dependent upon the source of the power for the third party
 2 sales and the inclusion of any costs associated with those sales in rates and PSCR
 3 adjustments. The magnitude of the third party sales in 2000 and 2001 is enormous with
 4 DECo generating over \$177 million in third party sales. If these revenues are used to offset
 5 stranded costs, it will result in elimination of stranded cost for the next several years. In
 6 simple terms, third party sales revenue should be included in the revenue stream used to
 7 offset stranded costs;

- 8 1. If DECo has procured the rights to power supply sources using funds from the PSCR
- 9 surcharge, or
- 10 2. If the power sold is generated by DECo generation resources included in rate base,
- 11 or
- 12 3. If DECo procured the rights to the power for the purposes of serving retail
- 13 customers, or
- 14 4. If the power DECO sold to third parties was the result of reduced load created by
- 15 customers participation in retail access.

16 If any of these factors are present, then DECO should include the revenues from third party
 17 sales in its calculation of stranded costs.

18 Q. Should the revenues associated with third party sales in 2000 and 2001 be included in the
 19 stranded costs calculation?

20 A. It is clear that the 2000 third party sales should be included in the stranded cost calculation
 21 because the power purchases were made prior to the start of retail access and were included
 22 in DECo's last PSCR case. DECO was able to take advantage of high market prices to sell
 23 power and these revenues should be used to offset stranded costs. With regard to the 2001

1 third party sales, changes in market conditions and lower loads also provided DECo an
2 opportunity to take advantage of selling excess power into the market. Our review of
3 DECo's cost appears to include the costs of the options and hedges used as the basis for the
4 third party sales made in 2001. As such, the third party revenues should be included in the
5 stranded cost calculation.

6 Q. In Exhibit A-24 (MGV-5), lines 6-7, Edison Witness VanHaerents appears to propose that
7 excess securitization savings be used to fund the pre-securitization residential rate reduction.
8 What is your position on this adjustment?

9 A. I believe the Michigan Public Service Commission has previously rejected this position on
10 the grounds that the pre-securitization 5% reduction for residential customers was not a
11 stranded cost. My position is that all excess securitization savings should be used to reduce
12 transition charges and/or provide rate equalization payments as previously ordered by the
13 Commission.

14 Q. What is your position on the class specific transition charges proposed by DECo Witness
15 Mr. Falletich?

16 A. Class specific transition charges as proposed by Detroit Edison are anti-competitive because
17 they increase charges to the customers most likely to participate in competition. Also, class
18 specific charges appear to reallocate existing revenue requirements in violation of Public Act
19 141. Increases due to the reallocation also may violate the rate freeze in Public Act 141.

20 Q. What is your recommendation for setting the stranded cost charge or credit for 2003?

21 A. The \$554 million in Stranded Benefits should be first allocated to cover the 2003
22 securitization charge for Customer Choice and Experimental Program customers. A
23 negative transition charge equal to the prevailing Detroit Edison securitization bond and tax

1 charge would produce this result. The remaining \$505 million balance of 2000 and 2001
2 Stranded Benefits, should be used to offset any potential Stranded Costs in future years.
3 Excess Stranded benefits should be used, if necessary, to cover securitization charges to
4 Customer Choice and Experimental customers. If not needed for this purpose, excess
5 Stranded Benefits, should be used to continue the rate equalization credit established by the
6 Commission in previous cases.

7 Q. What is your position on the proposal of Edison Witness Padgett that customers returning
8 to the Edison bundled service from the Electric Choice service be billed retroactively for all
9 stranded costs existing during the years they were receiving Electric Choice service?

10 A. I oppose this proposal. It appears to be a form of retroactive rate making to the benefit of
11 Detroit Edison. Also, it clearly would have the impact of chilling the market for Electric
12 Choice and for that reason would have an anti-competitive impact. Finally, the Edison
13 proposal is unfair because it fails to include provisions which would credit returning Electric
14 Choice customers for the benefits produced to Detroit Edison by reducing expensive power
15 purchases.

16 Q. Does this conclude your testimony?

17 A. Yes.