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October 7, 2004

via Electronic Filing and Hand Delivery

Ms. Mary Jo Kunkle
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
Lansing, MI 48909

Dear Ms. Kunkle:

RE: In the matter of the application of The Detroit Edison Company to increase rates, amend its rate schedules governing the distribution and supply of electric energy, implement Power Supply Cost Recovery plans, factors and reconciliations in its rate schedules for jurisdictional sales of electricity and for miscellaneous accounting authority and regulatory asset recovery (MPSC Case No. U-13808)

Enclosed for filing are an original and four copies of The Detroit Edison Company's Replies to Exceptions, along with a Certificate of Service. Also enclosed is an extra copy of each document to be stamped and returned with our courier.

Please contact me if you have any questions.

Very truly yours,

FOSTER, SWIFT, COLLINS & SMITH, P.C.

Signature Not Verified
Stephen Rhodes
Digitally signed by Stephen Rhodes
DN: cn=Stephen Rhodes, o=Foster Swift, c=US
Date: 2004.10.07 15:43:11 -04'00'

Stephen J. Rhodes

/mkr
Enclosures
cc: Hon. Daniel E. Nickerson, Jr.
Parties of Record

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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of THE DETROIT EDISON COMPANY to increase rates, amend its rate schedules governing the distribution and supply of electric energy, implement Power Supply cost recovery plans, factors and reconciliation in its rate schedules for jurisdictional sales of electricity and for miscellaneous accounting authority and regulatory asset recovery.	)	Case No. U-13808

THE DETROIT EDISON COMPANY'S REPLIES TO EXCEPTIONS

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Dated: October 7, 2004

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INTRODUCTION

On September 16, 2004, The Detroit Edison Company ("Edison" or the "Company") filed its Exceptions to the Proposal for Decision ("PFD") issued on August 26, 2004 by Administrative Law Judge Daniel E. Nickerson, Jr. ("Judge Nickerson" or the "ALJ"). Exceptions were also filed by the Commission Staff, the Association of Businesses Advocating Tariff Equity ("ABATE"), the Attorney General, Constellation NewEnergy, Inc. ("Constellation" or "NewEnergy"), Energy Michigan, The Kroger Company ("Kroger"), the Michigan Environmental Council and Public Interest Research Group in Michigan ("MEC/PIRGIM"), and the Residential Ratepayer Consortium ("RRC").

Edison will generally respond to each of the other parties in these Replies to Exceptions. In an effort to be succinct yet complete, Edison may also address arguments collectively or by reference. Further detail regarding Edison's positions and the reasons therefore on many of these Replies to Exceptions can be found in Edison's May 14, 2004 Initial Brief, May 28, 2004 Reply Brief, September 16, 2004 Exceptions, and the attachments to those briefs and exceptions, which are incorporated by reference herein. Edison's corresponding decision not to separately address every issue raised or position taken by every other party should not be deemed to constitute an agreement with such issues or positions.[1]

REPLIES TO EXCEPTIONS

I. REPLY TO EXCEPTIONS OF STAFF

A. Staff's Proposal With Respect to Customer Choice and Return to Service.

The Staff contends (exceptions, pp 1-2) that the ALJ erred in adopting NewEnergy's proposal, and that the ALJ should have adopted the Staff's recommendation for a three year "stay

[1] Edison, of course, maintains all of its appellate rights.

out" from bundled service provision for Customer Choice participants. Edison agrees, in part. As Edison explained in its Exception No. 22, return to service criteria are fundamentally critical to the successful operation of the Choice program. Return to service criteria must not encumber Edison's ability to plan for and serve bundled customers' generation capacity needs in a reliable manner. In addition, the return-to-service time period must be sufficient in length to enable Edison to successfully mitigate its stranded production costs and prevent gaming by customers.

Edison recommended a return to service provision that assures that Choice customers will not be able to arbitrage the market unfairly by returning to Edison when the market price of electricity is higher than bundled generation rates and leaving again once the market price drops below tariff rates.[2] Edison's proposal is straightforward: the Company may charge market prices to any customer who returns from Customer Choice.

This approach protects bundled customers from subsidizing Choice customers and affords Edison the reasonable ability to operate its generation assets in an efficient and cost effective manner. It also enables the Company to effectively plan for electric supply to meet its reliability requirements.

Constellation recognized many of Edison's concerns, and proposed that returning customers should pay the higher of market rates or the bundled rate on a monthly basis. The ALJ properly agreed (PFD, pp. 99-100).

1. Staff Incorrectly Assumes That the Constellation Proposal for Returning Customers to be Served at the Higher of Market Prices or Cost-based Tariff Rates Upsets the "Balance" That Staff has Crafted in Developing its Return to Service Recommendation to the Commission's Customer Choice Program.

[2] This fundamentally inequitable ability to arbitrage market and tariff prices forms the basis for both ABATE's and Kroger's proposals. (ABATE exceptions, p 12; Kroger exceptions, p 2).

Staff proposed, and the ALJ apparently adopted, a new stranded cost methodology whereby the Company is responsible for recovering a significant amount of its production fixed costs ("PFC") via mitigation sales in the wholesale energy markets (PFD, pp 91-93). Staff also recognized that the Company's current return to service provisions must be modified to provide the Company with an adequate opportunity to sell the freed-up energy over longer periods of time by limiting the customers' ability to return to the Company's cost-based tariff rates. Accordingly, Staff proposed a three-year "stay-out" provision to provide the Company with an unencumbered period of time to maximize the revenues generated from longer-term sales in the wholesale energy markets (14 T 3142).

Although the ALJ did not adopt Staff's proposed return to service provisions, the Constellation return to service proposal, whereby returning Choice customers are required to pay the higher of market prices or cost-based tariff rates, accomplishes the same goal and does not upset the "balance" proposed by Staff in its proposed modifications to the Commission's Customer Choice program.

As noted in Staff's testimony (14 T 3142), under the Staff's new stranded cost methodology, the Company must be afforded the opportunity to recover its allocated production fixed costs via longer term sales at market prices in the wholesale energy markets. If the Company is required to serve returning Choice Customers at cost-based tariff rates, its ability to recover its allocated production fixed costs is diminished greatly, if not eliminated entirely, since the Company will need to reserve generating capacity to serve returning Choice Customers even if those Choice Customers never return to the Company's cost-based tariff rates. The Constellation return to service proposal more effectively accomplishes the same goal as Staff's return to service proposal in that the Company will be provided with the opportunity to recover its allocated production fixed costs in the

wholesale energy markets via longer-term sales at market prices since returning Choice Customers will be provided service at the higher of market prices or cost-based tariff rates.

2. Staff's Proposed Three-Year Stay-Out Provision Does Not Facilitate Market-Based Recovery or Mitigation of Stranded Costs.

Although Company witness Mr. Garnett stated that the Staff's proposed three-year stay-out and one year notice of return provisions may promote stability in the market, he also noted that Staff's proposed provisions will not facilitate market-based recovery or mitigation of stranded costs until prices rise late in the decade (13 T 2668-76). Accordingly, if the Commission should adopt Staff's proposed return to service provision, then the Commission should modify the three-year stay-out provision to properly capture the full market cycle of supply and demand in the ECAR region. This would require extending Staff's proposed three-year stay-out provision to at least five years. A five-year stay-out provision would be consistent with the existing Retail Access Service Tariff ("RAST") minimum five year term for RAST provided to new locations and also correspond to the five-year notice requirement in the Company's "Standard Contract Rider No. 10 Interruptible Supply Rider." (13 T 2838-39).

3. Staff Incorrectly States That the ALJ's Decision Means That Once off Bundled Rates, a Customer Could Never Return.

The Constellation return to service proposal simply requires that returning Choice Customers pay the higher of market prices or cost-based tariff rates. Nowhere in the Constellation proposal does it contemplate that customers could not return to the Company service once off bundled rates.

4. Staff Incorrectly States That the Constellation Proposal's Stay-Out Term is Unreasonably Long.

By the Commission's own admission, there is a significant level of competitive activity in the Company's service territory. For example, the Commission's Status of Electric Competition in Michigan: First Quarter 2003 Update, reported at page 4: "Over the past 12 months, Edison's ROA

program experienced growth of about 205% in terms of number of customers and almost 150% in number of MW served." Accordingly, the Company proposed that there should be no requirement for the Company to provide cost-based tariff service to any customer that chooses an alternative electricity supplier for its generation needs and subsequently wishes to return to the Company's generation service.

It is inappropriate for the Commission to require the Company to insulate customers that choose alternative electricity suppliers for their electricity generation requirements from the possibility of higher market prices for power and energy. The Constellation proposal recognizes this and properly requires returning customers to be serviced by the Company at the higher of market prices or cost-based tariff rates.

5. Staff Continues to Propose $43.6 Million of Historical Stranded Costs Which Edison Believes has Major Methodological Flaws.

The Staff asserts (exceptions, p 2), as a clarification to page 122 of the PFD, that there is no need to adjust the Staff's $43,613,000 calculation of historical stranded costs for the SMC contracts. Edison responds that this matter is in need of far more than a clarification, since there are major flaws in the methodology that the Staff used to calculate its historical stranded cost amount.

These flaws include using a prospective rate of return for historical years; using an outdated revenue allocation factor; and incorporating "stranded benefits."[3] Pages 81-86 of Edison's Exceptions discuss and correct these major flaws. Attachments XII and XIII of Edison's Reply Brief show the corrected Staff stranded cost calculation for years 2002 and 2003.

The following Table shows the increase in Staff's historic stranded costs and reflects Edison's corrections by using the Commission-authorized 10.01% pre-tax rate of return instead of a prospective rate, utilizing an updated production fixed cost revenue allocation factor and

[3] The term "stranded benefits" is found nowhere in Act 141.

determining 2004 stranded costs through the date of the Interim Order using the Commission-approved PFC methodology:

Historical Net Stranded Cost

($000)	Staff	Staff Corrected	Stranded Cost Increase
Year 2002	(12,983)	14,828	27,811
Year 2003	48,511	74,508	25,997
Jan 1 – Feb 20, 2004	8,085	10,411	2,326
Sub-Total	43,613	99,747	56,134
Carrying Charge		7,274	
Recoverable Net Stranded Cost		107,021	

These corrections represent a $56.1 million increase over the Staff's cumulative net stranded cost amount of $43.6 million. As a result, when corrected the Staff's cumulative unrecovered stranded costs are $99.7 million. With a carrying charge at the authorized overall pre-tax rate of return accrued through the date of the February 20, 2004 Interim Order in this case, the recoverable stranded cost amount is $107.0 million as shown in Attachment XVIII of Edison's Exceptions. Carrying charges will continue to accrue until the stranded cost amounts are fully recovered.

B. Regulatory Assets Clarification.

The ALJ stated that he "adopts Staff's proposed adjustments to Detroit Edison's proposed recovery of its regulatory assets. Detroit Edison accepts Staff's proposed adjustments" (PFD, p 58). The Staff asserts (exceptions, p 3) that for clarity, the adjustments should be specified. Edison generally agrees with the Staff on the proposed recovery of the following regulatory assets:

a. Clean Air Act Expenses.

b. Return of and on Capital Expenditures in Excess of Base Depreciation Levels.

c. Costs incurred pursuant to Midwest Independent transmission System Operator (MISO) Schedules 10, 16 and 17. Staff supports recovery of this item through 2004 while Edison supports recovery of this item through 2005 as discussed below.

d. 1997 Storm Cost Amortization Refund.

e. Prior to the expiration of the regulatory asset recovery surcharge ("RARS") the Commission should order a RARS reconciliation to replace any regulatory asset estimates with actuals and adjust the surcharge rate for each customer group to ensure recovery of the remaining regulatory asset balances with a return at the pre-tax overall rate of return.

Edison disagrees with the Staff on the proposed recovery of the following regulatory assets:

a. Staff wrongly removes the deferral of 2005 MISO charges and the 2005 Transmission Rate Increase for capped residential customers. Staff believes these costs are recovered in the 2005 PSCR. As discussed in detail on Page 88 of Edison's Exceptions, these costs should be deferred for recovery in this proceeding. Mr. VanHaerents' rebuttal testimony explains that rate caps prevent Edison from realizing any rate increases from residential customers in 2005 (13 T 2867-68). The decision to defer both MISO costs and transmission rate increases is not impacted by recovering these transmission costs either through base rates or the PSCR.[4] Therefore, the Commission must allow the Company to continue to defer MISO charges and transmission rate increases for capped customers in 2005 and include these deferred amounts in the regulatory asset recovery.

[4] As in 2004, residential customers' rates will be adjusted to ensure that they pay for service consistent with the Act 141 rate caps.

b. Transmission Integration Costs. As discussed in detail on Page 87 of Edison's Exceptions, these costs were not transaction costs in DTE Energy's sale of the transmission business in 2003; but were incurred in 2000 and 2001 to meet the transmission independence provision of PA 141 Section 10w(1). Therefore, Transmission Integration Costs must be included in the recoverable regulatory asset balances (13T 2866).

c. Rate of Return. Earlier in its Exception No. 9, Edison supported a 10.32% pretax overall rate of return as developed on Attachment IX of Edison's May 28, 2004 Reply Brief. Edison therefore requests that the Commission authorize RARS utilizing the 10.32% rate as part of the final order.

C. Rate Design

1. Revenue Deficiency Allocation

The Staff states (exceptions, p 4) that the ALJ correctly found that Staff's proposal to allocate the revenue deficiency among the rate classes on an equal percentage basis is consistent with the methodology employed by the Commission in its February 20, 2004 Interim Order and is consistent with the requirements of Act 141 that prohibit the reallocation of costs to capped classes of customers. The Staff applied an equal percentage increase to all classes including RAST customers, unlike Edison which allocated an equal percentage increase to bundled non-RAST tariffs and a different percentage increase to the RAST.

First, Edison disagrees that the allocation of one percentage increase to non-RAST bundled customers and another percentage increase to RAST customers is inconsistent with the prohibition on reallocation of costs language in Act 141. Edison has proposed to shift nothing; it only proposed a

methodology for allocating the rate increase. Absent the rate increase request in this proceeding, rates would remain unchanged. Mr. Falletich explained this distinction in great detail. He stated:

> "In my opinion I do not believe that the allocation of the proposed rate increase violates this cost shifting provision. I have proposed no shifting of the costs that are recovered under the Company's existing tariff structure. In other words, absent a rate increase request in this proceeding, I am proposing no change or cost shifting among the rate classes. What I have proposed is a methodology for allocating the proposed rate increase in this proceeding. Historically, allocations of rate increases or decreases to rate classes have taken many forms. These have included, but are not limited to, allocations based on demand, energy, equal percentage, or based on other considerations. For example, the 5% securitization related rate reduction implemented under 2000 PA141, was implemented on an equal percentage basis for all of the Company's full service tariffs. This, to my knowledge, has not been challenged as a violation of the cost shifting provision. In my opinion, the proposed allocation of the rate increase in this proceeding is no different than the 5% securitization related rate reduction, other than it represents a rate increase." (10 T 1590)

The application of one percentage increase for full service bundled tariff customers and another for the RAST does not conflict with Section 10d (2) of Act 141.

Second, it is inappropriate to assign the same percentage increase to RAST customers. The rate increase for customers served under the RAST was based on a separate distribution cost analysis. Edison's proposal represents an equal distribution percentage increase to both bundled and Choice while Staff's proposal represents an unequal percentage increase in distribution charges between bundled and Choice Customers. Staff's proposal essentially recovers only a Choice Customer's funding of the Low Income Program and provides no additional rate relief to recover the significant distribution cost increases that have occurred since rates were originally established based on 1995 cost levels and which were allocated to bundled customers. (13 T 2894-2895). The RAST increase has been based on a separate distribution cost analysis and, as Edison previously explained (Initial Brief, pp 114-15), reflects the significant increase in distribution revenue requirements that have occurred in the almost

ten years since the cost-of-service study was conducted, upon which Choice rates were established. One indication of the need for distribution rate increases is that from the time that the current RAST rates were developed, distribution net plant has increased by approximately 70%, but any offsetting sales growth increased only by 20%. Ignoring these significant increases in the RAST cost-to-serve only serves to further exacerbate the incentive to elect Choice and could be viewed as resulting in stranded distribution costs. Based on current commercial & industrial secondary choice sales levels, the RAST under recovery is approximately 30% when compared to the average cost which was used to develop the current RAST charges in Case No. U-11452. (13 T 2912-2913)

Clearly, if bundled customers are paying their fair share of the costs to maintain a reliable distribution system then so should RAST customers. To do otherwise would result in unlawful discrimination contrary to the mandates of MCL 460.557(4), and a reallocation of costs between Choice and bundled customers.

2. Transitional Primary Supply Rate (TPSR)/SMC Discounts

The Staff urged that the Commission should approve the Staff's proposed Transitional Power Supply Rate ("TPSR") and if not, Staff agreed with ABATE's calculation of imputed SMC revenue discounts in the amount of $43,541,000. Staff understands that the ALJ recommended adoption of the TPSR (exceptions, p 5).

Edison addressed this matter in its Exception No. 11. Edison agrees that if the Commission approves the TPSR, then it should not also impute any revenue discounts associated with the SMCs. If the Commission approves the TPSR, the contract revenue adjustment included in the ALJ's determination of adjusted net operating income for 2004 (PFD, p 63) in the amount of $40.601 million should be removed.

Edison, however, disagrees with the Staff's contention that ABATE's calculation of SMC/LCC contract discounts in the amount of $43,541,000 is the correct amount of the SMC discounts should the Commission not approve the TPSR. ABATE's $43,541,000 is comprised of $40,586,000 associated with the SMCs and $2,955,000 associated with the LCCs. (13 T 2268). Edison's cost-of-service Exhibit A-5, Schedule E1 shows an LCC total revenue deficiency of $391,000 on line 24, columns 28 and 29. When compared to LCC revenues that are well in excess of $100 million, Edison believes that there can be no reasonable dispute that it has met the Commission's requirement to cost justify the LCC contracts and consequently there should be no imputation of LCC contract revenue discounts regardless of whether the TPSR is approved.

D. LIEEF

The Staff excepts to the ALJ's finding that the statutory mandates regarding LIEEF programming no longer apply (exceptions, p 6). The Commission's Interim Order correctly recognized that "the issuance of interim relief ends the securitization savings." (Case No. U-13808 Interim Order dated February 20, 2004, p 61). Mr. Stanczak explained that since there are no securitization savings to fund Act 141's LIEEF, any connection between Act 141 and the LIEEF has ended.[5] Any LIEEF that the Commission establishes in this proceeding should continue only until Edison files its next general rate case (13 T 2588).

The Staff further asserts (exceptions, pp 6-7) that LIEEF funds should be used statewide despite Mr. Stanczak's explanation that only Edison customers are funding the LIEEF (14 T 3093). Mr. Stanczak explained that only Edison's customers should be eligible to receive benefits from the

[5] See MCL 460.10d(7), which provides "If securitization savings exceed the amount needed to achieve a 5% rate reduction for all customers, then, for a period of 6 years, 100% of the excess savings, up to 2% of the electric utility's commercial and industrial revenues, shall be allocated to the low-income and energy efficiency fund administered by the commission." (emphasis added). Detroit Edison had excess securitization savings until issuance of the Interim Order in this proceeding. Now there are none.

LIEEF, since it would be inappropriate and unsound regulatory policy to have only Edison's customers support the entire State's energy assistance needs. The LIEEF should be used only in Edison's service territory to support electricity and heating fuel assistance programs (13 T 2589). See also Edison's Initial Brief, pp 101-103; Reply Brief, pp 150-55.

E. PSCR.

The Staff correctly points out that the ALJ misunderstood Edison's PSCR request, and that the Commission needs to decide PSCR issues in this case (Staff Exceptions, pp 10-11). Edison discusses this matter in its Exception No. 1, and incorporates that detailed discussion by reference herein.

It bears emphasis that Edison agrees with the MPSC Staff that it did not withdraw its PSCR request and that the determination of the PSCR base is in fact before the Commission. Edison further agrees that the final 2004 PSCR plan and factor continue to be a part of this conjoined rate and PSCR plan case and are fully justified and supported by the record. Edison filed a separate PSCR Plan case for 2005 on September 30, 2004 (Case No. U-14275), and plans to file a separate 2004 PSCR reconciliation case by March 31, 2005. Edison agrees that the issues before the Commission regarding the new PSCR base include costs associated with SO_2 emission allowances, NO_X emission allowances, and network transmission. In addition, the recovery of production fixed costs associated with customers that have elected to receive their electric supply from alternative electric suppliers is properly before the Commission.

With respect to the recovery of production fixed costs, Edison needs explicit direction in advance on how its actions will be treated prior to filing its 2004 PSCR reconciliation case. Due

process requires that Edison know the rules now.[6] The PFD appears to have accepted the Staff's proposed assignment of the Choice share of production fixed costs, adjusted revenue to account for that assignment, and removed wholesale sales revenues from the PSCR Base calculation accordingly. Adoption of the Staff's proposal based upon a "slice" of generation system concept represents a major change from the current PSCR process. Edison needs to know that it will be allowed to: (1) retain 90% of the net revenues from wholesale sales up to 110% of the annual Choice sales volume, (2) calculate wholesale sales net revenues proceeds based on the average fuel and purchased power costs for PSCR and wholesale sales, (3) make long-term sales to capture higher market prices from longer term (forward) rather than spot sales, and (4) treat wholesale sales the same as firm bundled sales that must be served and recognize that Edison may have to make additional purchases to support the remaining PSCR customers. Further, there are a number of changes that would be required with respect to reporting and reconciliation. For instance, the 45 Day Report would need to be revised to reflect all of the above changes, including (1) inclusion and proper allocation of network transmission expenses, (2) inclusion of SO_2 and NO_X emission allowances, (3) removal of Edison's share of net proceeds associated with wholesale sales, (4) account for sales in excess of 110% of Choice sales on an annual basis versus a monthly basis[7] and

[6] Edison is entitled to know "the rules of the road" in advance. See Grayned v City of Rockford, 408 US 104, 108-09; 92 S Ct 2294; 33 L Ed 2d 222 (1972); Golembiowski v Madison Heights Civil Service Comm, 93 Mich App 137; 286 NW2d 69 (1979), lv den 408 Mich 893 (1980); Sponick v Detroit Police Dep't, 49 Mich App 162, 174-76; 211 NW2d 674 (1973); Allison v City of Southfield, 172 Mich App 592, 596; 432 NW2d 269 (1988). Edison is entitled to due process and has a right to be able to choose, in advance, the course(s) that it may lawfully pursue. Edison must be allowed to adequately prepare to economically supply its electric customers and mitigate stranded costs.

[7]Edison will have more freed up generation available during the non-summer months for wholesale sales, which may lead to Edison exceeding the 110% Choice volume level during those months, but still be under that level on an annual basis.

(5) proper treatment of Choice customers that return to full requirements service depending on the final disposition of the return to service conditions.

F. Overall Revenue Requirements.

1. Staff's Adjusted Net Operating Income ("NOI") Included in the Revenue Deficiency Does Not Include Several Necessary Corrections as Explained by the Company.

The Staff supports adjusted net operating income of $293,884,000 for 2004 as shown on Attachment 1 to the Staff's exceptions. Staff has rejected several other corrections to NOI supported by the Company. Edison takes exception to the Staff's exclusion of these necessary and reasonable adjustments. As supported in detail in Edison's Exceptions, the Company supports adjustments to include an increased merger control premium adjustment of $15,365,000; increased generation O&M expense of $45,359,000; reflection of the higher level of Choice sales penetration resulting in a bundled sales revenue reduction of $99,146,000; and the removal of the SMC discount revenue imputation penalty that resulted in a revenue reduction of $40,601,000.

The following Table summarizes the necessary corrections to the Adjusted Net Operating Income set forth in the PFD to arrive at a more appropriate and reasonable adjusted net operating income of $166,431,000 for 2004.

($000)	Revenue Increase (Decrease)	Expense (Increase) Decrease	Jurisdictional Adjusted NOI [1]
Staff's Adjusted NOI			293,884
Edison's Adjustments (Same as Reply Brief)			
Control Premium		(15,365)	(9,769)
Generation O&M Expense		(45,359)	(28,838)
Choice Sales Level	(99,146)		(63,034)
Special Contract Discounts	(40,601)		(25,813)
Reply to Exceptions Adjusted NOI			166,431

[1] Revenue and expense changes converted to NOI changes by dividing by 1.5729 Revenue Conversion Factor (Exh. S-118, Sch. A-2)

2. Staff's Revenue Deficiency Calculation is Incorrect.

The Staff calculates a revised revenue dificiency of $254,372,000 on Attachment 1 to their exceptions. In this Reply to Exceptions, the Company is supporting a revenue deficiency of $582,546,000 using necessary and proper adjustments to the Staff's case.

The Detroit Edison Company
Revenue Deficiency
For the Year Ended 12/31/04
($000)

Description	Jurisdictional Electric Staff	Jurisdictional Electric Staff's exceptions to PFD As Adjusted by Edison
Rate Base	7,123,562	7,123,562
Rate of Return	7.23%	7.54%
Income Required	514,804	536,796
Adjusted Net Operating Income	293,884	166,431
Income Deficiency	220,921	370,365
Revenue Multiplier	1.5729	1.5729
Revenue Deficiency	347,486	582,546
Adjustment to Revenue Deficiency	(93,113)	(115,973)
Adjusted Revenue Deficiency	254,372	466,572

This revenue deficiency incorporates the ALJ's finding that Edison's rate base is $7,123,562,000 (PFD, p 13) and subsequent agreement by Staff that it is appropriate (exceptions, p 11). Further this revenue deficiency is based on a 7.54% overall weighted cost of capital (Attachment IX to Edison's Reply Brief) using the Staff's 11% ROE, a 50/50 permanent capital structure, and an adjusted net operating income of $166,431,000 as discussed above. If the Commission adopts the Staff's recommendation to reduce the revenue deficiency of $582,546,000 for the production fixed cost responsibility relating to Choice customers, there are two corrections necessary to the production fixed cost allocation. These corrections incorporate the 10.32% pre-tax rate of return (7.54% on an after-tax basis) and adjust for the Company's more realistic forecasted higher level of Choice sales penetration of 9,250 GWh. As indicated on Attachment X, Column (d) of Edison's Reply Brief, these adjustments reflect a production fixed cost allocation of $115,973,000. Therefore, the $115,973,000 revenue deficiency reduction for production fixed cost allocation produces an adjusted revenue deficiency of $466,572,000 in the adjusted final case.

G. Edison Reply to MPSC Staff Exception VIII(3) – Comparison of Bundled Sales Rates to Choice Rates

Staff (exceptions, pp 12-13; Attachment 2) provided a comparison of bundled rate levels (total rate excluding generation and transmission costs) versus Choice rate costs for primary and secondary customers. The Staff states that the discussion and attachment were prepared to assist the Commission in its determination of the ability of Choice customers to absorb transition charges. Attachment 2 depicts the inequities in existing primary and secondary bundled rates due to rate subsidies and the fact that existing bundled rates in many cases vary greatly from cost-of-service.

The fact that rate subsidies exist has also been addressed by some of the other parties in this proceeding. Some parties have also called for an immediate total or partial deskewing of rates to

correct these rate subsidies (ABATE Initial Brief, p11; Kroger Initial Brief, p13). ABATE witness Mr. Selecky also recognized that Edison's exposure to stranded costs would decrease substantially if rate subsidies were eliminated. (13 T 2293) Out of the debate one thing has become manifest – rate subsidies do exist. The funding of these subsidies is highly concentrated among a few customers and represents a major financial risk to Edison unless the rate subsidy issue is addressed and correctly resolved. Because of the rate cap constraints of PA 141, the answer is not to deskew at this time but to instead implement some alternative solution that addresses these subsidies and results in eliminating the uneconomic and artificial incentives for Choice. Customers are currently opting for Choice based on false economic signals due to rate subsidies that artificially encourage customers to switch.

Attachment 2 to Staff's exceptions provides an additional and helpful perspective on the rate subsidy issue and its adverse impact on Choice switching economics. The Staff removed generation and transmission costs from various bundled service rates to determine the effective distribution cost recovery component of bundled rates and then compared them with the corresponding RAST (distribution) charges that Choice customers currently pay. Several observations are readily apparent from the data provided by the Staff in Attachment 2 to their exceptions.

First, if the generation and transmission component of bundled rates is priced at cost-of-service, then the distribution cost recovery component of bundled primary and secondary rates is substantially higher than the corresponding RAST charges paid by Choice customers. Stated differently, the data in Staff's Attachment 2 clearly shows that Choice customers provide substantially less cost recovery for the same distribution service than do bundled customers once the generation rate subsidy is removed.

Second, the level of distribution cost recovery varies significantly between bundled secondary and primary rate classes and clearly indicates that the level of inter-class rate subsidy is substantially higher for secondary rate classes. In other words, the data in Staff's Attachment 2 confirms the existence of significant inter-class rate subsidies in Edison's bundled tariffs.

While Staff did not recommend a specific solution to the inter-class rate subsidy problem (or the Choice vs bundled customer distribution cost recovery disparity issue), Edison has offered a solution for the Commission's consideration (exceptions, pp 73-76). Edison proposed a Regulatory Cost Adjustment ("RCA") that was based on the level of rate subsidy or disparity between Edison's rates and the cost-of-service (or the level of disparity between RAST and bundled customers relative to distribution cost recovery). The RCA would be calculated based on the subsidy level currently contained in Edison's bundled rates and applied to RAST customers' bills. The RCA charge would be separate from and in addition to the recovery of historic stranded costs via a transition charge mechanism as recommended in the PFD. The estimated revenues generated by the RCA adjustment (based on Staff's proposed Choice sales level) could then be used to reduce bundled customers revenue deficiency. The RCA adjustment would result in a $50 million reduction to the bundled revenue deficiency. The Commission cannot allow these artificial and uneconomic Choice incentives to continue. To do so would impart serious additional financial risk to the Company and ultimately would result in additional rate increases for the Company's remaining full service customers. The calculation of the RCA is shown below:

Regulatory Cost Adjustment	Source	Secondary	Primary
2002 Sales (GWH)	P-521, Pgs. 304-304.1	10,035	10,427
U-13808 COS Revenues ($mill)	Exh. A-5, Sch. E1, Pg. 4	$967	$699
COS Revenue Reqr.	Exh. A-5, Sch. E1, Pg. 4	$848	$653
Unit Price Revenues	Rev./Sales	9.6¢	6.7¢
Unit Price Rev. Reqr.	Reqr./Sales	8.5¢	6.3¢
Regulatory Cost Adjustment	**(rev. price -reqr. price)**	**1.2¢**	**0.4¢**
Staff Choice Sales (7,565)	See Notes Below	2,194	5,371
Revenue Deficiency Impact	***$50***	$26	$24

Notes:
- Sales Source 2002 P-521
- Secondary; Pg. 304 Lines 27, 28, 29, 31, 32, 33, 34 & Pg. 304.1 Lines 8,9
- Rate D6; Pg. 304 Lines 36,37,38 & & Pg. 304.1 Lines 23,24,28,31
  Less SMC/LCC 2002 Sales per discovery EMDE 1.19/19 (Supplemental) Pgs. 3&7 which is also a public report filed with the MPSC (filed 9/04/03)
- Staff Choice sales of 7,565 GWH allocated to primary/secondary per Exhibit A-97 primary/secondary split of 71%/29%

II. REPLY TO EXCEPTIONS OF ATTORNEY GENERAL.

A. The ALJ's Recommended Relief is Consistent with Act 141's Rate Caps, Which Allow "Backfilling" and Deferred Implementation of Rates Where Net Rates Are Not Increased During the Capped Periods.

The Attorney General contends (exceptions, pp 1-7) that the Commission may not consider any rate increase for capped customers in this case. Edison previously explained that the Attorney General's position lacks merit (Edison's Initial Brief, pp 21-23; Edison's Reply Brief, pp 11-13). It should be further noted that the Attorney General previously made essentially the same argument (Attorney General's Initial Brief Regarding Interim Rate Relief, pp 14-17). The Commission acknowledged the Attorney General's position (Interim Order, p 24), and rejected it. The Commission explained, for example:

> "As previously noted, interim rates are normally designed to recover an equal percentage increase from all customer classes. However, Detroit Edison is currently operating under a statutory rate cap that prohibits rates for residential customers from increasing before

> January 1, 2006, and commercial or manufacturing customers less than 15 kW from increasing before January 1, 2005. In this order, the Commission has required Detroit Edison to reduce its PSCR factor to a negative 1.05 mills per kWh. Accordingly, any increase in base rates for capped customers would violate the rate cap if the increase is more than the reduction in the PSCR factor. Accordingly, the Commission finds that base rates should be raised by 2.99 mills per kWh for residential customers and 3.09 mills per kWh for commercial and manufacturing customers less than 15 kW. All customers not subject to the rate cap should be assessed an interim surcharge of 7.243%, which results in an effective $101 million revenue increase for Detroit Edison." (Interim Order, pp 59-60, footnotes omitted).

The Attorney General essentially contends that the term "rates" in MCL 460.10d(2), means each individual element of rates – each of which is allegedly capped. The Attorney General cites no authority that relevantly supports his extreme position. Instead it is axiomatic that utility rates are overall rates. Federal Power Comm v Hope Natural Gas Co, 320 US 591, 602; 64 S Ct 281; 88 L Ed 333 (1944); Michigan Bell Telephone Co v Public Service Comm, 332 Mich 7, 37; 50 NW2d 826 (1952); MCL 460.6a(2)(b).

To the extent that the Commission sets total rates for customers subject to rate caps below the capped rate level established upon passage of Act 141 in 2000, Edison may lawfully backfill the PSCR reduction with a portion or all of the base rate increase that would be applicable to rate classes subject to the rate caps. The backfilling of the PSCR reductions is supported by MCL 460.10d(8) which states:

> "Except as provided under subsection (3), until the end of the period described in subsection (2), the commission shall not authorize any fees or charges that will cause the residential rate reduction required under subsection (1) to be less than 5%."

Contrary to the Attorney General's assertion that the Commission may not increase any existing rate element of capped rates or establish a new rate element in capped rates, MCL 460.10d(8) clearly allows increases as long as the overall rate cap is not exceeded. For the same

reason, cost deferrals that do not raise the total rates paid by capped customers in the freeze and cap period do not violate Act 141, as alleged by the Attorney General (brief, p 30; exceptions, pp 1-6).

It is appropriate under well-established law and procedure for the Commission to consider all rates in this general rate case.[8] See, for example, MCL 460.6j(18). If the Legislature had instead meant to have partial rate cases and individually frozen elements of each rate classes' rates as the rate caps expired, then the Legislature would have enacted such a law.

B. Edison's Authorized Return on Equity Should be 11.5%.

The ALJ followed the Staff's recommendation that Edison's authorized return on common equity ("ROE") should be in the middle to high end of the 10% to 11% range (PFD, p. 34). In developing their case, the Staff specifically used 11.00% (14 T 3001) and the ALJ largely adopted the Staff's case. The Attorney General contends (exceptions, pp 7-8) that the Commission should instead use the midpoint of the Staff's recommended range.

The Attorney General attempts to support his argument with references to the testimony of Mr. King. The problem with this is two-fold. First, the record in this case does not support the assumption that Mr. King is qualified to testify on the subject of rate-of-return on common equity. The closest to a qualification is the statement in Mr. King's summary of qualifications and experience claiming that he has presented testimony on rate-of-return. (10 T 1796) Mr. King does not explain the type of rate-of-return, where it was presented, or even if it was accepted. Second, Mr. King candidly admits: "I have performed no independent analysis of Edison's equity return." (13 T 2551) All that Mr. King has done is to determine that the midpoint of Mr. Ballinger's recommended range is 10.5% and that the midpoint of the average of the lows and the highs of the

[8] However, Edison herein preserves its position on appeal in Court of Appeals Docket No. 252966 that its PSCR clause must remain suspended for capped customers until their caps expire.

three approaches used by Mr. Ballinger is 10.33%. (13 T 2548-49) Surely, there needs to be a more expert basis for Edison's ROE than blindly calculating an average. If Mr. Ballinger and the Staff wanted to use the midpoint, they could easily have done so. They did not.

The Attorney General also argues that the Commission should not adopt an 11% rate-of-return on common equity, because that is the return the Commission approved in 1994 in Case No. U-10102. The Attorney General then attempts to argue that three significant changes have occurred since 1994 to lower the cost of equity, and that they are not disputed. The Attorney General is wrong. While treasury bond and corporate bond yields may be lower in 2004 than they were in 1993 (13 T 2549), this does not necessarily translate into a lower cost of equity, as other conditions may have changed. For example, as Dr. Morin testified in explaining his graph of "Allowed Risk Premium vs Interest Rates" (13 T 2135), the graph is "… depicting a clear, unequivocal, and statistically significant negative relationship between the allowed risk premium and the level of interest rates." (13 T 2145) Also, the Company disputes the claim that the Staff is raising the equity ratio from 40% in Case No. U-10102 to 46% in this case. Edison previously explained (exceptions, p 30), the equity ratio in Case No. U-10102 was 44.99% and the actual equity ratio on December 31, 1993 was 46.74%. The Company is currently on Negative Outlook by both Moody's and Standard & Poor's rating agencies (12 T 1890), and any proposal to reduce the equity ratio below the current level of 50% (12 T 1893) is simply irresponsible.

Noticeably absent from the Attorney General's list of changed circumstances since 1994 is Customer Choice and the passage of PA 141.[9] Mr. Champley testified: "Customer choice is the most significant business and regulatory risk facing Edison today . . ." (6 T 723) The Attorney General ignores the fact that this is 2004, not 1994. What the Commission may have found in 1994

[9] To intentionally ignore the substantial business risk imposed by Choice, as both ABATE and the Attorney General do, seriously undermines their credibility in this proceeding.

with regard to Edison's ROE has no relevance to today. Current studies, analyses, and expert testimony are on this record. The Commission should not try to adjust 1994 to today, and especially should not do so using the Attorney General's limited (and suspect) set of changes.

The proper rate-of-return on common equity for Edison is 11.5% as supported by Dr. Morin. (12 T 2075). Dr. Morin explained that Michigan is the only state in the U.S. with a full Customer Choice program that did not deregulate generation. (12 T 2137) As a result, DECo has moved further and further away from the average risk investment profile of the electric utility industry and is now among the riskiest utilities in the industry. (12 T 2138). Edison discussed the appropriate ROE at length in its Exception No. 5, and incorporates that discussion herein by reference.

C. PSCR.

The Attorney General reasserts his argument that Edison did not file a proper PSCR Plan case (exceptions, pp 9-12). Edison maintains that its filing was proper, as explained at pages 2-6 of its October 31, 2003 Reply Brief Concerning Implementation of the PSCR Process, and at pages 30-33 of its February 10, 2004 Interim Reply Brief. The Attorney General's characterization of the record is inaccurate, and there is no support for the Attorney General's assertion that it is now too late to conduct a 2004 PSCR plan case.[10] As a result of the Commission's December 18, 2003 Opinion and Order, Edison's filing has proceeded as a conjoined PSCR plan case and general rate case, which have been combined under the same docket for hearing and administrative efficiency. R 460.17301(5). The Commission now needs to make PSCR decisions in this case, as explained in Edison's Exception No. 1.

More specifically, in his exceptions, the Attorney General continues to argue that Edison's filing does not comply with the provisions of MCL 460.6j(18), because Edison did not propose

[10] The Staff and RRC clearly do not share the Attorney General's opinion in this regard. (Staff Exceptions, pp 10-11; RRC exceptions, pp 1-2).

PSCR factors to cover a future period of 48 months. Based on his flawed premise, the Attorney General asks the Commission to order Edison to file a 2004 PSCR reconciliation case pursuant to MCL 460.6j(12) – (16) and to also require Edison to file a 2005 PSCR plan case by September 30, 2004, pursuant to MCL 460.6j (3) – (7). The Attorney General also claims that it is too late to conduct a 2004 PSCR plan case under MCL 460.6j (3) – (7).

In its June 20, 2003 Application, the Company did request PSCR treatment pursuant to MCL 460.6j (18):

> "11. Applicant is requesting, pursuant to Act 304, MCL 460.6j (18), that the Commission reinstate the Company's PSCR mechanism for 2004 in this case, coincident with approval of the Company's request for a mitigation adjustment to operate in tandem with the PSCR mechanism. Because it is imperative that the Company's overall revenue deficiency be considered in tandem with the reinstatement of the 2004 PSCR mechanism, Applicant requests that the PSCR clause remain suspended and that implementation of a new factor not begin until the date of the Commission order authorizing adequate and compensatory relief for the Company.*
>
> * It is the Applicant's position that a new PSCR factor cannot be implemented without also providing the rate relief that is being requested contemporaneously with this application. Accordingly, if interim relief is not granted, or if interim relief is granted without the approval of the Company's mitigation adjustment, or if interim relief is not granted in an amount that adequately compensates the Company, the PSCR mechanism must remain suspended until a final order is issued in this case." (Application, p 4)

On August 18, 2003, the Commission issued an order setting a separate briefing schedule on the PSCR clause suspension issue. On December 18, 2003, the Commission issued its Order reinstating the PSCR clause effective January 1, 2004. The Commission found:

> "Because Act 304 permits implementation of a factor prior to a hearing in the plan case, it is not necessary to conduct a hearing before Detroit Edison incorporates its proposed factor in its rates. The distinct rate procedures prescribed by Act 304 for the recovery of PSCR costs refute Detroit Edison's claim that its factor must remain suspended until the Commission grants additional rate relief that is not subject to Act 304. Nothing in the rate cap provisions of Section

10d(2) precludes implementation of a factor that is consistent with those caps." (Order, p 9)

By reinstating the PSCR clause, effective January 1, 2004, the Commission, in essence, and effectively:

1. Used the discretionary authority granted in MCL 460.6j (18) to reject the Company's application to establish PSCR factors under 460.6j (18).

2. Established that the 2004 PSCR plan case will proceed under MCL 460.6j (3) – (7).

3. Consolidated the 2004 PSCR Plan case and the general rate case under the U-13808 docket for hearing and administrative efficiency as conjoined cases. R 460.17301(5). This makes sense as the requirements for a plan case under MCL 460.6j (3) and (4) are almost identical to the requirements for a general rate case under the Commission's Filing Requirements Order in Case No. U-4771, Part 2. It makes no sense to have two separate dockets covering the same material.

4. Rendered the Attorney General's argument that Edison's filing does not comply with MCL 460.6j (18) moot.

5. Required Edison to continue with the normal PSCR process, which includes filing a 2005 PSCR Plan case by September 30, 2004, as requested by the Attorney General. Detroit Edison has complied with this requirement. (See Case No. U-14275)

6. Required Edison to file a 2004 PSCR reconciliation case pursuant to MCL 460.6j (12) – (16), as requested by the Attorney General. Detroit Edison will comply with this requirement. Pursuant to MCL 460.6j (12), the parties to the reconciliation case are allowed reasonable discovery to obtain evidence concerning the reasonableness and prudence of expenditures and the amounts collected pursuant to the clause.

Therefore, most of the Attorney General's concerns, however unmeritorious, have been resolved. With respect to the claim that it is too late to conduct a 2004 PSCR plan case, the plan case has been conducted and all that remains is for the Commission to issue an order pursuant to MCL 460.6j (6) and (7). Contrary to the Attorney General's attempt at protestation, there is little opposition to the Company's filed PSCR plan for 2004 on this record, and no opposition to "zeroing

out" the PSCR factor. Zeroing out the PSCR factor was supported by Edison's Mr. Falletich (10 T 1602-1603) and Staff's Mr. Ancona (14 T 2968-2970). Adjusting the base and setting the PSCR factor to zero is routinely done in rate cases in order to better align revenue collection with the cost causation principles embodied in the Commission's cost of service methodology.

There is no opposition to the level of PSCR costs supported by the Company in its PSCR plan. The Commission ordered the implementation of a factor, based on the Company's PSCR plan, back in February 2004. The only opposition comes in the form of policy questions concerning what should be included in the PSCR process and how mitigation for Customer Choice will be handled. The Attorney General and others are, variously, against the inclusion of mitigation, network transmission and MISO costs. MEC/PIRGIM add opposition to Department of Energy ("DOE") charges for Spent Nuclear Fuel ("SNF"). These are all policy questions that have been extensively briefed, considered adequately, and are now properly before the Commission. The Company needs answers to these questions now, in order to properly plan for and operate its business. No legitimate purpose is served by leaving the issues open, as requested by the Attorney General.

D. Control Premium.

The Attorney General opposes the inclusion of any control premium in Edison's adjusted net operating income for three reasons (exceptions, pp 12-19). None of the three reasons have merit.

First, the Attorney General argues that Edison did not incur the cost of the control premium. Second, the Attorney General asserts that savings projected to result from the merger of DTE and MCN represent avoided costs, rather than cost savings, and that those savings will be recognized on DTE's consolidated financial statements. Third, the Attorney General reiterates his argument that inclusion of the control premium in Edison's adjusted net operating income will create a double recovery for DTE's shareholders. The Attorney General supplements his specific arguments by

asserting "the PFD's conclusions are specious and inconsistent with the principal statute governing how the MPSC is supposed to determine the price to be paid for electricity by ratepayers to electric utilities" (exceptions, p 13).

The Commission should reject the Attorney General's exception. The ALJ properly concluded that the control premium is a cost that should be recognized in the Company's adjusted net operating income. The ALJ cogently observed that parent companies routinely incur costs that are then allocated and billed to the subsidiary companies. The ALJ recognized that there is nothing new in this practice. (PFD, pp 44-45) The ALJ also properly acknowledged the Attorney General's position that "[i]f DECo had paid the cost of the control premium and if that cost had yielded net savings for DECo, then the cost could be recovered" (PFD, p 45, quoting Attorney General Brief, p 26) The ALJ described the Attorney General's argument as being only one step removed from the facts in this case. The ALJ then concluded that the Attorney General's one step removed principle is insignificant. That is, since it is clear that the savings from the merger exceed the costs of the merger, without regard to where these costs originated, the recovery of such cost is only fair and equitable. (PFD, p 45) Faced with the clear reasoning of the ALJ, the Attorney General creates a Byzantine set of legal arguments seemingly based on the Attorney General's opinion that the origin of the cost is dispositive of whether such cost is eligible for inclusion in the utility's revenue requirement. The Attorney General relies upon MCL 460.557(2) and its reference to "cost". The Attorney General then argues that only costs incurred by the utility would be eligible for inclusion in utility rates. (exceptions, pp15-16) The Attorney General's statutory gymnastics provide no useful insight to the Commission. The Attorney General belabors the origin of the cost with seemingly little regard for the fundamental issue of fairness. The simple fact is that the 2004 savings of $113 million exceed the $61 million in control premium costs (13 T 2587-88). While the cost of the

control premium was incurred at DTE, this cost has been properly allocated to Edison based on the proportion of savings to be realized by Edison (7 T 927-28). There is nothing new or novel about the inclusion of costs initially incurred and subsequently allocated and billed to utility subsidiaries. The Attorney General's attempt to create a statutory barrier ignores this well-developed principle.

The Attorney General then takes the issue of the origin of the cost into a new direction by suggesting that had Edison, rather than DTE, been the acquirer, then the inclusion of the control premium would also require the inclusion of MCN's net income. The Attorney General cites the ratemaking treatment of Midwest Energy Resources Company as an analogous situation. This argument has no support on the record. Indeed, it is an argument that strains credulity. Since there is no factual or legal basis for this argument, it must be summarily rejected.

Thus, the Attorney General's exception based on the argument that the control premium cost was incurred at DTE must be rejected.

The Attorney General also argues that DTE will be the beneficiary of the savings created by the merger rather than Edison's customers. Specifically, the Attorney General makes the following argument:

> "The PFD seems to imply that DECo's ratepayers, not DTE Energy, will be the ultimate beneficiaries of the so-called synergy savings. If that was the PFD's concern, then it is a spurious concern. DTE Energy is DECo's parent company and any costs avoided by DECo (i.e., savings for DECo) will also be avoided on DTE's consolidated books of account." (exceptions, p 17)

This new and novel argument represents a new height of sophistry. While the Attorney General is apparently conceding that significant merger savings are being realized as a result of the merger, he concludes that those savings are being retained by DTE through the consolidated financial statements. What the Attorney General seemingly overlooks, however, is the simple fact that the impact of the substantial cost savings will be passed through to Edison's customers through

the adoption of rates that reflect the resulting reduced costs. [11] The Attorney General's convoluted discussion of the interaction of Edison's operating costs with the consolidated financial statements of DTE is sheer obfuscation of this simple fact. As a result, the Attorney General's second rationale for the exclusion lacks merit.

Last, the Attorney General disputes the ALJ's rejection of his claim that the recognition of the control premium cost in Edison's revenue requirement would result in a double recovery for MCN's shareholders. While the Attorney General takes issue with the ALJ's conclusion that the rate of return and capital structure are not based on any premium paid to MCN stockholders, he conveniently ignores the second reason cited by the ALJ. Specifically, the ALJ concluded, "MCN stockholders who continue to hold DTE Energy shares and original DTE Energy shareholders absorb the interest costs, earnings dilution and other related risks associated with the merger". (PFD, pp 45-46) The Attorney General's exceptions fail to address this most salient fact. Instead, the Attorney General merely reiterates the stale argument that the acquisition of MCN was made possible through Edison's issuance of securitization bonds. (exceptions, pp 18-19) Yet, the facts belie the Attorney General's claim. First, there is no factual dispute that the proceeds from the securitization bonds were used to reduce Edison's outstanding debt and common equity. Similarly, the financing of the acquisition of MCN was unaffected by the securitization of assets. (13 T 2881-82) Moreover, the savings made possible through the securitization are already being passed through to Edison's customers. Second, any claimed impact of securitization on DTE's capital structure is also irrelevant. Since the cost of the control premium is based on Edison's overall cost of capital, the financing of the acquisition by DTE has no impact on the cost of the control premium (7 T 939).

[11] Indeed, Edison's customers are already enjoying the benefits of the cost savings made possible through the merger. The Commission's Interim Order in this proceeding deferred the issue of the recovery of the control premium to the final phase of this proceeding, while including the $113 million of projected cost savings from the merger.

The Attorney General's attempt to commingle the issue of the control premium with securitization must be rejected.

E. Pension.

The Attorney General excepts to the ALJ's adoption of the increase in pension expense (Exceptions, pp 19-23). The Attorney General apparently disagrees with the ALJ's recommendations, but fails to provide the Commission with any specific basis for the rejection of the ALJ's conclusions. Rather, the Attorney General merely reiterates the same stale arguments advanced in his initial brief. While the Company believes that the ALJ's discussion of the Attorney General's position is adequate and the reasoning provided by the ALJ for the rejection of the Attorney General's position compelling, the Company will repeat its arguments in opposition to the Attorney General's exception.

The Attorney General proposes (exceptions, pp 19-23) that the Commission recognize $46.4 million of pension expense rather than the $88.4 million of pension expense proposed by the Company ($113.3 million projected 2004 pension cost reduced by 22% for the portion capitalized and transferred, Exhibit A-83 and Exhibit A-84). The Attorney General's proposal is based on Mr. King's three year average of pension expense, but reduced by $44.7 million to reflect the purported effect of the amortization of the regulatory asset related to the minimum pension liability. This proposal must be rejected. It is based on an erroneous interpretation of the Company's proposal, is inconsistent with the provisions of SFAS 87, and is even a contradiction of the Attorney General's own witness's proposal. Last, if adopted it would preclude the Company from having a reasonable opportunity to earn its authorized rate of return.[12]

[12] As a matter of fundamental ratemaking law, Edison is entitled to a return of and on its investment in providing utility service. See Bluefield Waterworks Improvement Co v Public Service Commission of West Virginia, 262 US 679, 690-694; 43 S Ct 675; 67 L Ed 1176 (1923); Federal

The Attorney General's proposal has as its foundation the erroneous premise that the amortization of unrecognized losses included in the Company's projection of pension expense is related to the regulatory asset recognized by the Company at December 31, 2002 to offset the impact of the minimum pension liability. This is simply wrong. The accrual for the regulatory asset has absolutely no impact on the Company's pension expense. With or without the regulatory asset to offset the minimum pension liability, the Company would be required to amortize the unrecognized losses over the estimated remaining service lives of its employees (7 T 902). The Attorney General's dogmatic linkage of the amortization of unrecognized losses as a component of pension expense, as required under SFAS 87, to the regulatory asset obfuscates the issue. While an argument of some superficial appeal to those not well-versed in the requirements of SFAS 87, it does not withstand any serious analysis.

Due to the risk of confusion created by the Attorney General's argument, it is important to describe the specific requirements of SFAS 87 and the relationship of the measurement of periodic expense with the minimum pension liability.

First, SFAS 87 prescribes that the immediate impact of changes in either pension assets or liabilities not be recognized in the current period. This is designed to moderate the year-to-year volatility of such changes on annual pension expense (7 T 901-3). As a result, pension asset performance less than the long-term expected return on assets is not immediately recognized. Further, the impact of any increase in pension liability arising from lower discount rates also cannot be immediately recognized. Rather, both asset losses and actuarial losses are amortized as a

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Power Comm v Hope Natural Gas Co, 320 US 591, 603; 64 S Ct 281; 88 L Ed 333 (1944). See also Permian Basin Area Rate Cases, 390 US 747, 769-70; 88 S Ct 1344; 20 L Ed 2d 312 (1968); FPC v Memphis Light, Gas and Water Division, 411 US 458; 43 S Ct 1723; 36 L Ed 2d 426 (1973); General Telephone Co v Public Service Comm, 341 Mich 620; 67 NW2d 882 (1954); Michigan Consolidated Gas Co v Public Service Comm, 389 Mich 624; 209 NW2d 210 (1973).

component of pension expense in future periods. As a result of this phased recognition of gains and losses, Edison had total accumulated unrecognized losses of $775 million (7 T 904-905). It is the amortization of this unrecognized loss that is being amortized over the remaining service lives of employees that is included in pension expense, not the minimum pension liability or the related regulatory asset. SFAS 87 also prescribes that whenever the sponsor company's pension assets are less than the Accumulated Benefit Obligation ("ABO"), it must recognize a Minimum Pension Liability (7 T 905). Thus, as of December 31, 2002, the Company recognized a $632 million minimum pension liability for the amount that the ABO exceeded the value of the assets in the pension plan. It further recognized a write off of $150 million in prepaid pension assets less $50 million for the intangible asset related to unamortized prior service cost. This resulted in a net minimum pension liability of $532 million (7 T 906). While the Attorney General tries to treat this minimum pension liability as if it was the same as the $775 million of unrecognized losses, they must not be confused. It is this confusion that is at the core of the Attorney General's argument. Since it is the amortization of unrecognized losses ($775 million) that is included in the Company's pension expense projections and not the minimum pension liability ($532 million), there is no basis for the Attorney General's assertion that the accrual of the regulatory asset has any impact on future pension expenses (7 T 906). While the Company was required to recognize both the $532 million Minimum Pension Liability and the $411 million charge to Other Comprehensive Income , net of deferred income taxes, under SFAS 87, it also recognized an equal and offsetting regulatory asset under SFAS 71 based on the Commission's long-standing practice of recognizing pension expense as measured under SFAS 87 in the setting of rates. (7 T 906-9). Indeed, the accrual of the regulatory asset has no impact on the Company's revenue requirement in this case (7 T 911). It is SFAS 87 that is creating the higher pension expense, not the accrual of the regulatory asset under SFAS 71 that is

creating the impact on pension expense, notwithstanding the inaccurate characterizations of the Attorney General. This was properly recognized by the ALJ (PFD, p 50).

The Attorney General's misperception of the correlation of the Regulatory Asset to future pension expense then leads to a misplaced analysis of the Company's authority to recover the higher pension expense. But, as described above, the Company is not seeking to recover the Minimum Pension Liability-related Regulatory Asset in its rates. It is merely seeking to recover the pension expense measured under SFAS 87. As a result, the Attorney General's lengthy arguments pertaining to the recovery of the Regulatory Asset are irrelevant. However, for the sake of clarity the Company is compelled to respond.

First, the Attorney General asserts that SFAS 71 requires a Commission authorization to recover the Minimum Pension Liability as a precondition to accrue the Regulatory Asset. This assertion is in stark contrast with the facts on the record in this case. While it may represent the Attorney General's interpretation of the requirements of SFAS 71, his exceptions, not surprisingly, are devoid of any record evidence supporting this assertion. Indeed, the record demonstrates that the basis of the accrual was the Company's interpretation of existing Commission practice corroborated with a letter from the Staff (7 T 906-907).

Second, the Attorney General argues that the accrual of the Regulatory Asset was in violation of the Instruction for Account No. 182.1 of the Uniform System of Accounts (exceptions, p 20). Yet, there is no record support provided by the Attorney General on this assertion either. Further, his assertion, even if there were record support, is wrong. The account cited by the Attorney General pertains to Extraordinary Property Losses (MPSC Uniform System of Accounts). Since there is no record evidence that the Company used the account described by the Attorney General, the fact that prior Commission authority is required for such is irrelevant. More importantly, the

instruction for Account 182.3, Other Regulatory Assets provides no such requirement for prior Commission authority (MPSC Form P-521, p 232). Since the accrual of the regulatory asset was merely to reflect existing Commission policy that had no impact on the Company's revenue requirement, the accrual was proper and no prior Commission authority was required.

Third, the Attorney General erroneously argues that Commission approval of the deferral and recovery of this cost would constitute unlawful retroactive ratemaking (exceptions, pp 20-22). Once again, this is premised on the groundless assertion that the Company is seeking authority to defer and recover prior period expenses. Since the impact of unrecognized losses can only be recognized as a component of pension expense in future periods under SFAS 87, the Attorney General's plethora of purported Commission precedents for the recovery of expenses recognized in prior periods is little more than a red herring.

Fourth, the Attorney General argues that the deferral and future recovery of these costs is inconsistent with the rate freezes imposed by MCL 460.10d(1). Here again, the record does not support the Attorney General's claim. The impact of unrecognized losses can only be recognized as a component of pension expense in subsequent periods as required under SFAS 87. While $2.3 million and $32.0 million of the amortization of losses were recognized as pension expense in 2002 and 2003, respectively (Exhibit A-83), the Company is not seeking recovery of such expense. Rather, the Company is only seeking recovery of the pension expense to be recognized in 2004, including the amortization of losses, in this proceeding. Thus, there is no basis for the Attorney General's assertion that the Company is seeking to recover prior period expenses in this case.

Interestingly, the Attorney General's own expert witness, Mr. King, was apparently untroubled by the so-called "retroactive cost recovery" of the unrecognized losses. Instead, Mr. King supported a three year average of pension expense based on his belief that pension expense in

future years would decline. Specifically, Mr. King attempted to develop a "normalized" pension expense based on the average of the Company's 2002, 2003 and projected 2004 pension expense. This average includes amortization of losses of $2.3 million, $32.0 million and $50.0 million for 2002, 2003 and 2004, respectively, or a three year average of $28.1 million. Although Mr. King's proposal is flawed by its inconsistency with the fundamental principle of recognizing expense levels expected to be incurred in the period that rates are to be in effect, and subverts the "known and measurable change" standard, it at least avoids the repudiation of the basic elements of SFAS 87 in the determination of pension expense. In a direct contradiction of his own witness's testimony, the Attorney General now seeks to reduce the *average* pension expense by the Attorney General's computed amortization of losses included in the Company's *projected* 2004 pension expense. Thus, even though Mr. King's three year average of pension expense includes amortization of losses of only $28.1 million, the Attorney General proposes that $48.7 million of amortized losses be excluded from Mr. King's three year pension expense (exceptions, p 23). This inconsistency is further indication that the Attorney General's proposal lacks merit. While the Company agrees with the Attorney General that Mr. King's proposal should be rejected by the Commission, the Attorney General's hybrid proposal set forth in his Initial Brief and exceptions has even less basis in fact and law. Thus, the Attorney General's proposal must be rejected in favor of the Company's actuarially-determined projection of pension expense, as developed by Hewitt Associates LLC, an internationally recognized expert on pension matters. (See also, Edison's Reply Brief, pp 51-56).

The Attorney General also excepts to the PFD's failure to address Mr. King's proposal to exclude $4.1 million of expense for five management retirement plans plus $2.35 million of related tax expense. Since the Attorney General has not presented any rationale in support of this proposal,

there is insufficient basis for it to be adopted. Thus, the Attorney General's proposal must be rejected.

F. OPEB

The Attorney General excepts to the ALJ's rejection of the use of a three year average of Other Post Employment Benefits ("OPEB") of $81.7 million or $63.8 million after the 22% reduction for OPEB costs capitalized and transferred (exceptions, pp 23-24). This compares to the Company's updated projection of OPEB costs for 2004 of $105.7 million or $82.4 net of the portion to be capitalized and transferred (Exhibit A-84 and Exhibit A-82). Once again, the ALJ recognized that the Company's proposal is preferable to the Attorney General's. The $105.7 million projection is based on an analysis of the Company's OPEB cost, based on the requirements of SFAS 106 and prepared by Hewitt Associates, LLC, an internationally recognized expert on actuarial matters. In contrast, the Attorney General's proposal is an average of actual OPEB expense in 2002 and 2003 projected as the expense for 2004. The Attorney General offers no credible support for the use of a three- year average rather than the Company's actuarially-justified projection for 2004. Thus, the Attorney General's exception must be rejected. (See also, Edison's Reply Brief, pp 57-58).

G. The Attorney General Erroneously Excepts to the $58 Million Removal of Interconnection Sales Revenue from Adjusted Net Operating Income.

The ALJ correctly adopted the Staff's removal of $58 million of interconnection sales revenue from adjusted net operating income (PFD, p 38). The Attorney General opposes that removal (exceptions, pp 24-25). The purpose for the removal of the $58 million of interconnection revenue is to provide Edison the opportunity to partially mitigate Choice customers' share of production fixed cost ("PFC") of $93 million (14 T 2950-51, 2970-71). Conspicuously, the Attorney General does not except to the $93 million PFC reduction in revenue deficiency, which is directly linked to the removal of $58 million of interconnection revenue. The Attorney General has made a one-sided exception by accepting the $93 million PFC reduction in the revenue deficiency, but excepting to a $58 million increase in revenue deficiency that is assigned to partially recover the $93 million of PFC. Clearly, the Attorney General is in error by proposing a one-sided exception. Therefore, the Commission must reject the Attorney General's exception and remove the $58 million of third party interconnection revenues from adjusted net operating income.

H. Revenue Deficiency

The Attorney General asserts (exceptions, pp 25-26) that the PFD was unclear with respect to Edison's revenue deficiency. More significantly, the PFD understated Edison's revenue deficiency, as set forth in Edison's Exception No. 9.

III. REPLY TO EXCEPTIONS OF ABATE

A. Stranded Costs

ABATE contends (exceptions, pp 1-5) that the ALJ erred in accepting the Staff's stranded costs calculation, claiming that Edison has "negative" stranded costs or "stranded benefits".[13] ABATE further asserts that there should be (1) no stranded cost recovery, and (2) securitization offset credits should be provided to Choice customers. Edison's position on stranded costs is set forth in its Exception No. 18.

Edison agrees that Staff's $43.6 million of historical stranded costs has major flaws in the methodology, as discussed earlier in these Replies to Exceptions. However, ABATE's claim that Edison has historical "stranded benefits," due primarily to using a 16.32% revenue allocation factor to offset production fixed cost is also in error.

The Staff's PFC revenue allocation factor is 15.23% based on Case No. U-10102 initial data. However, Case No. U-10102 was updated during the hearing process and the final order was based on the update. ABATE's rebuttal reflects the updates from that case in calculating a 16.32% revenue allocation factor for PFC (13 T 2304-08). Energy Michigan also supports the 16.32% factor (exceptions, pp 11, 18-28). While Edison believes the 16.32% factor is more representative of Case No. U-10102 than the Staff's 15.23% factor, the 16.32% factor has the same inherent flaws as the Staff's factor. These flaws include not using fully allocated production plant; ignoring production working capital which is essential to the operations of production plant; and allocating revenues based on a ten-year old cost of service in Case No. U-10102 that does not properly reflect the current revenue requirements split between production and distribution (13 T 2854). With current

[13] The term "stranded benefits" is found nowhere in Act 141.

production fixed costs reflected in the revenue requirement of the net stranded cost calculation, it is necessary and logical that revenues assigned to recover these costs must also reflect the current revenue mix between production and distribution.

For example, Mr. Falletich testified that over the last 10 years, distribution net plant has increased by 70%, yet any offsetting sales growth has only increased by approximately 20% (13 T 2912). However, generation net plant increased by only 10% during the ten year period. As a result, the investment in distribution infrastructure has far exceeded that of the generation system, including any offsets for sales growth. As stated by Mr. VanHaerents in his rebuttal testimony, Case No. U-10102 production revenue requirement (excluding Fermi which the Staff removed) as a percent of total revenue requirements is significantly greater than today (13 T 2858). Demonstrable proof of this is clearly indicated in the Table below.

The Detroit Edison Company
Shift in Functional Net Plant Composition 1994 vs 2003
($000)

		Source	(a) 1994 Excluding Nuclear	(b) %	(c) 2003 Excluding Nuclear	(d) %	(e) % Change
1	**Production**						
2	Plant in Service (excl MERC)	P-521, pg 207 excl nuclear	4,601,843		6,071,840		
3	Depreciation Reserve	P-521, pg 219 excl nuclear	1,976,740		2,696,010		
4	Net Production Plant	line 2 - line 3	2,625,103		3,375,830		
5	less: Clean Air Act (Net Plant)	Exhibit I-207, Line 1	-		510,713		
6	Net Production Plant Excl CAA	line 4 - line 5	2,625,103	59.2%	2,865,117	48.2%	**-11.0%**
7							
8	**Distribution**						
9	Plant in Service	P-521, pg 209	2,785,386		4,971,233		
10	Depreciation Reserve	P-521, pg 219	976,756		1,896,358		
11	Net Distribution Plant	line 9 - line 10	1,808,630	40.8%	3,074,875	51.8%	**11.0%**
12							
13	Total Direct Net Plant Excl CAA	line 6 + line 11	4,433,733	100.0%	5,939,992	100.0%	

Using Form P-521 plant data, from 1994 to 2003 production net plant as a percent of total production and distribution net plant decreased by 11%. This decrease must be reflected in the

allocation of functional revenues. Otherwise revenues for production would be overstated and there would be a deficiency in distribution.[14]

In order to correct the flawed ABATE/Energy Michigan 16.32% revenue allocation factor, it must be reduced by 11% to properly reflect the shift in functional net plant composition from 1994 to 2003. Attachments XII and XIII, line 28a, of Edison's Reply Brief show the increase in revenues by replacing Staff's 15.23% factor with ABATE/Energy Michigan's 16.32% factor and results in a revenue increase of $38 million and $34 million for the years 2002 and 2003, respectively. Line 28b of Attachments XII and XIII reflects the revenue decrease of $62 million for 2002 and $57 million for 2003 based on reducing the 16.32% factor by the11% shift in net plant composition discussed above. As a result, Edison supports $14.8 million and $74.5 million of net stranded costs for years 2002 and 2003 respectively and $10.4 million for 2004 through the date of the Interim Order. Since Edison has incurred stranded costs, the Commission must reject ABATE's claim that Edison has "stranded benefits". In fact, on page 92 of the PFD, the ALJ properly rejected the notion of "stranded benefits."[15]

In addition, ABATE also calculated net stranded costs using a per unit of production fixed cost method based on 2001 data to allocate revenues. This method is also flawed since Edison's rates were frozen at that time which was prior to the significant Choice migration. With large generation margin customers migrating to Choice, as a result of the rate skewing acknowledged by all parties, this fixed revenue allocation factor is overstated based on the current mix of bundled

[14] The Commission can and should take official notice of the annually filed P-521 plant data pursuant to the Rules of Practice and Procedure before the Commission R 460.17327.

[15] The notion of stranded benefits is simply untenable, especially in light of the fact that Edison generation continues to be regulated.

customers' contribution to PFC. ABATE's per unit of production fixed cost method is flawed and does not properly measure net stranded costs and, therefore, should be rejected by the Commission.

Finally, ABATE proposed that "stranded benefits" be used to offset the securitization charge for Choice customers. The determination of a utility's functional (production, transmission and distribution) revenue deficiency/sufficiency, including PFC determination, is a zero sum process. That is, the algebraic sum of the individual functional revenue deficiencies/sufficiencies must total to the overall utility revenue deficiency/sufficiency. If Edison's production fixed cost function has significant "stranded benefits", as alleged by ABATE, yet Edison is experiencing a significant revenue deficiency on an overall company basis, as found by the Commission in the Interim Order, then it logically follows that Edison must have a very significant distribution (RAST) revenue deficiency.

This conclusion would have obvious rate design implications -- the large production revenue sufficiency would be utilized to reduce the generation rates for bundled customers. The reduction should be allocated exclusively to bundled customers because Choice customers do not use, or intend to use, Edison's generation system.

The distribution revenue deficiency should be used to increase the distribution (RAST) rates to bundled and Choice customers since both groups of customers use the distribution system. The impact of these rate adjustments would be a larger rate increase for Choice customers at a time when ABATE opposes even the modest RAST increase proposed by Edison.

It should be apparent that any derivation of "stranded benefits" from the PFC framework is simply a fictional result; Choice sales losses cannot and do not create an incremental source of cash flow from which Edison can provide securitization offset credits to Choice customers. ABATE would have the Commission permit Choice Customers to cash out these fictional benefits; and doing

so would be at the expense of bundled customers. Moreover, ABATE would have the Commission force Edison to carry forward any unused previous years' estimates of these fictional "stranded benefits". The Commission should summarily reject ABATE's proposal.

B. Control Premium.

ABATE excepts to the ALJ's proposed inclusion of the control premium in the Company's revenue requirement until the next rate case (exceptions, pp 5-7). ABATE supports this position by arguing that there are no benefits to customers as a result of the merger. Specifically, ABATE relies on a simplistic comparison of pre-merger O&M expense levels and the Staff-proposed 2004 O&M expense level. ABATE concludes that total Edison O&M increased by 24% between 2000 and 2002. ABATE also concludes that controllable O&M absent the impact of the merger-related savings increased between 1999 and 2002 by 20.2% or 6.33% per year. Lastly, ABATE relies upon a conclusion by Mr. Selecky that Corporate Support Group expense was projected by the Company to increase 15.6% between 2002 and 2004.

ABATE's exception must be rejected. The summary conclusion by ABATE that increases in O&M between 2000 and 2004 demonstrate that no benefits are inuring to customers from the cost savings made possible by the merger is a spurious claim not supported by the record. The record is replete with descriptions of changes in operations and the environment in which Edison operates that have had significant impacts on its costs. ABATE's reliance on Exhibit S-125 is merely a mathematical exercise that provides no recognition of these changes in operations and external factors. A more rigorous and useful analysis of the changes in the Company's O&M expense is provided on Exhibit A-16, Schedule F5-10. That analysis identifies each of the significant components of O&M expense pre and post merger. This more meaningful analysis, for example, recognizes the impact of pension and OPEB increases, generation strengthening, and other external

factors. Indeed, the analysis of Exhibit A-16, Schedule F5-10 also separately identifies the costs of the Low Income Energy Fund and the merger interest recorded in 2002, for which no such expense was incurred in the pre-merger periods. Exhibit S-125, as relied upon by ABATE makes no such distinctions. Thus, ABATE'S simplistic comparison of pre and post merger total O&M expense provides no useful insight into the measure of the cost savings achieved from the merger.

ABATE's remaining analysis of changes in O&M expense before and after the merger were sponsored by Mr. Selecky. Yet, as demonstrated by Mr. Stanczak's rebuttal testimony, these analyses were incorrect and thus have no credibility as a basis for assessing the savings realized from the merger (13 T 2599-2603). Specifically, Mr. Selecky's analysis of controllable O&M incorrectly included the cost of the control premium. When corrected, controllable O&M increased only 13.8% between 1999 and 2002, or 4.6% annually (13 T 2601). While this increase is greater than inflation, cost increases related to generation strengthening, storms, September 11, 2001 terrorists attacks and other external factors have been the cause (Exhibit A-16, Sch F5-10). Next, Mr. Selecky's analysis of Corporate Support Group expense between 2002 and 2004 is also wrong. Since Mr. Selecky incorrectly excluded benefit costs from his calculation, the correct measure of increases in Corporate Support Group expenses between 2002 and 2004 is 11.6%, or 5.8% per year (13 T 2602).

Based on this, it is clear that the Company is indeed realizing substantial cost savings from the merger. Further, it is clear that these savings are far in excess of the cost of the control premium. Thus, ABATE's exception must be rejected. (See also, Edison's Reply Brief, pp 39-40).

C. Large Manufacturing Tariff should be limited to customers currently served by SMC contracts

ABATE states (exceptions, pp 7-10) that the Commission must reject the Staff's proposal to establish a new tariff for only the SMC customers and that a large manufacturing tariff should be

applied not only to SMC customers, but also to all customers having loads of 5MW and above. ABATE contends that their proposed large manufacturing tariff was based on the cost-to-serve all customers having loads of 5MW and above. Edison witness Falletich testified that extending the availability of the rate to customers having loads of 5MW and above would result in an annual revenue reduction of $10 million and, if the Commission were to extend the availability of the tariff it must also increase Edison's revenue deficiency by $10 million (13 T 2901). ABATE claims that the revenue deficiency adjustment is not necessary since ABATE's proposed large manufacturing tariff is based on cost-of-service, and that Mr. Falletich's adjustment is not supported on the record.

ABATE is mistaken on both counts. First, ABATE's claim that their proposed tariff was based on the cost-to-serve customers having loads 5MW and above, is simply not the case. Mr. Phillip's cost analysis was predicated on Mr. Falletich's filed cost-of-service for 2002. Exhibit A-5, Schedule E1, Page 5 of 6, Columns 26 and 27, which was prepared for only the SMC class. To assert that this is representative of all customers 5MW and above with no supporting evidence is pure speculation by ABATE. Second, contrary to ABATE's allegation that Mr. Falletich's $10 million is not supported by the record, Mr. Falletich, did in fact, testify to this amount, which was not challenged or refuted by any other party (13 T 2901). Since ABATE's cost analysis was only based on the cost-to-serve SMC customers, not all customers having loads of 5MW and above, the Commission should reject ABATE's proposed large manufacturing tariff.

D. Edison's Authorized Return on Equity Should be 11.5%.

ABATE contends (exceptions, pp 10-11) that the ALJ erred in recommending that Edison's ROE should be 11%. ABATE asserts that Edison's ROE should instead be 10.5%, based on the

false premise that Edison's business risk has decreased. In reality, Edison's business risk has increased,[16] and Edison is now among the riskiest utilities in the industry (12 T 2138).

The Company has previously discussed return on equity in its Exception No. 5 and in its Reply to the Exceptions of the Attorney General and incorporates by reference herein those responses in reply to the Exceptions of ABATE.

ABATE tries to use the ranges for return on equity developed by the Staff in each of their three methodologies to argue for a ROE of 10.5%. Expert judgement, however, is comprised of more than calculating a midpoint. The Staff could have have simply calculated a midpoint, but chose not to. Also, the Staff's ranges are too low, as explained by Dr. Morin:

1. **DCF Dividend Yield and Flotation Costs.** Mr. Ballinger's dividend yield component is understated by 30 basis points because it does not allow for flotation costs, and a legitimate stockholder expense is left unrecovered.
2. **DCF Functional Form.** Mr. Ballinger's DCF formulation slightly understates the cost of common equity capital. Use of the proper DCF functional form raises his estimate by approximately 15 basis points.
3. **CAPM Beta Estimate.** Mr. Ballinger's historical beta estimates understate the Company's risk. Use of a more representative beta raises his CAPM estimate by 50 basis points.
4. **CAPM and Empirical CAPM ("ECAPM").** The plain vanilla version of the CAPM used by Mr. Ballinger understates the Company's cost of equity.

[16] To intentionally ignore the substantial business risk imposed by Choice, as both ABATE and the Attorney General do, seriously undermines their credibility in this proceeding.

5. **Capital Structure Adjustment.** Mr. Ballinger did not adjust his recommended cost of equity for the fact that his recommended capital structure is weaker than that of the Company's actual capital structure. (12 T 2151).

As for the Risk Premium methodology, substituting the long-term Treasury Bond yield of 6.0% used by ABATE's Mr. Gorman (13 T 2334) for the 5.60% used by Mr. Ballinger in Exhibit S-124, Schedule D-5 would increase the Staff's Cost of Equity using the Risk Premium Method to 11.20% - 11.35%.

Also, Dr. Morin found that using the long-term Treasury Bond yield forecast of 6% used by ABATE witness Mr. Gorman produced the following results, including flotation costs:

Risk Premium Electric Utility Treasury Bonds	11.9%
Risk Electric Utility A-Rated Bonds	11.2%
Risk Premium Natural Gas Treasury Bonds	12.0%
Risk Premium Natural Gas A-Rated Bonds	12.3%
Allowed Risk Premium Treasury Bonds	11.3%
Allowed Risk Premium A-Rated Bonds	11.2%

(12 T 2157-58)

ABATE also seems to be ignoring the testimony of its own witness, Mr. Gorman, who found DECo's proposed 50/50 capital structure to be reasonable.

> "Q: WHAT CAPITAL STRUCTURE IS THE COMPANY REQUESTING TO USE TO DEVELOP ITS OVERALL RATE OF RETURN FOR ELECTRIC OPERATIONS IN THIS PROCEEDING?
>
> "A: The Company's overall rate of return was developed using the capital structure shown on Dr. Morin's Exhibit A-12, Schedule No. D1-2. The investor capital structure, excluding deferred taxes and investment tax credits, is shown below in Table 1.

TABLE 1 DECo's Proposed Capital Structure - 2004	
Description	Percent of Total Capital
Common Equity	49.25%
Short-Term Debt	1.50%
Long-Term Debt	49.25%
Total Financial Capital Structure	100.00%

"Q. DO YOU BELIEVE THAT DECo'S PROPOSED CAPITAL STRUCTURE IS REASONABLE FOR SETTING ITS OVERALL RATE OF RETURN?

"A. In my professional opinion, DECo's proposed capital structure is reasonable based on a review of the relative weights of debt and common equity to total capital, and considering DECo's other debt equivalents, including DECo's off-balance sheet debt equivalents. The financial benchmark total capital debt ratio published by Standard & Poor's for a BBB rated utility with a business position ranking of six is within the range of 46.0% to 53.5% (Standard and Poor's Utilities & Perspectives, Utility Financial Targets Are Revised, June 21, 1999). DECo's total capital debt ratio of 50.7% is within this range." (13 T 2325-26)

The Company believes that it has fully justified an authorized return on equity of 11.5% on a 50% Debt/50% Equity capital structure as amply supported by Mr. Khouri and Dr. Morin (12 T 1845-93; 2025-2162; 13 T 2229).

E. Pension.

ABATE excepts to the ALJ's recommendation to adopt the Pension Equalization Mechanism ("PEM") (exceptions, p 11). ABATE supports the concept of the equalization mechanism, but opposes the specific mechanism proposed by the Company and supported by the Staff. ABATE's opposition is twofold. First, ABATE argues that the PEM is an automatic adjustment mechanism

that does not allow for a review of the expenses for reasonableness or prudency. Second, the derivation of surcharges or credits on an equal per kWh basis will, ABATE alleges, overallocate pension expense to high load factor customers. ABATE proposes (exceptions, p 11) that the Commission adopt an alternative proposal whereby differences in actual pension expense from the pension expense reflected in rates be deferred as regulatory assets or liabilities with the balance addressed in the Company's next general rate case.

ABATE's exception should be rejected by the Commission. ABATE proffers no material basis for the rejection of a mechanism designed to balance the interests of both customers and Edison. The Company proposed the PEM as a means to address the concern that the Commission expressed in its Interim Order in this case to insure that the Company funded its pension plan based on the pension expense recognized in rates (13 T 2574). The PEM provides a proper and reasonable response to this concern and is a superior means of balancing the interests of customers with the Company (13 T 2575-76). ABATE's proposal would unnecessarily delay the timeliness of the true-up of expense with no meaningful benefit. ABATE'S claim regarding the rate design impacts of the PEM is premised on the inaccurate assumption that only surcharges would be implemented under the PEM. Since there is no basis for presuming that credits would be any less likely than surcharges, there is no reason to presume that high load factor customers would be disadvantaged by the uniform kWh methodology.

F. Return to Service.

ABATE contends (exceptions, pp 12-13) that the ALJ erred in recommending Constellation's return to service proposal, and that the Commission should instead adopt ABATE's proposal. Edison incorporates by reference herein its Exception No. 22, and the discussion supra in reply to the Exceptions of Staff and further explains why ABATE is wrong infra.

1. ABATE incorrectly states that the Constellation proposal would be contrary to the policy the ALJ said was important to support: providing customers with choice of electric suppliers.

The Constellation return to service proposal does not restrict in any manner a customer's ability to choose between electric suppliers. The Constellation return to service proposal simply requires customers returning to the Company to pay the higher of market prices or cost-based tariff rates. Customers are still free to choose from the 18 licensed alternative electricity suppliers currently operating in the Company's service territory. Constellation's proposal provides no restriction on movements between Edison and alternative electric suppliers. In fact, the ALJ found that it did not restrict customer movement (PFD, pp 98-99).

2. ABATE incorrectly assumes that the utilization of Edison generating facilities to supply returning customers would result in the Company receiving a windfall as a result of Constellation's pricing mechanism.

ABATE's assertion that the utilization of Edison generating facilities to supply returning customers would result in the Company receiving a windfall as a result of Constellation's higher of market or tariff pricing mechanism is simply incorrect. As noted previously, Staff proposed, and the ALJ apparently adopted, a new stranded cost methodology whereby the Company is responsible for recovering a significant amount of its production fixed costs via mitigation sales in the wholesale energy markets (14 T 3140-41). Staff also recognized that the Company's current return to service provisions must be modified to provide the Company with an adequate opportunity to sell the freed-up energy over longer periods of time by limiting the customers' ability to return to the Company's cost-based tariff rates (14 T 3142). If the Company is not allowed to utilize its generating facilities to mitigate its allocated production fixed costs, then the Staff's stranded cost methodology would fail, thereby requiring the allocated production fixed costs to be recovered from Choice Customers via higher transition charges or from bundled customers via higher bundled rates. Simply stated,

ABATE cannot have its cake and eat it too. The Company must be afforded the opportunity to recover its allocated production fixed costs either through wholesale mitigation sales, transition charges to Choice Customers, or higher bundled rates. There is no other option. The PFD adopted a well-reasonsed approach that balanced various interests.

3. ABATE incorrectly states that the Constellation proposal is unfair.

ABATE concludes that the Constellation return to service proposal is simply unfair (exceptions, p 12). On the contrary, the Constellation return to service proposal is quite fair to both customers and the Company. Under the Constellation return to service proposal, customers are able to freely choose their supplier of electricity at any time; no restrictions are imposed on their ability to choose whatsoever. At the same time, the Company is provided with the opportunity to recover its allocated production fixed costs in the wholesale energy market over a longer time frame thereby capturing the benefits of longer-term sales in the wholesale energy markets.

4. ABATE incorrectly assumes that the act of paying a securitization or historical stranded cost charge entitles a customer to some future claim on the Company's production-related assets.

The ABATE return to service proposal improperly assumes that the act of paying a securitization or historical stranded cost charge entitles a Choice customer to some future claim on the Company's production-related assets. This assumption is incorrect. The securitization charge only services the debt primarily associated with the Company's nuclear facilities; there is no contribution to operation, maintenance, or other expenses via the securitization charge. The transition charge contemplated under Staff's proposed stranded cost methodology only compensates the Company for a portion of its unrecovered historical production fixed costs (2002, 2003, and two months of 2004 pursuant to Staff's proposed stranded cost methodology). Since the costs being recovered via the transition charge contemplated under Staff's proposed stranded cost methodology

are historical costs, the only possible claim on the Company's production facilities would be on a historical basis. However, no return to service prohibitions existed during the 2002, 2003, and two months of 2004 timeframe over which the net stranded costs were incurred by the Company. Furthermore, no provision of Act 141 supports ABATE's purported entitlement. This response equally applies to ABATE's incorrect assertion that its return to service proposal is justified because Choice customers are allegedly making a contribution to support Edison generation.

5. ABATE ignores the proposed Staff methodology whereby a portion of the fixed costs of production are allocated to the Company to be recovered via wholesale mitigation thereby necessitating a modification to the Company's return to service provisions.

As noted previously, Staff proposed, and the ALJ apparently adopted, a new stranded cost methodology whereby the Company is responsible for recovering a significant amount of its production fixed costs via mitigation sales in the wholesale energy markets. Staff also recognized that the Company's current return to service provisions must be modified to provide the Company with an adequate opportunity to sell the freed-up energy over longer periods of time by restricting the customers' ability to return to the Company's cost-based tariff rates. (14 T 3142).

6. ABATE incorrectly asserts that its return to service proposal for Choice customers to commit to an alternative supplier for two years would provide "certainty on both sides of the meter and allows Edison to make timely decisions to sell power or purchase power to meet summer peak requirements."

Contrary to ABATE's assertion, the ABATE return to service proposal does not provide certainty to the Company; it does not allow the Company to make timely decisions to sell power or purchase power to meet summer peak requirements, nor does it allow the Company to mitigate its allocated production fixed costs under the Staff's proposed stranded cost methodology. As noted previously, under Staff's proposed stranded cost methodology, a significant portion of the

production fixed costs would be allocated to the Company to be mitigated via sales in the wholesale energy markets. Simply requiring customers to commit to an alternative energy supplier for two years does not provide sufficient opportunity for the Company to recover its allocated production fixed costs (13 T 2669).

Under the ABATE return to service proposal, customers would commit to an alternative energy supplier for two years. At the end of the two-year period, the customer may or may not return to the Company's cost-based tariff rates. By design, the ABATE return to service provision would limit the Company's ability to mitigate its allocated production fixed costs by restricting wholesale mitigation sales to two years due to the possibility that a customer may return to cost-based tariff rates.

From the customer perspective, it provides the best of both the regulated and unregulated worlds to the detriment of Edison; the customer can choose to migrate to an alternative electricity supplier when prices are low and return to the Company when prices are high, and thus require either the Company or bundled customers to make up for any shortfall. Further, it would be inappropriate (and anti-competitive) for the Commission to require the Company to insulate customers that choose alternative electricity suppliers for their electricity generation requirements from the possibility of higher market prices for power and energy.

G. LIEEF.

ABATE suggests (exceptions, pp 13-14) that the Commission might lack authority to increase rates to fund the LIEEF, and asserts that the Commission should consider the fund's effect on Edison's uncollectible expense. ABATE provides no material support for its position, this case properly examined the topic (Interim Order, pp 43-45; PFD, pp 103-109), and therefore ABATE's exception does not merit serious consideration.

IV. REPLY TO EXCEPTIONS OF ENERGY MICHIGAN.

A. Return to Service.

Energy Michigan contends (exceptions, pp 3-6) that the ALJ erred in recommending NewEnergy's return to service proposal, and that the Commission should instead adopt either ABATE's or Energy Michigan's proposal, together with a reduction in Edison's stranded costs. Edison incorporates by reference herein its Exception No. 22, and the discussions above in response to the Staff and ABATE and further explains why Energy Michigan is wrong infra:

1. Energy Michigan incorrectly states that Energy Michigan's and ABATE's return to service proposals accomplish the twin goals of increasing certainty for Edison and reducing transition charges.

Under Staff's proposed stranded cost methodology, as apparently adopted by the ALJ, the Company must be afforded the opportunity to recover its allocated production fixed costs. Staff properly recognized that this opportunity exists only if the Company is allowed to sell its freed-up energy into the longer-term wholesale energy markets without simultaneously having to serve returning customers at cost-based tariff rates (14 T 3142). As noted previously, the ABATE return to service proposal does not provide certainty to the Company, it does not allow the Company to make timely decisions to sell power or purchase power to meet summer peak requirements, nor does it allow the Company to mitigate its allocated production fixed costs under the Staff's proposed stranded cost methodology.

Similarly, Energy Michigan's return to service proposal does not provide certainty for the Company. Under Energy Michigan's return to service proposal, customers would be required to notify the Company 12 months in advance of returning to cost-based tariff rates. During that 12-month notice period, if a customer returned to the Company, in violation of the tariff, the customer would be required to pay market level rates. Further, if a customer did not commit to taking retail

service from the Company for 12 months upon his return, market level rates would apply. In simple terms, the Energy Michigan return to service proposal would allow a customer to return to the Company's cost-based tariff rates on 12 months notice (13 T 2841-42).

Under Staff's proposed stranded cost methodology, the Energy Michigan return to service proposal would not provide the Company with any meaningful ability to mitigate its allocated production fixed costs in the wholesale energy markets over longer time frames -- a critical component of the Staff methodology. Under Energy Michigan's proposal, returning customers would be required to notify the Company 12 months in advance of its return to cost-based tariff rates. Even more problematic than the ABATE return to service proposal, the Energy Michigan return to service proposal would limit the sale of freed-up energy to a one-year timeframe since Choice Customers could return to the Company's cost-based tariff rates on twelve months notice. It is highly unlikely that the Company would be able to mitigate its allocated production fixed costs under the ABATE return to service proposal and next to impossible under the Energy Michigan return to service proposal. As a result, Energy Michigan is incorrect when it states that Energy Michigan's and ABATE's return to service proposals would reduce transition charges. On the contrary, transition charges would likely increase under their return to service provisions to reflect not only historical unrecovered production fixed costs, but future unrecovered allocated production fixed costs as well.

2. Energy Michigan improperly and incorrectly interprets the Commission's Interim Order by concluding that the Commission stated that new Return to Service provisions could be linked to reduction of transition charges.

Energy Michigan improperly and incorrectly characterizes the Commission's direction to the parties in the Commission's Interim Order regarding stranded costs and return to service. In its exceptions, Energy Michigan stated:

> "Energy Michigan cited the Commission's own Interim Order in this matter which stated that more stringent Return to Service provisions could be linked to a reduction of transition charges. U-13808, February 20, 2004, p. 59". (Energy Michigan's exceptions, p 5)

However, the Commission's Interim Order actually states:

> The Commission wishes to encourage all parties to use the final phase of this proceeding to suggest ways that stranded costs could be mitigated so as to reduce transition charges as much as possible *and to analyze and make recommendations regarding the relationship between stranded cost determinations and return to service provisions for ROA customers.* U-13808 Interim Order dated February 20, 2004, p. 59 [emphasis added]

At no time does the Commission's Interim Order provide that new return to service provisions could or should be linked to a reduction in transition charges.

3. Energy Michigan's statement that the Constellation proposal provides less predictability regarding the amount of power that would have to be provided by the incumbent utility is irrelevant.

Energy Michigan is correct that the Constellation return to service proposal would provide less predictability regarding the amount of power that would have to be provided by the Company; however, since the returning customers would pay the higher of market prices or cost-based tariff rates, the issue is immaterial. The Company is obligated to provide service to any customers wishing to return to the Company's service via Company-owned generation or purchases in the wholesale market; the issue is simply the price the returning customer will pay for the energy. Since returning Choice Customers will pay the higher of market prices or cost-based tariff rates under the Constellation return to service proposal, the Company will be better positioned to mitigate its allocated production fixed costs.

4. Energy Michigan incorrectly asserts that the unpredictability of customer returns would likely translate into lower prices for sale of unneeded power by Edison and potentially higher prices for the purchase of requirements which were only known at the last moment.

Contrary to Energy Michigan's claims, the adoption of the Constellation return to service proposal will likely result in higher prices for the sale of freed-up power by the Company since the Company will be able to sell power for longer periods of time in the wholesale energy markets. Since returning customers will pay the higher of market prices or cost-based tariff rates, the Company, and more importantly bundled customers, will be protected from higher prices for the purchase of requirements for returning Choice customers that were only known at the last moment. Since returning customers are causing the Company to purchase higher priced power to meet their needs, it is only appropriate that the returning customer bear the burden of those potentially higher prices.

5. Energy Michigan incorrectly asserts that the Commission should reduce otherwise justified transition charges to account for the improved financial performance that can be achieved by Edison with new return to service standards.

Energy Michigan wrongly asserts that a modification to the Company's return to service provisions should result in a reduction in transition charges. As noted previously, Staff proposed, and the ALJ apparently adopted, a new stranded cost methodology whereby the Company is responsible for recovering a significant amount of its production fixed costs via mitigation sales in the wholesale energy markets. The proposed modifications to the Company's return to service provisions were designed to provide the Company with an opportunity to recover its future allocated production fixed costs. The transition charges contemplated under Staff's proposed stranded cost methodology were designed to recover historical unrecovered production fixed costs (2002, 2003, and two months of 2004 pursuant to Staff's proposed stranded cost methodology). Since the costs being recovered via the transition charge contemplated under Staff's proposed stranded cost methodology are historical costs, it would be highly inappropriate for the Commission to reduce the transition charges. The only possible claim on the Company's production facilities would be on a

historical basis. However, no return to service prohibitions existed during the 2002, 2003, and two months of 2004 timeframe over which the net stranded costs were incurred by the Company. Therefore, transition charges should NOT be modified due to changes in the return to service provisions of the Company's tariffs.

6. Energy Michigan incorrectly states that Edison provided a numerical evaluation of the reduction in transition charges that should be ordered due to adoption of more stringent Return to Service measures.

The Company did not provide a numerical evaluation of the reduction in transition charges that should be ordered due to the adoption of more stringent return to service measures. Energy Michigan's mischaracterization (exceptions, pp 2, 6) of the Company's estimation for the value of the option to return to the Company's cost-based tariff rates is patently false. Exhibit A-116, page 3 of 3, does not contain Mr. Edward Falletich's evaluation of the value of the option to return to service. He simply restated Mr. Garnett's recommendation for completeness along with Mr. Falletich's recommended transition charge.

The Company presented the testimony of Mr. Garnett to address Staff and Intervenor testimony on several issues related to the determination of stranded costs relative to power markets (13 T 2664-2700). In addition, Mr. Garnett explained the degree to which a requirement that Choice Customers stay off bundled service for an extended period might help mitigate stranded costs, as well as the value of the optionality Choice Customers have relative to the Company's role as the provider of last resort ("POLR").

Mr. Garnett's testified:

> **"Q. Should Choice customers be charged for the value of the option Edison provides?**
>
> "A. Yes. Because it has value, Choice customers should be charged for the value of the backstop Edison provides as POLR. If

Choice customers are not charged, the costs of providing the option will continue to be borne by Edison customers.

"Q: Can that value be estimated?

"A. Yes. We used standard options pricing techniques to price an option to return for a 12-month period, exercisable monthly over the next year. This approach required us to somewhat simplify the issue and actually to overlook some of the customer's potential benefits. In other words, this approximation probably understates the value of the option to return.

A returning customer will receive energy at the fixed tariff rate rather than the variable spot price. Ignoring shaping and locational basis, the spot price is the value toward which the forward price converges. When a customer returns for an extended period, they receive a guarantee of delivery for that period – effectively a sequence of forward contracts – for which they commit to pay only the tariff. Therefore, exercising the option to return may be modeled as the exercise of an option to buy a "forward strip". Hence the option to return should be priced like a call option on the forward curve.

We assumed that current Choice customers are happy with that decision and that their providers are currently solvent. If forward prices begin to rise, both conditions would begin to change, and an important assumption is the amount by which prices would have to rise before customers return or are returned to bundled service. For the purposes of this analysis we assumed that if the forward curve rises 0.5 c/kWh, customers will return to bundled service. In short, we represented the option to return to bundled service as a series of 12 monthly options on the 12-month forward strip, whose strike prices (the prices at which customers return) are 0.5 c/kWh above the current price. The value of such an option is 0.31 c/kWh, or $3.10/MWh. This would change slightly with a 3-year stay-out period because of the longer tenor involved. (13 T 2697-99).

The Company never suggested that transition charges should be reduced due to the adoption of more stringent return to service measures. Quite the contrary, Mr. Garnett demonstrated that Choice Customers should be charged for the right to return to the Company's cost-based tariff rates.

Under Staff's proposed stranded cost methodology, Choice Customers do not pay any transition charges associated with future net stranded costs. The transition charges contemplated

under the Staff's proposed stranded cost methodology are designed to recover the Company's historical unrecovered production fixed costs (2002, 2003, and two months of 2004 pursuant to Staff's proposed stranded cost methodology). There is no nexus between the transition charges contemplated under Staff's proposed stranded cost methodology and the option premium associated with the ability to return to the Company's cost-based tariff rates.

Mr. Garnett's testimony provided a simple, and admittedly conservative, calculation of the value of the option to return to the Company's cost-based tariff rates for a 12-month period. Choice customers are not currently paying the option premium to return to the Company's cost-based tariff rates. Therefore, if no modifications are made to the Company's return to service provisions, then the Commission should adopt Mr. Garnett's recommendation to impose an option premium on Choice Customers that recognizes the value of the option to return to the Company's cost-based tariff rates. Mr. Garnett conservatively estimated the value of the option to return to the Company's cost-based tariff rates under Staff's proposed return to service provisions to be 0.31¢/kwh. Assuming no modifications are made to the Company's return to service provisions, the option premium to return to the Company's cost-based tariff rates should be greater than the 0.31¢/kwh option premium estimated by Mr. Garnett.

B. Energy Michigan's Proposed RAST Credit: A Device to Have Edison Pay Choice Customers to Leave.

Energy Michigan (exceptions, pp 7-8) proposed the implementation of a RAST credit concept, which would use the sales of excess Fermi power into the marketplace to benefit Choice Customers. The credit essentially would be used as a securitization offset.

The Energy Michigan RAST Credit is an inequitable, ill-conceived proposal that is flawed and should be rejected by the Commission. The RAST Credit concept employs a "mechanism", which would compare the market price of power to the variable cost of Fermi to arrive at Energy

Michigan's RAST Credit. The most glaring flaw here is that Energy Michigan's credit is predicated only on the variable cost of Fermi 2 production, and ignores other critical and relevant production cost items. First, Energy Michigan's proposal is flawed because it would award Choice Customers a full pro-rata share of the operational benefits of Fermi 2 without requiring them to pay a full pro-rata share of the associated costs. Not included in the charges paid by Choice customers, or in Energy Michigan's RAST credit calculation, are the property taxes, insurance, O&M, administrative overheads, and post-securitization capital additions (Edison's nuclear plant in service was $95 million for the year ending December 31, 2003). Second, the Commission, in its order in MPSC Case No. U-11726, approved accelerated amortization of Fermi due to impairment. Unlike Energy Michigan's concept of stranded cost, Case No. U-11726 involved a comprehensive analysis that properly took into account all of the relevant costs and found that the asset should be impaired because market prices were inadequate to cover those costs. Third, Energy Michigan's proposal would result in a shift of costs from Choice Customers to bundled retail customers. The financial burden associated with Energy Michigan's RAST credit would eventually be borne by bundled retail customers in the form of a rate increase. Finally, it is the existence and operation of base-loaded generation units such as Fermi that make it possible for alternative electric suppliers to conduct transactions on the Edison system in the first place. Clearly, that is at least part of the reason that Act 142 made securitization charges nonbypasssable.[17]

C. Historic Stranded Cost Recovery.

[17] See for example, MLC 460.10h(f) "'Nonbypassable charge' means a charge in a financing order payable by a customer to an electric utility or its assignees or successors regardless of the identity of the customer's generation supplier."

Energy Michigan contends (exceptions, pp 10-29) that the ALJ overcalculated Edison's historic stranded costs, and that Edison instead has "stranded benefits."[18] While Edison supports $107.0 million of historical stranded costs with a carrying charge through the date of the Interim Order, Energy Michigan has made four drastic errors in its assertion that Edison should not be awarded even the PFD and Staff supported $43.6 million of historic stranded costs. Those four errors are discussed infra.

Energy Michigan Error No. 1. Energy Michigan claims that the $43.6 million of historic stranded costs should be reduced by the 4 mill transition charge from the date of the Interim Order.

The Commission authorized a 4 mill transition charge as part of its Interim Order and in doing so, reduced the Company's 2004 interim revenue deficiency to be recovered from bundled customers by $30 million consistent with the Staff's Interim Report (Staff estimated that a 4 mill transition charge would generate $30 million revenue recovery) (Interim Order, p 58). In other words, the Interim Order required that a portion of the Company's 2004 interim revenue deficiency be recovered from Choice customers.

As a result, the 4 mill transition charge cannot be used twice – once to recover a portion of the 2004 interim revenue deficiency and then a second time to reduce historic (pre-interim) stranded costs as Energy Michigan would have the Commission do. The Staff recognized that the 4 mill transition charge should not be used twice during the time period between the Interim and Final Orders. Consequently, the Staff proposed to initiate recovery of historic stranded costs at the time of the Final Rate Order (14 T 3415).

Consistent with the Interim Order and Staff's position, Edison has determined its 2004 stranded costs subsequent to the Interim Order recognizing the realized interim rate increase

[18] The term "stranded benefits" appears nowhere in Act 141.

including the 4 mill transition charge. Energy Michigan's position would preclude Edison from recovering either a portion of its 2004 or historical stranded costs because the 4 mill transition charge revenues collected between the Interim and Final Orders would be improperly used twice. Therefore, the Commission must reject Energy Michigan's proposal and establish a transition charge to recover historic stranded costs commencing on the date of the Final Order (14 T 3145). This would ensure that the Final Order is consistent with the Interim Order.

Energy Michigan Error No. 2. Energy Michigan incorrectly asserts that hedge sales revenue of $78 million should be used to offset stranded costs.

Energy Michigan contends (exceptions, p 14) that Staff's recommended $43.6 million of historic stranded cost should be reduced to reflect over $78 million of revenue from the sale of unneeded hedges or options during the 2002-2003. Energy Michigan's contention fails because the sale resulted in a loss of $32.4 million (purchases of $159.0 million less sales of $126.6 million; Exhibit A-16, Sch F7-1 and F7-2). Both the purchase of the hedges and the sale of the hedges were used to "lock in" the price of summer power during the PSCR freeze. Moreover, the options were needed to serve bundled load, and were not related to any Choice Customer load as explained by Mr. Byron. (13 T 2644-51).

Energy Michigan asserts (exceptions, p 15) that "Edison received over $126 million from the sale of options and hedges financed by its customers in the frozen rates but was not required to refund this money to its customers." Energy Michigan's assertion is inaccurate. As shown on Exhibit A-16, Schedule 7-1, the expense for the hedges was over $150 million, which was not charged to the customers during the rate freeze. Also, the calculation of the Staff's stranded costs removed the cost of purchasing the hedges. Energy Michigan does not include any expense of the hedges in their proposal to include the revenue from the sale of the hedges. As clearly explained, the expense of the hedges ($159 million) exceeded the sale revenue ($127 million) by $32 million.

Adding this net expense would increase the stranded cost by $32 million. The historical net stranded cost is $99,747,000 as has been previously described.

Energy Michigan Error No. 3. Energy Michigan supports ABATE's 16.32% bundled sales revenue allocation factor to offset stranded costs.

Edison has already explained, in its reply to the exceptions of ABATE concerning stranded costs supra, how the 16.32% bundled sales revenue allocation factor is just as flawed as the Staff's 15.23% factor. As corrected in Attachments XII and XIII of Edison's Reply Brief, Edison justifies and supports $14.8 million and $74.5 million of net stranded costs for years 2002 and 2003 respectively and $10.4 million for 2004 through the date of the Interim Order. Since Edison has correctly calculated historic stranded costs, the Commission must reject Energy Michigan's use of the 16.32% bundled sales revenue allocation factor in determining historic stranded costs. The Commission must also reject Energy Michigan's erroneous conclusions that Edison has no stranded costs; should refund the transition charges collected since the date of the Interim Order; and should eliminate the transition charge.

Energy Michigan Error No. 4. Energy Michigan incorrectly asserts the Commission should reduce transition charges by 3.1 mills to account for the improved financial performance that can be achieved by Edison with new return to service standards.

Edison has already explained, in its reply to the exceptions of Energy Michigan, supra, why the Commission must reject Energy Michigan's modifications to the transition charge.

D. Transition Charge.

Energy Michigan contends (exceptions, pp 29-34) that the ALJ erred in failing to calculate a specific transition charge to collect historic stranded costs. Energy Michigan proposes that the collection of historic stranded costs be spread over at least 5 years (exceptions, p 31). Energy Michigan asserts (without proof) that Choice Customers are burdened and should not pay for three years (2002, 2003 and 2004) of stranded costs at any given time. The Staff's $43.6 million of

historic stranded costs concludes that 2002 had no stranded costs so that only 2003 and 51 days of 2004 through the date of the Interim Order results in stranded costs (1 1/6 year of stranded costs). The application of the 4 mill transition charge will recover the $43.6 million in less than a year and a half. This seems to be a reasonable match. Edison supports $107.0 million of historical stranded costs with a carrying charge for years 2002, 2003 and 51 days of 2004 through the date of the Interim Order (2 1/6 years of stranded costs). The 4 mill transition charge would recover this amount in approximately 2 ½ years. Again, this is a reasonable match and consistent with the Case No. U-12639 intent of setting transition charges where annual stranded cost amounts would be recovered in a lagging annual period with a transition charge true-up to recover succeeding years stranded costs. Under Energy Michigan's 5 year timeframe, 2003 and 2004 stranded costs amounts would not be recovered until 2009. Therefore, Energy Michigan's 5 year timeframe to recover stranded costs is significantly longer than the period during which the stranded costs were incurred and should be rejected by the Commission. At a minimum, the Commission must set a 4 mill transition charge in the final order to recover historic stranded costs.

E. The Commission Should Not Impute Full Cost of Service Revenue to Staff's Proposed Transitional Primary Supply Rate.

Energy Michigan argues (exceptions, pp 34-38) that the Commission should impute full cost-of-service revenue to Staff's proposed TPSR tariff. Energy Michigan cites purported Commission precedent with respect to revenue imputation for special contracts. The revenue imputation test or the burden to show that rates are based on cost-of-service may be appropriate for a special contract that was voluntarily entered into between Edison and the customer. However, revenue imputation for discounts is clearly not appropriate for a Commission imposed tariff, particularly for a tariff that

was not implemented at Edison's request.[19] Many of Edison's current Commission-approved tariffs vary from cost-of-service (the entire residential class, for example), a fact which many parties to this proceeding did not dispute. Yet, those existing tariffs cause no revenue imputation, nor should they. Many considerations enter into the establishment of rates, one of which is cost-of-service. The Staff, in an effort to temper rate shock, elected to factor in the concept of gradualism.

Energy Michigan further argues that the TPSR harms competition since it is a discounted tariff rate that is lower than the price available through the use of market rate energy. The only thing that should be discounted is Energy Michigan's haphazard conclusion. Energy Michigan is comparing a SMC price to an estimated market price for a customer served at the primary voltage level excluding SMC customers (see Exhibit A-95). This comparison is meaningless for two reasons. First, Energy Michigan compares the SMC rate to an estimated market price for non-SMC type primary voltage customers. Second, SMC customers are predominantly served at subtransmission and transmission voltage levels and operate at significantly higher load factors than other smaller non-SMC primary voltage-served locations. SMC customers with their higher voltage level of

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[19] As a matter of fundamental ratemaking law, Edison is entitled to a return of and on its investment in providing utility service. See Bluefield Waterworks Improvement Co v Public Service Commission of West Virginia, 262 US 679, 690-694; 43 S Ct 675; 67 L Ed 1176 (1923); Federal Power Comm v Hope Natural Gas Co, 320 US 591, 603; 64 S Ct 281; 88 L Ed 333 (1944). See also Permian Basin Area Rate Cases, 390 US 747, 769-70; 88 S Ct 1344; 20 L Ed 2d 312 (1968); FPC v Memphis Light, Gas and Water Division, 411 US 458; 43 S Ct 1723; 36 L Ed 2d 426 (1973); General Telephone Co v Public Service Comm, 341 Mich 620; 67 NW2d 882 (1954); Michigan Consolidated Gas Co v Public Service Comm, 389 Mich 624; 209 NW2d 210 (1973).

Edison also has protections against takings and confiscatory rates under the federal and Michigan Constitutions. See generally, Missouri ex rel Southwestern Bell Telephone Co v Public Service Comm of Missouri, 262 US 276; 43 S Ct 544; 67 L Ed 981 (1923); Federal Power Comm v Natural Gas Pipeline, 315 US 575; 62 S Ct 736; 86 L Ed 1037 (1942); Duquesne Light Co v Barasch, 488 US 299; 109 S Ct 609; 102 L Ed 2d 646 (1989). See also, Northern Michigan Water Co v Public Service Comm, 381 Mich 340; 161 NW2d 584 (1968); Consumers Power Co v Public Service Comm., 415 Mich 134; 327 NW2d 875 (1982); ABATE v Public Service Comm, 430 Mich 33; 420 NW2d 81 (1988).

service and higher load factors will command lower market prices than those assumed by Energy Michigan. Energy Michigan's conclusions are in error and should be rejected by the Commission.

F. Unbundling.

Energy Michigan contends (exceptions, pp 38-40) that Edison should be ordered to file an unbundling case. Mr. Falletich explained that Edison appropriately complied with MCL 460.10b(2) by filing an application for unbundling with the Commission in Case No. U-13286. The Commission has not yet issued a final order in Case No. U-13286. Energy Michigan's recommendation that Edison should file new unbundled tariffs is unreasonable unless rates are deskewed at the same time, and it would be preferable to minimize customer confusion by delaying any unbundling until 2006 when all rate caps have expired. (See also, Edison's Initial Brief, p 163).

G. Requiring Edison to Install Electric Choice Interval Meters Within 30 Calendar Days Ignores the Practical Realities of Performing Physical Work at Customer Locations, Will Result in a Measure Edison Cannot Meet Without Significant Adverse Consequences on Customer Service Provided to Bundled Customers, and Ignores Better Solutions Already in the Record.

Energy Michigan contends (exceptions, pp 40-41) that Edison should be required to install new Choice meters within 30 days. Energy Michigan's contention should be rejected because installing an interval meter at a customer location requires one or more site visits, customer (and sometimes supplier) cooperation, and is not within Edison's sole control. As Mr. Newbold stated in his rebuttal testimony:

> "Mr. Polich's second timeframe, 30 days when meter work is needed, is simply not realistic at this point in time. Installing an interval meter is a complex process often involving multiple trips to a customer site, which requires customer cooperation (and action on the telephone line). Recent high enrollment volume has made the 45-day requirement difficult to meet. Reducing it to 30 days is unreasonable without substantial program changes, such as requiring the telephone line to be installed prior to enrollment, and effective mechanisms to encourage customer and AES cooperation." (13 T 2767)

Setting a stricter standard, without streamlining the program requirements to provide Edison with a reasonable chance to succeed during periods of high enrollment activity, is nonsensical and counter-productive. Such a measure would wrongly incentivize Edison to prophylactically move resources away from bundled customers, further increasing their subsidy of Electric Choice (13 T 2767).

Energy Michigan's proposal is ill-timed, in two respects: It comes after the backlog it was proposed to solve has already been resolved, and it comes at a time when the meter threshold issue can be resolved based on proposals made in this proceeding.

Edison demonstrated that it was recovering from being overwhelmed by a massive volume of enrollments received in the Fall of 2003 (13 T 2763) and further indicated that the problem had been solved and the situation was neither acute, nor significant at the time rebuttal testimony was prepared. (13 T 2763-65)

Further, Energy Michigan's proposal only treats the symptom (delayed enrollments), while two tenable and similar proposals to fix the root cause (an unreasonably low interval meter threshold in relation to other states' retail access programs) are pushed off to a collaborative effort when there is enough on the record in this proceeding to fix this program flaw. There is no need for a collaborative effort to further study this issue. There has been an abundance of testimony and exhibits proffered in this case regarding proposed RAST changes.

Both Constellation and Edison presented somewhat similar positions on when interval meters should be required. Constellation's witness, Mr. Brock, suggested raising the threshold requiring interval meters and suggested that other Choice programs have thresholds from 100 to 500 kW, which he categorized as "well above the Single/Three Phase threshold…" (14 T 3189). Edison offered a similar proposal in Mr. Falletich's rebuttal testimony that proposed energy-based rates for secondary voltage customers and interval meters for primary voltage customers. (13 T 2914-15) Further, Constellation asked the Commission to either approve a 500 kW threshold or to approve Edison's proposal that interval meters not be required of customers on existing energy rates. (Constellation Brief, p 9)

It is imperative that the Commission resolve the meter threshold issue in an expeditious manner. It is not necessary to further delay resolution of this matter. Additional delay in resolving these issues would only serve to prolong the uncertainty for Edison, its customers, and suppliers.

Energy Michigan's exception only serves to distract the parties from constructively dealing with the real issue, which is within the Commission's, not Edison's, power to remedy.

V. REPLY TO EXCEPTIONS OF KROGER.

A. Return to Service.

Kroger contends (exceptions, pp 1-3) that the ALJ erred in recommending Constellation's return to service proposal, and that the Commission should instead adopt ABATE's return to service proposal. Kroger's contention lacks merit as explained above in sections IIIF and IVA regarding ABATE's and Energy Michigan's similar contentions and as further explained infra.

1. Kroger incorrectly states that shoppers pay for the safe harbor of cost-based tariff rates via the historic stranded cost charge and the securitization charge.

As noted previously, Kroger, like ABATE and Energy Michigan, improperly assumes that the act of paying a securitization or historical stranded cost charge entitles a Choice Customer to some future claim on the Company's production-related assets. This assumption is incorrect. The securitization charge only services the debt primarily associated with the Company's nuclear facilities; there is no contribution to operation, maintenance, or other expenses via the securitization charge. The transition charge contemplated under Staff's proposed stranded cost methodology only compensates the Company for a portion of its unrecovered historical production fixed costs (2002, 2003, and two months of 2004 pursuant to Staff's proposed stranded cost methodology). Since the costs being recovered via the transition charge contemplated under Staff's proposed stranded cost methodology are historical costs, the only even arguable claim on the Company's production facilities would be on a historical basis. No return to service prohibitions existed during the 2002, 2003, and two months of 2004 timeframe over which the net stranded costs were incurred by the Company. Finally, it is the existence and operation of base-loaded generation units such as Fermi

that make it possible for alternative electric suppliers to conduct transactions on the Edison system in the first place. Clearly, that is at least part of the reason that Act 142 made securitization changes nonbypassable.[20]

B. Grace Period.

Kroger contends (exceptions, pp 3-4) that if the Commission adopts the ALJ's return to service recommendation, then Choice customers should have a grace period to return to bundled rates.

1. Kroger's suggestion to incorporate a grace period in light of modifications to the Company's return to service provisions is acceptable so long as such a grace period is reasonable in length and administration.

The Company agrees with Kroger that any modification to the Company's current return to service provisions should be accompanied by a reasonable grace period; however, any grace period must be reasonable in terms of length and administration. Specifically, the Commission should require that all current Choice Customers provide the Company, or in the alternative the Commission, with the expiration date of the customer's current AES contract. Under no circumstances should the grace period extend beyond the length of the customer's current AES contract, and the Commission must ensure that customers are prevented from "gaming the system" to extend the grace period beyond the length of their current AES contract.

In the alternative, the Commission could impose a grace period expiring on a date certain in the near future. The administrative ease of such a defined grace period would more than likely out weigh any negative consequences of such a defined period.

[20] See for example, MLC 460.10h(f) "'Nonbypassable charge' means a charge in a financing order payable by a customer to an electric utility or its assignees or successors regardless of the identity of the customer's generation supplier."

C. The Commission Should Not Relieve Primary Voltage Customers from Continuing to Pay Transition Charges.

Kroger contends (exceptions, pp 4-7) that the evidence in the record shows that an across the board transition charge is not appropriate and that class specific charges are justified. Kroger also states that Edison experiences very little generation margin loss when a primary customer switches to Choice because Edison, through avoidance of purchased power costs, saves more than it receives under its primary rate. Kroger therefore wrongly concludes that there is little incentive for primary customers to migrate to Choice and that the primary transition charge should be zero.

Edison would agree with Kroger on one point – class specific transition charges are both supported by the record and warranted (6 T 730, 775; 13 T 2993-94, 2906-10; Exhibit A-116). Edison does not agree with Kroger's contention that Edison experiences very little generation margin loss from primary customers, that savings from the avoidance of purchased power costs exceeds the margins received from primary customers under full service tariffs, and that there is very little incentive for primary customers to migrate to Choice. Kroger's assertion that Edison experiences very little margin loss and that there is low or negative headroom appears to be based on the headroom amounts calculated by Mr. Stojic (Exhibit S-144). Kroger's conclusion that there is low and negative headroom for the primary class is wrong and misinforms this Commission. Mr. Stojic's exhibit shows no headroom for the Rate D6, 600 hours use customer, but shows positive headroom for customers at 400 and 500 hours use. For Kroger to conclude that the primary class has no headroom based on the 600-hour use category is a misrepresentation of the class headroom. Edison has very few customers at the 600 hours use level. In fact, the average hours use of the D6 rate class per Exhibit A-13, Schedule E6, Page 26 of 48, Column (b), Line 34 divided by Line 3 indicates that the average D6 customer hours use is approximately 450 hours use of demand. At this level based on Mr. Stojic's Exhibit S-144, the headroom by interpolation for a 450 hours use

customer is approximately 0.5¢ kWh or almost 10% of Edison's tariff price. Kroger would have this Commission believe that all the customers should be incentivized to migrate to Choice. What Kroger does not realize or acknowledge is that Edison's rates for these high load factor customers may already be competitive with the market.

Edison also disagrees with Kroger's contention that the savings from avoided purchases is more than Edison receives under its primary rates. One would assume based on Kroger's assertion that that Choice sales mitigation is accomplished solely through the avoidance of power purchases. This is not only untrue but also unrealistic. Edison projected approximately 9,000 GWH of Choice sales yet projected only 3,084 GWH of power purchases (Exhibit A-16, Schedule F7-3). Not only were power purchases significantly less than the level of sales lost to Customer Choice, these purchases are typically made for only a few hours per year and predominantly in the summer months to serve peak demands. Choice sales, on the other hand, occur year round both on-peak and off-peak. Kroger's assertion is both wrong and unrealistic and should be rejected by the Commission.

VI. REPLY TO EXCEPTIONS OF MEC/PIRGIM.

A. Control Premium.

MEC/PIRGIM contends (exceptions, pp 1-14) that the ALJ's proposed recognition of the control premium is beyond the ratemaking jurisdiction of the Commission and contrary to sound regulatory policy. Specifically, MEC/PIRGIM argues that costs incurred by DTE Energy for the acquisition of MCN are not proper costs to be recognized in Edison's revenue requirement. It supports this claim by referring to the lack of identification of such cost in MCL 460.557. It also excepts to the ALJ's conclusion that recovery of the control premium is authorized pursuant to Act 304. MEC/PIRGIM further asserts that the inclusion of the control premium in Edison's revenue requirements would be unreasonable because of a number of claimed public policy concerns. These

concerns include MEC/PIGRIM's claims that authorization of control premium recovery would have a negative impact on "rate base regulation", there is no recognition of acquisition premiums by either the Internal Revenue Code or under Generally Accepted Accounting Principles, the Commission was not sufficiently involved in the negotiation of the acquisition price, sound public policy would eliminate the existence of utility holding companies, and the method by which the control premium was allocated to Edison. MEC/PIRGIM also argues that there is no logical nexus between the claimed merger savings and the control premium. In that regard, MEC/PIRGIM also claims that cost savings are "phantom costs" that should not be recognized in Edison's revenue requirement. MEC/PIRGIM expands on this argument by claiming that the cost savings were "hopelessly exaggerated, self-serving and unverifiable". In addition, MEC/PIRGIM claims that recognition of the control premium would result in an unjust enrichment through a perpetual cash flow annuity that is further exacerbated by the claimed gross-up for the impact of income taxes. Last, MEC/PIRGIM avers that the ALJ's recommended inclusion of the cost of the control premium in Edison's revenue requirement fails to recognize the Commission's duty to protect ratepayer interests.

The Commission must deny MEC/PIRGIM's exception. MEC/PIRGIM provides over 12 pages of random musings with a variety of legal, public policy and purported factual assertions that are unsupported by the record and that misconstrue the Commission's legal authority. Given the complete lack of record support for a variety of the factual claims made by MEC/PIRGIM, these claims should be given no weight. MEC/PIRGIM's attempt to make a factual argument at this late date must be denied. Regarding MEC/PIRGIM's claim of insufficient statutory authority, the Company refers the Commission to Edison's reply to the Attorney General's exceptions. That is, the absence of a specific reference in MCL 460.557 to the inclusion of a control premium as a cost

component eligible for recovery by a utility does not provide a sound basis for concluding that such cost is thereby precluded from recovery[21]. In any event, the Commission explained the criteria for recovery of costs arising from a combination of utilities in its Order in Michigan Gas Company. (Case No. U-9323, September 29, 1990). As a result, MEC/PIRGIM's exception is without merit and should be rejected.

B. The Commission Should Reject MEC/PIRGIM's Position Regarding Spent Nuclear Fuel.

MEC/PIRGIM sets forth extensive contentions (exceptions, pp 14-78) regarding spent nuclear fuel ("SNF") attacking the PFD's ultimate conclusion that SNF is being addressed appropriately. Edison previously explained (Initial Brief, pp 138-60) that MEC/PIRGIM's arguments regarding SNF lack merit, and have been repeatedly rejected. MEC/PIRGIM's arguments, although lengthy, do not raise any meritorious point. No law requires what MEC/PIRGIM demands. Edison's PSCR and base rate evidentiary presentation has met any reasonable standard of completeness and demonstrates prudent Company strategies and actions. MEC/PIRGIM simply rehash their failed appellate attacks on the Commission's rejection of their arguments. Michigan Environmental Council v Public Service Comm, unpublished opinion per curiam of the Court of Appeals, decided December 9, 2003 (Docket Nos. 240403 and 240406; affirming the Commission in Case Nos. U-12613 and U-12615); Michigan Environmental Council v Public Service Comm, unpublished opinion per curiam of the Court of Appeals, decided May 11, 2004 (Docket Nos. 244354 and 246744; affirming the Commission in Case No. U-12725).

More specifically, MEC/PIRGIM attempts to challenge Edison's recovery, in its rates, of the Nuclear Waste Fund fees for SNF that Edison must pay to the Department of Energy ("DOE")

[21] Furthermore, MCL 460.557 does not provide an exclusive list of the elements permitted to be recovered in rates.

pursuant to 42 USC § 10222(2). MEC/PIRGIM further advocates the imposition of new financial and reporting requirements on Edison for the disposal of SNF. MEC/PIRGIM has repeatedly raised these same issues in past cases, and the Commission has consistently rejected their arguments. For the reasons discussed below, the Commission should similarly reject MEC/PIRGIM's arguments in this case.

1. The Commission Has Consistently Rejected MEC/PIRGIM'S SNF Arguments in Past Cases.

The Commission and Edison have appropriately addressed the costs of SNF disposal and storage in a number of Commission cases over the last several years. Edison's SNF costs became an issue in Edison's 1995 PSCR Plan Case, Case No. U-10703. Through the settlement and order in that case, Edison agreed to and did provide the Commission a comprehensive report addressing Edison's SNF costs, as well as semi-annual reports on those issues. Edison continued the reporting in 1995, 1996 and 1997.

In Case No. U-11314, the Commission initiated its own inquiry on January 28, 1997, into issues concerning payment for SNF storage and disposal. After receiving substantial comments from interested parties, including Edison, the Commission concluded that inquiry on December 4, 2000, without granting any of the relief that MEC/PIRGIM now requests.

MEC/PIRGIM have been parties to several other Commission cases in which they have unsuccessfully raised the identical SNF issues that they present in this case. MEC/PIRGIM were parties to In re Application of ABATE Formal Complaint for the Reduction of The Detroit Edison Company's Rates for the Sale of Electricity, Case No. U-11495, a rate complaint proceeding initiated by ABATE. During that case there was direct testimony and cross-examination concerning the DOE's delay in acceptance of SNF and its impact on Edison (MPSC Case No. U-11495, 6 T 469, 532-545). At the conclusion of the case, the ALJ recommended rejection of various claims for

disallowance of Edison's SNF costs, similar to the claims now made by MEC/PIRGIM in this case (PFD, Case No. U-11495, March 17, 2000, pp 37-44). The Commission ultimately dismissed ABATE's rate complaint case in its entirety due to the effect of Act 141. (Case No. U-11495, June 19, 2000).

MEC/PIRGIM also intervened in Edison's 2000 PSCR case (Case No. U-12121), where they cross-examined Dr. Tso-Cheng Hsieh extensively on the same SNF issues they now present here, even though that cross-examination clearly exceeded the scope of Dr. Hsieh's direct testimony. (MPSC Case No. U-12121, 2 T 33-68). MEC/PIRGIM also filed more than 40 pages of testimony to recommend that Edison be denied recovery of its federally-mandated SNF disposal fees. After the effective date of Act 141, the Commission dismissed that case. (U-12121, June 19, 2000).

The Commission's June 19, 2000 Opinions and Orders dismissing the proceedings in Case Nos. U-11495 and U-12121 encouraged MEC/PIRGIM to participate in Case No. U-12487 (customer information and environmental notice requirements of Act 141) and any subsequent cases involving the Energy Efficiency Fund. On July 21, 2000, MEC/PIGRIM filed a petition to intervene in U-12487, but their September 20, 2000 testimony and subsequent briefs in that case contained no mention of SNF costs.

In In re Application of Wisconsin Public Service Corp for Approval of a PSCR Plan for the 12-month Period Ending December 31, 2001, Case No. U-12613 (November 20, 2001), another PSCR case, MEC/PIRGIM challenged the reasonableness of WPS Corporation's recovery of SNF fees paid to the Nuclear Waste Fund, and argued that the Commission should require WPS Corporation to make escrow payments equal to the 1 mill SNF fee. MEC/PIRGIM contended that the escrow would provide a contingent funding source for disposal of SNF in the event that the DOE defaults on its obligation to take utilities' SNF. They further argued that WPS Corporation should

recover only the escrow payments with its PSCR clause, and not the fees that it paid to the DOE. In the alternative, MEC/PIRGIM argued, the Commission should require WPS Corporation to post a performance bond or purchase liability insurance to guarantee SNF disposal. The Commission rejected the merits of their claims.

> "[T]he MEC/PIRGIM's proposals are not necessary to correct any showing of an unreasonable or imprudent action or omission on the part of WPS Corp's management that adversely affects the rates paid by PSCR customers. The problem is larger than WPS Corp's nuclear operation, feasible alternatives to the DOE's construction of a permanent repository are not readily apparent, and the Commission is unable to find that WPS Corp has been imprudent. [Id. at 8-9 (citation omitted).]

MEC/PIRGIM raised the identical arguments again in In re Application of Wisconsin Electric Power Co for Approval of a PSCR Plan for the 12-month Period Ending December 31, 2001, Case No. U-12615 (November 20, 2001). Using the same analysis as in U-12613, the Commission rejected MEC/PIRGIM's contentions. (Id. at 14-16).

The Michigan Court of Appeals affirmed the Commission's rejection of MEC/PIRGIM's arguments in Case Nos. U-12613 and U-12615. Michigan Environmental Council v Public Service Comm, unpublished opinion per curiam of the Court of Appeals, decided December 9, 2003 (Docket Nos. 240403 and 240406).[22]

MEC/PIRGIM intervened in five consolidated cases to implement Act 141 (U-12649, U-12650, U-12651, U-12652, and U-12655), and filed testimony relating to SNF issues on March 19, 2001. On the motion of the MPSC Staff, the ALJ struck this testimony from the record as irrelevant on April 10, 2001. MEC/PIRGIM initially filed an emergency appeal to the Commission on April

[22] MEC/PIRGIM's weak attempt to distinguish the present case from the Wisconsin cases merely serves to highlight the fragility of their arguments. For instance, MEC/PIRGIM attempts to characterize these cases as "preliminary." (exceptions, pp 75-76).

18, 2001, but then mooted their appeal by filing a Statement of Non-Objection to the Settlement Agreement on July 25, 2001.[23]

Despite the consistent and repeated rejection of their arguments, MEC/PIRGIM nevertheless persisted in making the same arguments in the context of WEPCo's recent rate case. In In re Application of Wisconsin Electric Power Co for Authority to Increase its Rates for the Sale of Electricity in Michigan, Case No. U-12725 (September 16, 2002), they urged the Commission to require WEPCo to establish an escrow account, to post a bond or obtain insurance to cover alternative means of SNF disposal, or to impose monitoring and reporting requirements on WEPCo. The Commission again rejected MEC/PIRGIM's arguments, citing its reasoning in its November 20, 2001 Order in Case No. U-12615. (Id. at 30). The Court of Appeals affirmed the Commission's rejection of MEC/PIRGIM's arguments in that rate case. Michigan Environmental Council v Public Service Comm, unpublished opinion per curiam of the Court of Appeals, decided May 11, 2004 (Docket Nos. 244354 and 246744).

MEC/PIRGIM have repeatedly failed in their challenges to the reasonableness of utility recovery of SNF disposal fees. MEC/PIRGIM have repeatedly failed to prevail on their arguments for additional utility financial requirements with respect to the disposal of SNF. MEC/PIRGIM rehash the same failed arguments in this case.

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[23] The Settlement Agreement provided, in part:

"14. SNF Disposal Fee: Issues concerning spent nuclear fuel were excluded from this case by the Administrative Law Judge's ruling. The nuclear utilities represent that they are collecting the 1 mil/kWh SNF surcharge from retail and wholesale customers using nuclear power. The imposition of the SNF disposal costs on nuclear utilities is governed by federal law and the recovery of the costs from customers is the subject of state or federal rate proceedings. Any consideration of issues regarding collection and/or allocation of SNF disposal costs among nuclear utility customers may be a matter for future rate or other proceedings." (emphasis added).

As further explained below, MEC/PIRGIM's arguments are defective as a matter of law. The Commission has repeatedly recognized these fatal defects, rejected MEC/PIGRIM's arguments, and declined to disallow the recovery of SNF fees and costs.

2. As a Matter of Federal Preemption, The Commission is Required to Allow Edison to Recover its SNF Fees and Costs.

a. Federal Law Requires Edison to Pay SNF Fees and Costs

Federal law requires Edison to pay a 1.0 mill per kilowatt hour charge on electricity generated by Fermi 2. 42 USC § 10222(2). The Nuclear Waste Policy Act of 1982 ("NWPA") assigned to the DOE the responsibility of building and placing into operation a permanent geologic repository for commercially-generated SNF. MEC/PIRGIM unlawfully and unreasonably propose that, notwithstanding the controlling federal law, the Commission should hold Edison responsible in the event the DOE does not construct the contemplated facility. There is no merit in MEC/PIRGIM's proposal to place SNF fees in escrow (13 T 2498). Edison has no option, short of violating federal law (and jeopardizing its Fermi 2 license), but to pay the federally-mandated charge (13 T 2634).

The NWPA represents a "comprehensive scheme" for the disposal of SNF and establishes specific duties and responsibilities for the federal government, the States and the civilian nuclear power industry. General Electric v Dep't of Energy, 764 F2d 896, 898 (CA DC, 1985). Among the many important responsibilities delegated by the NWPA to the federal government are express responsibility for the long-term storage and permanent disposal of SNF and high-level nuclear wastes (42 USC § 10143), the process of siting storage and disposal facilities for nuclear waste (42 USC § 10121-10175) and the establishment of a funding mechanism to pay for these activities, i.e., the Nuclear Waste Fund (42 USC § 10222).

The NWPA requires civilian nuclear power generators to contract to pay the U.S. Treasury 1 mill/kWh on electricity generated and sold from nuclear generating plants. As conditions for federal acceptance of SNF and the avoidance of any further financial obligation for long-term storage and disposal, nuclear power generators must pay the 1 mill/kWh SNF disposal surcharge and execute the DOE contract (42 USC § 10222(a)(2)).

The NWPA further directs the Nuclear Regulatory Commission to require that its nuclear power licensees enter into the DOE contract. The law also directs the DOE not to accept SNF unless the fuel owner is under contract with DOE (42 USC § 10222(b)). There is not authority under the Act for a state regulatory agency to substitute its judgment or require a utility to alter the federally-mandated relationship between the utility, the DOE and the Nuclear Regulatory Commission.

Edison entered into a contract with the DOE pursuant to 42 USC § 10222. There is no element of discretion involved – if you own a nuclear plant, the NWPA specifies what must be done. The collection of the 1 mill/kWh surcharge is required by the federal Act. If Edison desires to ultimately send its SNF to the DOE and avoid any further financial obligation for long-term SNF storage and disposal, it must pay the 1 mill surcharge and execute the DOE contract.

As shown in the above argument, the Commission has properly allowed Edison to recover its SNF costs and fees from its retail electric customers through retail electric rates. Other commissions and courts that have considered the issue have agreed that SNF fees and costs should properly be passed through to the utility customers who benefited from the use and enjoyment of the power generated by the nuclear facilities. Re Northern States Power Co, 1982 WL 175332 (NDPSC, 1982); Town of Concord v FERC, 729 F2d 824, 828-830 (CA DC, 1984); Florida Power & Light Co v Westinghouse Electric Corp, 826 F2d 239, 279 (CA 4, 1987); Re Florida Power & Light Co, 2002 WL 192104 (Fla PSC, 2002); Re Entergy Gulf States, Inc., 2002 WL 32077784 (Tex PUC, 2002).

Although Edison shares the frustration of many others regarding the DOE's progress in developing a facility for the disposal of SNF, the Commission cannot prevent Edison from receiving full and timely recovery of the mandatory SNF fees and costs from its customers. The utility financial reporting and other remedies advocated by MEC/PIRGIM would not accelerate developing a safe, cost-effective and timely federal facility for disposing of SNF. Rather, they would simply penalize Edison, without any legal or rational basis for such a penalty. The Commission should find, as it did in Case No. U-12613, supra, that MEC/PIGRIM's "proposals are not necessary to correct any showing of an unreasonable or imprudent action or omission on the part of [utility] management . . . and the commission is unable to find that [the utility] has been imprudent." U-12613, pp 8-9.

The use of the mechanisms advocated by MEC/PIRGIM also would not further the goal of obtaining contract performance by DOE. If DOE repudiates its contractual obligations entirely, the appropriate protection for electric ratepayers would be for Edison to seek relief from DOE under the contract, including refund of all amounts previously paid to DOE under the contract, in addition to other available relief against DOE.

Further, it should be noted that the funds paid to DOE by Michigan utilities are already protected by the federal government. The Nuclear Waste Policy Act provides that all fees paid to DOE by utilities be deposited in the Nuclear Waste Fund. The NWPA specifically states that the fund may be used only for radioactive waste disposal expenses. Alabama Power Co v Dep't of Energy, 307 F3d 1300, 1312-16 (CA 11, 2002). Thus, monies collected from utilities around the nation by DOE are already earmarked for the purposes specifically identified by NWPA.

MEC/PIRGIM incorrectly assert that Edison and its shareholders should be required to guarantee the actions of the federal government, or else face a disallowance of the pass-through of

these federally-mandated costs in the event that DOE defaults on its SNF obligations. This proposition lacks merit and should be rejected.

b. Federal Preemption Prohibits State Utility Regulators From Denying Utility Pass-Through of Federally Mandated SNF Fees and Costs.

Edison respectfully submits that federal preemption requires the Commission to allow Edison to recover its federally-required SNF fees and costs. Both state and federal courts have consistently held that a state utility commission setting retail rates must allow, as reasonable operating expenses, any costs incurred by a utility pursuant to federal mandate. In the leading case, Narragansett Electric Co v Burke, 119 RI 559; 381 A2d 1358 (1977), cert den 435 US 972 (1978), the Supreme Court of Rhode Island held that the state utility commission could not prevent a utility from recovering amounts it paid under federally-authorized wholesale rates. Recovery of those amounts from the utility's retail customers could not be denied on the grounds that those costs, for whatever reason, were "unreasonable."

The Michigan Court of Appeals, as well as other state courts that have considered the question, have uniformly agreed that a utility's costs based upon federally-established charges must be treated as reasonably-incurred operating expenses for the purposes of setting appropriate utility rates. ABATE v Public Service Comm, 192 Mich App 19, 22-27; 480 NW2d 585 (1991); Attorney General v Public Service Comm #2, 171 Mich App 700, 702; 431 NW2d 49 (1988); Public Service Comm of Colorado v Public Utilities Comm, 644 P2d 933 (Colo, 1982); United Gas Corp v Mississippi Public Service Comm, 240 Miss 405; 127 So2d 404 (1961); General Motors Corp v Illinois Commerce Comm, 143 Ill 2d 407; 574 NE2d 650 (1991); Citizens Gas Users Ass'n v Public Utility Comm, 165 Ohio State 536, 138 NE2d 383 (1956); Washington Gas Light Co, v Public

Service Comm, 508 A2d 930 (DC App, 1986); and Eastern Edison Co v Dep't of Public Utilities, 388 Mass 292; 446 NE2d 694 (1983).

This principle has been recognized by the United States Supreme Court to be a matter of federal supremacy. Nantahala Power and Light Co v Thornburg, 476 US 953 963; 90 L Ed 2d 943, 952; 106 S Ct 2349 (1986). In Nantahala, the Court held that a state utility commission exercising jurisdiction over retail utility rates may not prevent a utility from passing through to its retail customers the costs the utility has incurred through payment of federally-authorized wholesale rates. The Court explained that "a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price. . . " 476 US at 965; 90 L Ed 2d at 955. The Court adopted and applied the Narragansett line of cases:

> "[F]or a state ratemaking agency to disregard a FERC-filed rate would clearly be inconsistent with the exclusive federal regulatory scheme over interstate wholesale power prices. The FERC-approved rate at which the middleman purchased power would not be fully recognized as a cost in the retail market, thereby forcing the middleman to sell power at less than its reasonable cost as determined by the federal agency. . . .
>
> "When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate. [Citing Narragansett line of cases]. Such a 'trapping' of costs is prohibited. Here, Nantahala cannot fully recover its costs of purchasing at the FERC-approved rate if the state commission's order is allowed to stand." 476 US at 969-70; 90 L Ed 2d at 956.

In Mississippi Power & Light Co v Moore, 487 US 354; 108 S Ct 2428; 101 L Ed 2d 322 (1988), the United States Supreme Court again applied this principle to bar a state public utility commission's attempt to prohibit a utility's recovery of FERC-mandated payments through local retail utility rates. The Court stated:

> "In this case as in Nantahala we hold that 'a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price . . . Once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A State must rather give effect to Congress' desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority.' Nantahala, 476 US at 965, 966; 106 S Ct 2349; 90 L Ed 2d 943. Thus we conclude that the Supremacy Clause compelled the MPSC to permit MP&L to recover as a reasonable operating expense costs incurred as the result of paying a FERC-determined wholesale rate for a FERC-mandated allocation of power." 487 US at 373; 101 L Ed 2d at 339-340.

This principle of federal preemption, first articulated in Narragansett and other state court decisions and later recognized by the United States Supreme Court in Nantahala and Mississippi Power & Light, precludes the Commission from disallowing Edison's federally-mandated SNF fees and costs. Moreover, the federal rates at issue here were not just set by a federal agency pursuant to Congressional delegation - - they were set by Congress itself.[24] In the NWPA, Congress created a comprehensive scheme for the interim storage and ultimate disposal of SNF generated by civilian nuclear power plants. Congress has expressly mandated Edison's payment of SNF fees to the DOE pursuant to 42 USC § 10222. The Supremacy Clause (US Const, art VI, § 2) and the cases cited above therefore require the Commission to allow Edison to recover from its customers all such federally-mandated charges through Act 304, or through its general rates.

[24] MEC/PIGRIM, again, makes a weak attempt to distinguish the present circumstances in this proceeding from those addressed in a long line of cases prohibiting "cost trapping." (exceptions, pp 63-69). The differences are either immaterial or weigh strongly in favor of Edison's position, not the unreasonable positions of MEC/PIRGIM.

3. Edison Has Been Reasonable and Prudent With Respect to the Incurrence of SNF Costs, and The Relief Requested by MEC/PIRGIM Would Result in an Unconstitutional "Taking."

Edison has constitutional protections against "takings" and confiscatory rates under the Fifth Amendment to the U.S. Constitution, which is applicable to the states through the Fourteenth Amendment. Similarly, Mich Const 1963, art 10, § 2 provides in part, "Private property shall not be taken for public use without just compensation therefore being first made or secured in a manner prescribed by law." These constitutional protections have been recognized and applied to public utility rates in well-established case law. See generally, Missouri ex rel Southwestern Bell Telephone Co v Public Service Comm of Missouri, 262 US 276; 43 S Ct 544; 67 L Ed 981 (1923); Federal Power Comm v Natural Gas Pipeline, 315 US 575; 62 S Ct 736; 86 L Ed 1037 (1942); Federal Power Comm v Hope Natural Gas Co, 320 US 591; 64 S Ct 281; 88 L Ed 333 (1944); Permian Basin Area Rate Cases, 390 US 747; 88 S Ct 1344; 20 L Ed 2d 312 (1968); Duquesne Light Co v Barasch, 488 US 299; 109 S Ct 609; 102 L Ed 2d 646 (1989). See also, Northern Michigan Water Co v Public Service Comm, 381 Mich 340; 161 NW2d 584 (1968); Michigan Consolidated Gas Co v Public Service Comm, 389 Mich 624; 209 NW2d 210 (1973); Consumers Power Co v Public Service Comm., 415 Mich 134; 327 NW2d 875 (1982); ABATE v Public Service Comm, 430 Mich 33; 420 NW2d 81 (1988).

Edison's SNF-related costs,[25] as well as similar future costs, unquestionably constitute a multi-million dollar property interest that Edison is entitled to recover under its retail electric rates. The Commission has, to date, properly allowed Edison to recover these costs through PSCR factors, decommissioning charges and base rates.

[25] Mr. Colonnello explained the errors in Mr. Callen's SNF fee calculations (13 T 2638-40).

As in Case Nos. U-12613 and U-12615 (rejecting similar arguments by MEC/PIRGRIM), there is no basis to find that Edison has been imprudent. Instead, it is beyond credible dispute that Edison reasonably and prudently built Fermi 2 years before the present SNF issues emerged.[26] Edison's power purchase and generation decisions (with brief exceptions) have been subject to annual review and reconciliation by the Commission under Act 304 since 1983 (the same year Congress enacted the NWPA) and under the Commission's general ratemaking authority prior to and since that time. Under these circumstances, Edison cannot be denied full recovery of these reasonable and prudently incurred SNF costs.[27] As the Illinois Supreme Court found under similar circumstances:

> " . . .[I]t would be difficult to say in what respect distributors have been imprudent in incurring these particular costs. The distributors did not know and could not have foreseen at the time that those purchasing decisions would lead to the imposition of direct-billed take-or-pay costs years later. Until 1985, when FERC issued Order No. 436 establishing the open-access policy, no one knew that the long-term take-or-pay contracts between pipelines and producers would create multi-billion dollar liabilities for the pipelines. And it was not until FERC issued Order No. 500 in 1987 that distributors had any idea that pipeline take-or-pay liabilities would be passed on to them. [Citation omitted]. By that time, the purchasing decisions that led to the long-term contracts had long since been made.
>
> "As the distributors point out in their briefs to this court, unless clairvoyance has become an element of prudence, there simply is no basis on which the ICC could conduct a meaningful prudence review." 574 NE2d at 658-659. (emphasis added)

[26] For a review of the shifts in federal policy that caused SNF to be converted from an asset for reprocessing to a liability for storage and disposal, see, Town of Concord, supra, 729 F2d at 825-26; Florida Power & Light Co, supra, 826 F2d at 243-53.

[27] The Fermi 2 plant continues to be used and useful providing electric energy to Edison customers, as demonstrated in this and other rate proceedings and Edison's annual Summer Capacity Plan and Electric Supply Reliability Plan filings (e.g., Case Nos. U-11889, U-12292, U-13283, U-13695 and U-14005).

The same is true under Michigan law. The reasonableness and prudence of a utility's purchasing decisions must be determined in the light of the conditions faced by the utility when it made the purchases. ABATE v Public Service Comm, 208 Mich App 248, 260; 527 NW2d 533 (1994) (" . . . utilities are compensated for their actual costs when made regardless of whether the investments are deemed necessary and beneficial in hindsight."); Attorney General v Public Service Comm, 161 Mich App 506, 517; 411 NW2d 469 (1987), lv den 429 Mich 879 (1987) (utility's decision to enter into long-term contracts for liquefied natural gas was found to be reasonable and prudent, even though the market for liquefied natural gas later changed dramatically, resulting in the utility having booked gas costs exceeding current market prices); Ohio Power Co v FERC, 668 F2d 880, 896-7 (CA 6, 1982) ("while hindsight may indicate that [the utility] would have been better served from a capacity cost standpoint by the construction of a non-nuclear generating plant, there is no suggestion that the decision to undertake this plant was in any way imprudent."); Re Consumers Power Co, 106 PUR 4th 45, 54 (MPSC, 1989) ("in judging what was reasonable and prudent planning in this situation, we must look at the circumstances under which the utility made its decision"); and Re Consumers Power Co, 14 PUR 4th 1, 16 (MPSC, 1976) (decision to build a synthetic gas plant was not "imprudent . . . in light of the circumstances that existed at the time that the decision was made").

As discussed above, Edison has no choice but to pay the federal SNF fees and to incur SNF-related costs, because of the requirements of federal law. The federal law leaves Edison no option to withhold the required payments based on the possibility that the DOE will "default" in its SNF obligations. Conditioning Edison's recovery of these costs on the DOE's future success (which will

be driven by factors outside of Edison's control) would be unreasonable, confiscatory and contrary to the fundamental ratemaking law.[28]

Further, MEC/PIRGIM's allegations regarding the DOE's future conduct are speculative, and the DOE's construction of an SNF repository is beyond Edison's control. Thus, there is no sound basis for Edison to pay the DOE and escrow an additional amount. Such action would unreasonably increase Edison's costs and be contrary to the interests of Edison and its ratepayers. Although the DOE is behind schedule, there is no reason to believe that the federal government will "permanently fail" to accept SNF for disposal, particularly in light of the federal government's recommendation of the Yucca Mountain Site in 2002, and the importance of SNF disposal to national security (13 T 2634-35).

Similarly, it is unreasonable for Mr. Callen to conclude that "substantial risks exist that the federal government may never perform its SNF duties". (13 T 2502) The NRC found in 1990 and reconfirmed in 1999 that there is reasonable assurance that a SNF repository will be developed and operational during the first quarter of this century (13 T 2636-38).[29]

It would also be unreasonable for the Commission to re-evaluate the prudency of Edison's SNF costs based on the Commission's future and subjective evaluation of the DOE's future success, because any review of prudency properly considers only historical costs and the knowledge that existed when those costs were incurred, without regard to whether the expenditures prove to be

[28] See Bluefield Waterworks Improvement Co v Public Service Commission of West Virginia, 262 US 679, 690-694; 43 S Ct 675; 67 L Ed 1176 (1923); Federal Power Comm v Hope Natural Gas Co, 320 US 591, 603; 64 S Ct 281; 88 L Ed 333 (1944). See also Permian Basin Area Rate Cases, 390 US 747, 769-70; 88 S Ct 1344; 20 L Ed 2d 312 (1968); FPC v Memphis Light, Gas and Water Division, 411 US 458; 43 S Ct 1723; 36 L Ed 2d 426 (1973); General Telephone Co v Public Service Comm, 341 Mich 620; 67 NW2d 882 (1954); Michigan Consolidated Gas Co v Public Service Comm, 389 Mich 624; 209 NW2d 210 (1973).

[29] In any event, Fermi 2 SNF is not likely to be removed from the site until later in the first quarter of this century because of its place in the queue for such services. (4 T 217).

necessary or beneficial in hindsight. See ABATE, supra, 208 Mich App at 256-58. See also Duquesne Light Co, supra, 488 US at 309.

Under well-established ratemaking law, rates for utility service must be set so that the utility provides service and its customers receive service at rates, which are based on the estimated costs of providing that service, plus a reasonable return on the utility's investment. This is part of the "regulatory compact" of the regulatory regime, under which the utility dedicates its private property to serve the public, and correspondingly receives a reasonable return on the value of its private property.

In Board of Public Utility Comm'rs v New York Telephone Co, 271 US 23; 46 S Ct 363; 70 L Ed 808 (1926), the United States Supreme Court explained that the Just Compensation clause of the Fourteenth Amendment guarantees a utility a reasonable return on the value of the property used at the time that the property is being used for the public service. Rates not sufficient to yield that present return are confiscatory. 271 US at 31.[30] MEC/PIRGIM's proposed relief, which would expose Edison to present or future forfeitures based on factors beyond Edison's control, cannot withstand constitutional scrutiny, and must be rejected.

[30] By contrast, utility customers have no property interest in their utility rates. Therefore, as the Court held in Roedler v Dep't of Energy, 255 F3d 1347, 1354 -56 (CA Fed, 2001) utility customers have no viable "takings" claim against the DOE in connection with the mandatory SNF fees that are passed through to utility customers in their rates.

4. MEC/PIRGIM Have Failed to Allege or Demonstrate Any Credible Basis for Finding that SNF Costs Are Unreasonable or Imprudent.

a. Edison's Costs are Presumed to be Reasonable and Prudent.

MEC/PIRGIM attack Edison's recovery of SNF costs as unreasonable or imprudent, but they failed to carry their burden to (1) allege specific unreasonable and imprudent conduct, and (2) establish that claim before the Commission. A utility's expenses must be presumed reasonable and prudent, absent a clear showing of bad faith or abuse of discretion. Public Utilities Comm v Michigan State Tel Co, 228 Mich 658; 200 NW 749 (1924). To attack a utility's expenses, "waste or negligence . . . must be established by evidence." West Ohio Gas Co v Public Utilities Comm of Ohio, 294 US 63, 68; 79 L Ed 761, 767; 55 S Ct 316 (1934). Further, "good faith is to be presumed on the part of the managers of a [utility]." 294 US at 72; 79 L Ed at 769.

The United States Supreme Court has long honored the principle that utility costs must be presumed to be reasonable and prudent. In Missouri ex rel Southwestern Bell Telephone Co v Public Service Comm of Missouri, 262 US 276, 288-289; 67 L Ed 981, 985; 43 S Ct 544 (1922), the Court established the controlling principle:

> "[W]hile the state may regulate, with a view to enforcing reasonable rates and charges, . . . 'it is not empowered to substitute its judgment for that of the [utility]; nor can it ignore items charged by the utility as operating expenses unless there is an abuse of discretion in that regard by the [utility].'" (Emphasis added)

The Michigan Supreme Court reiterated this same principle in Union Carbide Corp v Public Service Comm, 431 Mich 135, 148; 428 NW2d 322 (1988). Also see Ohio Power Co v FERC, 880

F2d 1400, 1413 (CA DC, 1989) (Mikva, J., concurring) ("[I]t has been long-settled that a utility's costs are presumed [subject to rebuttal] to be prudently incurred.")[31]

MEC/PIRGIM have failed to demonstrate that Edison's response has been materially different than the responses of numerous other utilities, and they make no credible criticism of the way Edison has managed its SNF (13 T 2631). MEC/PIRGIM have failed to carry their burden of pleading and proof, just as they have repeatedly failed in the past.[32] As the Commission well knows, SNF disposal is a national issue, which is far bigger than Edison and beyond Edison's control. Thus, the Commission will be "unable to find that [Edison] has been imprudent." (Case No. U-12613, pp 8-9, rejecting MEC/PIRGIM's identical arguments.

b. Edison Has Taken Reasonable and Prudent Actions Regarding its SNF Costs.

It is beyond credible dispute that Edison was reasonable and prudent in paying federally-mandated SNF fees, instead of risking the loss of its Fermi 2 license. Past proceedings at the Commission have already established that Edison has taken substantial action over the years regarding its SNF costs.

On this record, Mr. Colonnello further testified that Edison has been reasonable and prudent with respect to actions and associated costs for storing SNF at the Fermi 2 plant. Edison has also taken actions to protect its rights under the Standard Contract with the DOE, and to protect itself and ratepayers regarding the DOE's delays (13 T 2631).

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[31] MEC/PIRGIM has, however, unreasonably exploited the luxury it has as an intervenor to continually claim that Edison has not done "enough" or has failed to produce "enough" evidence. (Exceptions of MEC/PIRGIM, pp 71-72).

[32] Furthermore, they have never demonstrated that any of their proposed solutions would be effective.

In 1994, Edison anticipated the loss of storage capability in the spent fuel pool, and evaluated options for expanding the capacity to store SNF onsite. Edison's current SNF storage strategy provides balance between establishing timely capacity and preserving capital expenditures. Edison's approach is consistent with industry experience, and reasonable and prudent for minimizing the costs of storing SNF onsite (13 T 2631-32).

Edison has also taken ongoing actions for almost a decade to protect itself and its ratepayers regarding the DOE's delays. In September, 1995, Edison and other utilities sued the DOE, arguing that it had a legal responsibility to begin taking SNF by the 1998 Contract date. In January 1997, Edison and 35 other nuclear utilities filed suit to attempt to force the federal government to meet its legal obligation to begin accepting SNF. In December 2002, Edison sued the DOE for damages under the contract associated with the DOE's failure to begin accepting SNF (13 T 2632-33). Edison has also worked over the past 10 years to solicit public and congressional support for legislative efforts to advance the acceptance of SNF. These efforts have successfully contributed to the present progress towards construction of a SNF repository at Yucca Mountain. These actions by Edison were appropriately responsive, very reasonable, and consistent with the actions of most other U.S. nuclear utilities (13 T 2633-34).[33]

Edison also participated as an intervenor in one of the early cases involving the disposal of SNF in the Yucca Mountain repository in the ongoing dispute between Nevada and the DOE. State of Nevada v Watkins, 914 F2d 1545 (CA 9, 1990). In that case, Edison supported the DOE's interpretation of rules and regulations in an effort to move that nuclear waste storage project

[33] The Commission may similarly take administrative notice that in Case No. U-12121, where both MEC and PIRGIM were parties, Dr. Hsieh explained, through cross examination elicited by MEC/PIRGIM, that Edison has joined in filing several legal actions attempting to assist and/or require the DOE to discharge its duties with respect to SNF (U-12121, 2 T 42); Edison participated in a private SNF storage initiative (Id. at 44-45) and Edison continues to actively monitor related industry events (Id., at 45, 49, 67).

forward. In other lawsuits that have evolved from the Yucca Mountain controversy, Edison has been indirectly involved by being a member of the Nuclear Energy Institute, which is an amicus curiae in those cases.

Edison joined with the MPSC as a founding member of the Nuclear Waste Strategy Coalition in 1993. The primary purpose of that organization is to lobby Congress and the DOE to move forward with the nuclear waste disposal program. In connection with this coalition, there have been communications and exchanges of information regarding SNF between Edison and the MPSC from 1993 through the present. Through the Coalition, representatives from Edison met frequently with MPSC Staff and Commission members to discuss and share information related to SNF issues. These meetings and exchanges of information are reflected in the annual reports of the Coalition, which have been provided to the MPSC.

SNF costs also became an issue in Edison's 1995 PSCR Plan Case, U-10702. As part of the settlement and order in that case, Edison agreed to provide the Commission a comprehensive report addressing the SNF issues, which report was filed with the Commission on April 3, 1995. Pursuant to the settlement and order, Edison also provided the Commission semi-annual reports on SNF issues in 1995, 1996, and 1997, which updated the Commission on Edison's continuing actions with regard to SNF.

Edison also participated in the Commission's inquiry into SNF issues in Case No. U-11314, beginning in 1997 and continuing until the Commission terminated that inquiry on December 4, 2000 (Order, Case No. U-11314). In addition to its activities with the MPSC in the Nuclear Waste Strategy Coalition, Edison filed detailed comments with the MPSC in Case No. U-11314, responding to the MPSC's questions.

Edison was also involved in key SNF litigation, including Indiana Michigan Power Co v Dept of Energy, 88 F3d 1272 (DC Cir 1996) and Northern States Power Co v Dept of Energy, 128 F3d 754 (DC Cir 1997).[34] In those cases, Edison either directly or through a utility group, cooperated and exchanged information about SNF with members of the Commission and other interested parties. There were also several strategic meetings among Edison, other utilities, and the Commission to discuss litigation strategy in those cases.

MEC/PIRGIM's own attorney surely cannot question Edison's efforts in this regard. In his former role as Assistant Attorney General in charge of the Public Service Division, he participated in meetings of the Nuclear Waste Strategy Coalition, and he personally argued the cases of Indiana Michigan Power Co, supra, and Northern States Power Co, supra, on behalf of a large number of the affected parties. In those cases, the public service commissions of many states and many utility companies joined forces to seek relief from the DOE's progress in dealing with SNF disposal. A review of those decisions reveals that the issues in those cases are in essence the same issues MEC/PIRGIM now attempts to inject and rehash in this case.

Edison has, from the beginning, initiated and supported appropriate efforts regarding its SNF costs. These efforts have more than satisfied any objective "reasonable and prudent" standard. Under these circumstances, there is no credible basis on which to further question the reasonableness and prudence of Edison's SNF costs.

Finally, there is no merit to Mr. Callen's recommendation that the Commission establish annual filing and reporting requirements for Edison regarding SNF. (13 T 2503) Mr. Colonnello explained that the nuclear utility industry is one of the most highly monitored and regulated

[34] MEC/PIRGIM, by contrast, failed to participate in any of these proceedings, which took place in the proper federal forum, to raise the issues they now wrongly seek to raise before the Commission in this proceeding.

industries in the country. The Commission already receives reports every 3 years on the nuclear decommissioning fund, which includes SNF information. Additional information is available to the Commission and Staff on request. MEC/PIRGIM's proposed filing and reporting requirements would increase costs, without any benefit to the Commission (13 T 2641).

5. MEC/PIRGIM Seek Relief That is Outside The Commission's Statutory Authority and Jurisdiction.

MEC/PIRGIM essentially complains about the claimed inaction of the DOE, a federal agency outside the Commission's supervision or jurisdiction. There is also no Michigan statutory authority for the Commission to involve itself in the federally-mandated contract between the DOE and Edison. Even apart from federal preemption, Commission action is precluded because, as a legislative agency, the Commission has only those powers granted it by the Legislature. The Commission does not possess any common law powers. Union Carbide Corp v Public Service Comm, 431 Mich 135; 428 NW2d 322 (1988). Authorizing statutes must be strictly construed. Regulatory authority must be affirmatively or plainly granted because "a doubtful power does not exist." Miller Brothers v Public Service Comm, 180 Mich 227, 232; 446 NW2d 640 (1989). Since there is no Michigan statute that authorizes the relief requested by MEC/PIRGIM, the requested relief must be denied.

VII. REPLY TO EXCEPTIONS OF RRC.

A. PSCR Proposal.

The RRC contends (exceptions, pp 1-2) that the PFD is unclear regarding PSCR issues, and vaguely references positions that it presented in this case. Edison has not withdrawn its PSCR plan, as explained in its Exception No. 1 at pages 1-18. As to RRC's suggestion that the Commission adopt RRC's position regarding the transmission charges and the other PSCR related issues as presented in its Initial and Reply Final Phase Briefs, Edison opposes RRC for the reasons set forth in

Edison's Initial Brief (pages 126-138), Reply Brief (pages 141-144), and other pleadings in this case.

RELIEF

Edison respectfully requests that the Commission:

A. Grant Edison's request for Final Relief, as further supported in its Application, testimony, exhibits and its briefs, approving rates that will recover the following revenue deficiencies:

Final Rate Relief Request ($000)

Filed Base Rate Relief Request	**553,427**
Updated Adjustments discussed in Brief (Table 4)	
Regulatory Asset Adjustment - Return on Capped Customers	(13,101)
A&G Capitalized	(16,325)
Rate Base Offset	2,610
Levelized Control Premium	(19,167)
Pension & OPEB	(1,608)
Additional Choice Revenue Deficiency	77,000
Final Base Rate Relief Request	**582,837**

Regulatory Asset Recovery ($000)

Regulatory Asset Recovery Surcharge	**1st year**	**Surcharge**
First Year Regulatory Asset Cost Recovery		
Surcharge Phase-In		
Date of Final Order – Cust. > 15 kW	$16,460	0.91559 (mills/kWh)
2005 - Special Cont. and Cust. < 15 kW	$7,377	0.67051 (mills/kWh)
2006 - Residential Cust.	$40,411	2.64295 (mills/kWh)
Customer Choice Implementation Cost Recovery Annual Recovery starting in 2006	$28,240	0.5 (mills/kWh)
Stranded Costs		

Historical Stranded Cost amount to be recovered	$107,021	To be collected pursuant to PA 141

B. Approve the implementation of Edison's requested final relief as described in the rate design parameters set forth in Edison's testimony and exhibits in this case and as set forth in its briefs and exceptions and these replies to exceptions;

C. Approve the Company's request to use the authorized pre-tax overall rate of return on all unrecovered regulatory asset amounts, including Customer Choice Implementation Costs and Net Stranded Costs;

D. Approve the Company's 2004 PSCR Plan and factors including the proposed operation of the PSCR process set forth in Edison's exceptions and these replies to exceptions;

E. Approve a stranded cost recovery plan and mitigation process consistent with Edison's exceptions and these replies to exceptions; and

F. Grant such other lawful relief that the Commission deems reasonable and appropriate.

Respectfully submitted,

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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of THE DETROIT EDISON COMPANY to increase rates, amend its rate schedules governing the distribution and supply of electric energy, implement Power Supply Cost Recovery plans, factors and reconciliations in its rate schedules for jurisdictional sales of electricity and for miscellaneous accounting authority and regulatory asset recovery.	)	Case No. U-13808

CERTIFICATE OF SERVICE

STATE OF MICHIGAN)
) ss
COUNTY OF INGHAM)

Stephen J. Rhodes, being duly sworn, deposes and says that he is an employee of Foster, Swift, Collins & Smith, P.C., and that on October 7, 2004, a copy of The Detroit Edison Company's Replies to Exceptions, and Certificate of Service, were served upon:

See Attached Service List

Service was accomplished via electronic mail and by depositing same in a United States Postal Service mail depository, enclosed in envelopes bearing first-class postage, fully prepaid, and properly addressed.

Signature Not Verified

Stephen Rhodes

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