

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

\* \* \* \* \*

In the matter of the application of	)	
<b>THE DETROIT EDISON COMPANY</b> to	)	
implement the Commission’s stranded cost recovery	)	Case No. U-13350
procedure and for approval of net stranded cost	)	
recovery charges.	)	
_____	)	

At the July 31, 2003 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. Laura Chappelle, Chairman  
Hon. David A. Svanda, Commissioner  
Hon. Robert B. Nelson, Commissioner

**OPINION AND ORDER**

History of Proceedings

On May 31, 2002, The Detroit Edison Company (Detroit Edison) filed an application pursuant to MCL 460.10a, seeking a determination of the company’s net stranded costs in 2000 and 2001 and authorization to collect a transition charge from its retail open access customers during 2003.

On September 5, 2002, Administrative Law Judge Barbara A. Stump (ALJ) granted leave to intervene to Energy Michigan; the Association of Businesses Advocating Tariff Equity (ABATE); Adrian Energy Associates LLC, Michigan Cogeneration Systems Inc., Riverview Energy Systems, and Sumpter Energy Associates Limited Partnership (Adrian et al.); Kroger Co.; Attorney General Jennifer M. Granholm (Attorney General);<sup>1</sup> and the National Energy Marketers Association

<sup>1</sup> On January 1, 2003, Michael A. Cox replaced Jennifer M. Granholm as Attorney General.

(NEMA). The ALJ also denied a petition for leave to intervene by Ontario Power Generation. The Commission Staff (Staff) appeared and participated.

At a hearing on December 18, 2002, Detroit Edison, ABATE, Energy Michigan, Kroger, NEMA, and the Staff sponsored testimony and exhibits, which the ALJ admitted into the record upon the stipulation of the parties, without cross-examination. Thereafter, the parties filed briefs and, except for the Staff and Adrian et al., reply briefs. Because the Commission agreed to read the record, the ALJ did not issue a proposal for decision or make provision for the parties to file exceptions or replies to exceptions.

#### Case No. U-12639

The Commission previously addressed the stranded cost computations of Detroit Edison and Consumers Energy Company (Consumers) for calendar year 2000 in the December 20, 2001 order in Case No. U-12639. In that order, the Commission accepted the Staff's proposed methodology, which computes net stranded costs as the difference between the utility's revenue requirement necessary to recover the year's fixed production costs and the contribution provided by the utility's yearly revenues toward the recovery of fixed production costs. The fixed cost revenue requirement sums the utility's return on net generation plant and related regulatory assets, production-related depreciation and amortization, plant property taxes, and capacity charges incurred for purchased power. The contribution to fixed costs is the portion of the utility's revenues from rates that is allocable to the recovery of fixed production costs, plus net revenues from third-party wholesale transactions. See Case No. U-12639, Exs. S-22, S-24, S-26, S-28.

As applied to Detroit Edison in 2000, the Staff's computation produced a negative balance of \$320.3 million. Id., Ex. S-26. Upon finding that both Detroit Edison and Consumers realized negative balances in 2000, the Commission determined that both utilities should assess a zero

transition charge on their retail open access sales in 2002. In view of limitations in the record that precluded more definitive findings, the Commission indicated that the methodology was “an evolving process” and that the Commission would “defer[] the issues of refining the methodology, and recalculating net stranded costs for 2000, to the case where the transition charges for 2001 will be calculated.” Order at 14.

### Positions of the Parties

#### a. Detroit Edison

The starting point for Detroit Edison’s computation of its revenue requirement attributable to fixed production costs was its \$4.1 billion total electric revenue requirement, which it developed from cost data reported in its books and records for calendar year 2000. Ex. A-18. Using the rate unbundling analysis it had previously proposed in Case No. U-13286,<sup>2</sup> Detroit Edison allocated the revenue requirement by function and thus isolated its production-only costs. Id. (The functional analysis proposed in Case No. U-13286 produces percentages that allocate the revenue requirement between the transmission and distribution and the production functions: 40.2% for transmission and distribution, 59.8% for production.) Under Detroit Edison’s methodology, production costs for 2000 include the direct costs of generating and procuring power, as well as an allocation of indirect costs for such items as administrative and general expense. From these costs, it removed fuel-related and nuclear decommissioning costs and operation and maintenance (O&M) expense, leaving fixed production costs of \$1.1 billion. Exs. A-17, A-18.

Because Detroit Edison issued securitization bonds on March 9, 2001 pursuant to a financing order issued on November 2, 2000 in Case No. U-12478, it made adjustments to remove qualified

---

<sup>2</sup> Detroit Edison filed its rate unbundling application in Case No. U-13286 to comply with MCL 460.10b(2). The case is pending.

costs associated with securitized production-related assets from its fixed production cost revenue requirement. Exs. A-20, A-21. Its stated purpose for the adjustments was to determine if there are additional stranded costs beyond those qualified costs that have already been securitized.

Tr. 165-66, 210-11. (Detroit Edison made corresponding adjustments to the revenue contribution, as indicated below.) With these adjustments, Detroit Edison computed a fixed production cost revenue requirement of \$627 million for 2000, or \$614 million on a jurisdictionalized basis.<sup>3</sup>

To compute its revenue contribution toward the recovery of fixed production costs, Detroit Edison started with its reported electric revenues from 2000, reduced them for the collection of fuel-related costs and nuclear decommissioning surcharges, and then made a functional allocation using the percentages from Case No. U-13286 to determine production-related revenues.

Ex. A-18. After reducing those revenues for an allocation for O&M expense recovered through base rates, Detroit Edison computed its revenues attributable to its fixed production costs to be \$1.2 billion. Ex. A-17, l. 17. In Exhibit A-21, Detroit Edison made further pro forma adjustments to remove the revenue effects of securitization and nonrecurring revenues from bundled sales to Rouge Complex customers that have since been displaced by an on-site cogeneration facility, reducing the revenues to \$624 million. Next, Detroit Edison removed nonjurisdictional revenues to compute revenues contributing to the recovery of fixed production costs of \$611 million in 2000. Ex. A-5. It also computed the revenue contribution per energy unit of 2000 bundled sales to be 1.25¢ per kilowatt-hour (kWh). *Id.* It used the unit rate as an assumption in computing future years' revenue contributions toward the recovery of fixed production costs.

---

<sup>3</sup> Jurisdictionalization is an adjustment that eliminates the effects of sales that fall outside of the Commission's statutory authority, e.g., wholesale sales to municipal utilities.

Detroit Edison computed its net jurisdictional fixed production cost revenue deficiency for 2000 as the \$3 million difference between its production fixed cost revenue requirement of \$614 million and the contributing revenues of \$611 million. Ex. A-4.

As a refinement to the Staff's methodology used in Case No. U-12639, Detroit Edison proposed to determine its recoverable net stranded costs as the lesser of two amounts: the net jurisdictional revenue deficiency noted above, and a fixed production cost revenue deficiency that is specifically attributable to customer choice. Detroit Edison performed the second proposed computation separately for each of the three major rate classes affected by customer choice: residential, commercial and industrial secondary, and commercial and industrial primary. It computed the fixed production cost revenue contribution that it foregoes as a result of customer choice by multiplying each rate class's customer choice sales by the unit price representing that class's fixed production cost revenue contribution embedded in tariff rates. Ex. A-9. (The unit contribution price is 0.35¢ per kWh for the residential class, 3.36¢ per kWh for the secondary class, and 0.94¢ per kWh for the primary class.) The total of the amounts for the three rate classes is the deficiency attributed to customer choice. Id.

For 2000, Detroit Edison had no customer choice sales and thus deemed the deficiency attributed to customer choice to be zero. Because the lesser of the fixed production cost revenue deficiency of \$3 million and zero is zero, Detroit Edison determined that it had no stranded costs in 2000. Ex. A-6.

For 2001, Detroit Edison applied the same methodology to its actual costs to determine its jurisdictional fixed production cost revenue requirement of \$638 million. Exs. A-4, A-19, A-23. It then computed the revenues contributing to the recovery of fixed production costs of \$596 million by multiplying its bundled sales in 2001 by the 2000-based unit revenue contribution

of 1.25¢ per kWh. Ex. A-5. It further adjusted the resulting \$42 million difference between the fixed production cost revenue requirement and revenue contribution downward by \$1 million to recognize the net revenue contribution from third-party wholesale interconnection sales, resulting in the net jurisdictional fixed production cost revenue deficiency for 2001 of \$41 million. Ex. A-4. Detroit Edison also computed a fixed production cost revenue deficiency attributed to customer choice of \$13 million. Ex. A-9, at 1. It thus determined that the lesser amount of \$13 million was its recoverable net stranded costs in 2001. Ex. A-6.

Detroit Edison applied the same methodology to projected sales and costs to estimate recoverable net stranded costs of \$53 million and \$83 million for 2002 and 2003, respectively. Id.

Detroit Edison stated that if it were to compute a transition charge to recover its 2001 net stranded costs from its choice customers during 2003, the amount of the charge would be 1.31¢ per kWh. Tr. 96-97. However, Detroit Edison believes that it is appropriate for choice customers to pay a transition charge that recovers stranded costs as Detroit Edison contemporaneously incurs them, instead of those incurred two years previous. To eliminate the two-year lag in cost recovery, Detroit Edison proposes to recover the net stranded cost balance of \$13 million for 2001 and the estimated balance of \$53 million for 2002 by using actual and projected excess securitization savings from 2001 through 2003 for that purpose. Exs. A-8, A-25. It further proposes to collect its estimated 2003 recoverable net stranded cost balance of \$83 million against that year's retail open access sales by imposing a transition charge of 1.28¢ per kWh during 2003. Ex. A-7. Its

proposal would further eliminate the Section 10d(5)<sup>4</sup> securitization surcharge offsets<sup>5</sup> and the rate reduction equalization credits<sup>6</sup> currently provided in its retail access service tariff.

The following chart compares the charges in mills per kilowatt-hour that a retail open access customer of the commercial and industrial primary class currently pays (in addition to the distribution charges provided in the retail access service tariff) with the charges that Detroit Edison proposes in this case (as summarized in Exhibit A-3):

	<u>Current</u>	<u>Proposed</u>
Stranded cost or transition charge	-0-	12.80
Securitization bond and tax surcharges	4.24	4.24
Securitization offset	(4.24)	-0-
Rate reduction equalization credit	(2.80)	-0-
Section 10d(6) credit	_____	_____
Net charges (or credits)	<u>(2.80)</u> mills per kWh	<u>17.04</u> mills per kWh

---

<sup>4</sup> Act 609 of 2003 amended Section 10d, MCL 460.10d, by adding provisions and renumbering existing provisions. Thus, the provisions that Detroit Edison cites as Section 10d(5) are now Section 10d(6). Unless otherwise indicated, statutory references in this order will refer to Section 10d as it currently appears.

<sup>5</sup> The financing order in Case No. U-12478 authorizes Detroit Edison to collect the surcharges required to service the securitization bond principal and interest and related income tax liabilities. As adjusted by the February 5, 2003 true-up order in Case No. U-12487, the current securitization surcharges are 3.36 mills per kilowatt-hour (kWh) for bond principal and interest and 0.88 mills per kWh for tax, or a total of 4.24 mills per kWh. The financing order also required Detroit Edison to implement an offset or credit equal in amount to the surcharges on the bills of both bundled and choice customers. Order dated November 2, 2000, at 29. See also order dated December 20, 2001, Case No. U-12639, at 24-26, which continues the offset.

<sup>6</sup> The financing order further required Detroit Edison to provide its choice customers with rate reduction equalization credits (in addition to the securitization offsets described supra note 5) that are equal in amount to the 5% reduction in bundled rates achieved through the enactment of Section 10d and the issuance of securitization bonds. Order dated November 2, 2000, Case No. U-12478, at 32-33. Currently, the rate reduction equalization credits are 0.46¢ per kWh for the residential class, 0.48¢ per kWh for the commercial and industrial secondary class, and 0.28¢ per kWh for the commercial and industrial primary class.

b. ABATE

In Exhibit I-26, ABATE computed the revenue contribution toward the recovery of fixed production costs on the basis of the cost data used to set Detroit Edison's base rates in the January 21, 1994 order in Case No. U-10102, with further adjustments to account for the rate decreases implemented in the December 28, 1998 and March 8, 1999 orders in Case No. U-11726. Expressed as cents per unit of sales, the revenue contribution was 2.417¢ per kWh. Ex. I-26. To determine the revenue contribution provided by Detroit Edison's rates toward the recovery of its fixed production costs in 2000 and 2001, ABATE multiplied Detroit Edison's bundled sales in each year by 2.417¢ per kWh and added the net revenue contribution from third-party wholesale interconnection sales (\$28.4 million in 2000, \$26.2 million in 2001) as computed by Detroit Edison in Exhibit A-1. Ex. I-27. The resulting revenue contributions totaled \$1,241 million in 2000 and \$1,208 million in 2001. Id. In Exhibit I-28, ABATE next computed the fixed production cost revenue requirement for each year by making adjustments to Detroit Edison's computations of the same in Exhibits A-21 and A-23. ABATE removed asset balances and costs related to general and intangible plant, working capital, and nuclear decommissioning and recalculated the cost of capital using the authorized rate of return from Case No. U-10102. It also rejected Detroit Edison's adjustment removing securitized assets prior to the issuance of securitization bonds in March 2001. ABATE thus calculated fixed production cost revenue requirements of \$1,011 million for 2000 and \$1,025 million for 2001. Ex. I-28. The difference between the fixed production cost revenue contributions and requirements for each year—\$230 million in 2000, \$183 million in 2001—was ABATE's computation of negative net stranded costs. Ex. I-27.

As an alternative, ABATE determined that Detroit Edison's fixed production cost revenue requirement as computed in Exhibit I-26 amounted to 41.357% of its total revenue requirement (excluding fuel and purchased power). Ex. I-29. ABATE multiplied that percentage by Detroit Edison's revenues for 2000 and 2001 (again excluding fuel and purchased power, but including imputed revenues based on the discounts from tariff rates for special contract sales) to determine the revenue contribution. To the differences between each year's revenue contribution and its corresponding revenue requirement in Exhibit I-28, ABATE added the net revenue contribution from third-party wholesale interconnection sales. It thus calculated negative net stranded costs of \$190 million in 2000 and \$176 million in 2001. Ex. I-30.

Because both of its stranded cost calculations produced negative balances for 2000 and 2001, ABATE proposed that the Commission approve a zero transition charge for 2003. ABATE further proposed to accumulate and carry forward the negative balances, with carrying charges, as offsets to future stranded costs or other deferred costs. Because its stranded cost calculations included the revenue requirement associated with the Fermi 2 nuclear plant, ABATE contended that the Commission should retain choice customers' securitization offsets.

c. Energy Michigan

In Exhibit I-32, Energy Michigan performed the fixed production cost revenue requirement and revenue contribution calculations by making adjustments that were, in some respects, similar to those proposed by ABATE. Thus, Energy Michigan used the rate of return authorized in Case No. U-10102 and removed nuclear decommissioning expenses (and surcharge revenues) from the computation. It made adjustments to Detroit Edison's revenue contribution by including the special contract discounts as imputed revenues and reversing Detroit Edison's exclusion of sales revenues in 2000 from Rouge Complex customers. Unlike Detroit Edison, it included both the

expense and related revenues from production O&M in its computation. Energy Michigan also opposed Detroit Edison's adjustment for the effects of securitization prior to the issuance of securitization bonds. Energy Michigan thus computed negative stranded cost balances of \$196.0 million in 2000 and \$358.5 million in 2001, or a total of approximately \$554 million.

Ex. I-32.

Energy Michigan recommended that \$49 million of the negative stranded cost balances should be applied to offset the securitization surcharges otherwise incurred by retail open access sales in 2003, with the remaining balance carried forward to fund future years' stranded costs, choice customers' securitization surcharges, or rate reduction equalization credits.

d. Kroger

Kroger proposed three adjustments to Detroit Edison's computation of net stranded costs for 2000 and 2001. First, it proposed to apply the net revenue credits for third-party wholesale sales, as computed by Detroit Edison in Exhibit A-1, as a direct reduction to stranded costs. This contrasts with Detroit Edison's approach, which allocated those revenues over all bundled and unbundled retail sales. Second, Kroger proposed an adjustment that would equate the revenue contribution in bundled rates that is allocated to recover fixed production O&M expense with the amount of O&M expense used to compute the fixed production revenue requirement. Exs. I-39 to I-41. Third, Kroger reversed an adjustment made by Detroit Edison to its capital structure based on the divestment of its transmission system to International Transmission Company in 2001, which, in turn, lowered the rate of return for 2001 from 10.67% to 10.51%. Ex. I-42. With these adjustments, Kroger computed negative balances of net stranded costs of \$39 million in 2000 and \$3 million in 2001. Ex. I-38.

Kroger proposed a zero stranded cost charge for 2003. Similar to the positions advanced by ABATE and Energy Michigan, Kroger proposed to retain retail open access customers' securitization offsets and rate reduction equalization credits in 2003 and to fund those obligations with excess securitization savings. It further proposed to carry forward the stranded cost deficiencies it computed for 2000 and 2001 to fund future years' obligations otherwise incurred by retail open access customers for stranded costs, securitization surcharges, and rate reduction equalization credits.

e. NEMA

NEMA did not offer a computation or propose adjustments, but it recommended that the stranded costs computed under any methodology should be recovered from all of the load served by Detroit Edison's system. According to NEMA, Detroit Edison should collect stranded costs through a competitively neutral, non-bypassable surcharge assessed against all energy units of sales, and not only retail open access sales.

f. Staff

The Staff proposed three adjustments to Detroit Edison's stranded cost computation: using the entire amount computed in Exhibit A-1 as the net revenue credit for third-party wholesale interconnection sales, removing costs associated with compliance with the Clean Air Act, 42 USC 7401 et seq., from the computation of the fixed production cost revenue requirement, and reversing Detroit Edison's adjustment removing Rouge Complex sales revenues from the fixed production cost revenue contribution. With these adjustments, the Staff computed a \$53,101,000 negative balance of net stranded costs for 2000 and a positive balance of \$10,012,000 for 2001. Ex. S-43. Using the 2001 balance, it computed a 2003 transition charge of 1.8 mills per kWh. Ex. S-44.

In addition to the proposed transition charge, the Staff supported Detroit Edison’s proposal to replace the securitization offsets and the rate reduction equalization credits with a credit of 2.22 mills per kWh based on excess securitization savings. Ex. S-45. Under the Staff’s proposal, a choice customer would pay the following charges (in mills per kWh):

Stranded cost or transition charge	1.80
Securitization bond and tax surcharges	4.24
Securitization offset	-0-
Rate reduction equalization credit	-0-
Section 10d(6) credit	<u>(2.22)</u>
Net charges	<u>3.82</u> mills per kWh

Overview of Stranded Cost Determinations

In this order, the Commission is retaining the zero transition charge for stranded cost recovery that it originally set for Detroit Edison in the December 20, 2001 order in Case No. U-12639. The record in this case supports this outcome, notwithstanding Detroit Edison’s efforts to modify the Staff’s methodology from Case No. U-12639 and propose a number of adjustments supporting a higher transition charge. The Commission finds that the net stranded cost balances for 2000 and 2001 are negative on the basis of several of the issues raised in this case.<sup>7</sup> A negative balance results even when the adjustments are incorporated into Detroit Edison’s own computation of net stranded costs. As in the December 20, 2002 order in Case No. U-13380 (Consumers’ stranded cost case), it is not necessary at this time to undertake an additional detailed examination of all of the other issues or proposed adjustments that could affect the stranded cost methodology or its outcome. Therefore, this order will not further address those issues, nor should it be understood as indicating whether or not those issues would have validity in future cases.

---

<sup>7</sup> As discussed below, this order rejects Detroit Edison’s proposal to use the transition charge to collect projected stranded costs for 2003.

This order also maintains a methodological consistency with Consumers' stranded cost computations in Case No. U-13380. Uniform treatment of stranded cost issues is appropriate, absent a persuasive reason to treat the two utilities differently. The development of competitive retail electric markets throughout Michigan should proceed as evenly as possible within the service territories of the two dominant electric utilities.

The Commission is aware that the findings and decisions made in this order will not satisfy the need expressed by some for year-to-year predictability, either as to the stranded cost methodology or the transition charge it produces. To that, the Commission can only say that the record developed in this case (as well as Cases Nos. U-12639 and U-13380) and the parties' diverse proposals for refining the methodology do not give the Commission the measure of confidence it needs to set in stone a formula that will facilitate markets in the long run. The stranded cost methodology must, of necessity, continue to evolve in light of actual experience.

It was with these limitations in mind that the Commission instituted a collaborative effort in the December 20, 2002 order in Case No. U-13380, at 18. The Commission remains hopeful that collaborative discussions on various issues will produce consensus that can be incorporated into the stranded cost process. It stands ready to implement any recommendations coming out of the collaborative that would serve the public interest in free, fair, and open markets.

### Special Contracts

In the March 23, 1995 order in Case No. U-10646, the Commission approved special contracts that Detroit Edison had negotiated with the Big Three automotive manufacturers. The purpose of the contracts was to give rate discounts as a means of retaining the sales of customers with feasible competitive alternatives to continuing to take electric service under utility tariffs. The order established a basic template for evaluating requests to approve special contracts. Since that time,

Detroit Edison has entered into a number of special contracts, and the Commission has approved them subject to essentially the same terms and conditions as in Case No. U-10646.

In its stranded cost computations, Detroit Edison used the actual revenues collected from its special contract customers to determine its revenue contribution toward the recovery of its fixed production costs. Energy Michigan, ABATE, and the Attorney General support an adjustment that would impute additional revenues for the dollar amount of the differences between the tariff rates and the corresponding discounted rates provided in the contracts.

Energy Michigan proposes to allocate all of the \$56.9 million of discounts in 2000 as a revenue contribution toward the recovery of fixed production costs, arguing that the discounts are related entirely to the production component of the cost of service.<sup>8</sup> Energy Michigan further argues that withholding an imputation adjustment would have the effect of increasing the transition charge and thereby subsidizing the discounts that Detroit Edison uses to compete with alternative suppliers. Energy Michigan contends that the Commission anticipated efforts to recover special contract discounts through other utility rates in Case No. U-10646 and imposed a high burden of justification that the utility must surmount if it is to succeed in recovering those discounts. Energy Michigan states that Detroit Edison has failed to show that the contracts do not impede the development of competition, did not present a cost-of-service study justifying the contracts, and has not done anything else to meet its burden of justification in this case.

Detroit Edison argues that imputation of special contract discounts is without justification and illegal. It contends that the contracts benefit all of its customers, and not only the few who signed them, through their effects on load retention and economic development, which have reduced stranded costs by \$100 million. It further claims that the retained loads have experienced sales

---

<sup>8</sup> In the alternative, Energy Michigan acknowledges that ABATE's use of a fixed production cost allocator to apportion the discounts is a possible approach.

growth of approximately 20% over the lives of the contracts, which translates into \$33 million of annual revenues contributing to the recovery of fixed costs.

Detroit Edison asserts that because the imputed revenues do not actually exist as dollars, the proposed adjustment for them is speculative. It argues that if it had not negotiated special contracts with some customers, they would have become likely candidates to participate in customer choice programs. Not only would this have increased stranded costs, it says, but it also would have the perverse effect of using an imputed revenue adjustment to lower the transition charge. In effect, it posits, those customers that were able to demand special contracts would benefit twice, once by receiving the discounted contract rates and a second time by using the discounts to reduce the future transition charges they would pay after switching to customer choice. It says that this perverse effect would be aggravated by an illegal carryforward of negative stranded cost balances, as Energy Michigan and others propose.

Detroit Edison further contends that Energy Michigan's proposal to designate 100% of imputed revenues to recover fixed production costs is based on the speculative assumption that the contract discounts are solely attributable to the production function. Although Detroit Edison allows that ABATE's allocation of a percentage of the imputed revenues to fixed production is more reasonable, it adds that the computation of the percentage reflects stale cost data used to set base rates in Case No. U-10102.

The Commission finds that an adjustment for the imputed revenues is warranted, as that outcome is dictated by the standard for rate recovery in the March 23, 1995 order in Case No. U-10646. As Energy Michigan explains, to ignore this adjustment would have the effect of using the discounts to increase stranded costs. In the December 20, 2002 order in Case

No. U-13380, at 11-13, the Commission analyzed the same issue, in the context of Consumers' stranded costs, by applying the cost recovery template set forth in Case No. U-10646, as follows:

Anticipating the potential consequences if Consumers were to seek to recover the discounts from other ratepayers, the Commission approved the special contracts subject to the same protective conditions that it had previously imposed on Detroit Edison's special contracts in the March 23, 1995 order in Case No. U-10646. Those conditions assigned presumptive responsibility for the revenue shortfall to the utility shareholders and further indicated that any attempt to reallocate the discounts to other ratepayer classes would require "a compelling showing" to overcome the "substantial burden" of the presumption. Order dated October 25, 1995, Case No. U-10961, at 4 (quoting the March 23, 1995 order in Case No. U-10646, at 21). It set forth the test for reallocating cost responsibility as follows:

This burden would require, at a minimum, a clear, convincing, and unequivocal demonstration either (1) that the contract prices and terms are justified on the basis of cost of service, or (2) that the benefits for other (non-participating) ratepayers are substantial and have a value that outweighs the costs that are not recovered from the contract customers. Either showing would require support from a cost-of-service study that identifies and quantifies all costs incurred under the contracts. In addition, both showings would require [the utility] to demonstrate that its service provided in conjunction with the contracts has not, and will not in the future, impede the development of competition in its service territory.

Id. at 4-5 (quoting order in Case No. U-10646, at 21). Thus, Consumers' business decision to offer the discounts meant that it was voluntarily accepting the risk of foregoing part of the revenue requirement otherwise recoverable under the base rates established in Case No. U-10685.<sup>[9]</sup>

Consumers contends that the test applies only in the context of a future rate case, but it does not adequately explain why shareholders should be fully insulated from the cost of the discounts in the meantime. Although the present mechanism for computing stranded costs was not known when the Commission approved the special contracts, the concerns regarding cost shifting were fully apparent, and the stranded cost computation implicates those concerns fully. If the discounts cannot be shifted to other bundled rates, it is also reasonable that they not be shifted to the transition charge.

On the record in this case, Consumers cannot meet the substantial burden of justifying a reallocation of the discounts to other rates, whether bundled or retail

---

<sup>9</sup> The February 5 and November 14, 1996 orders in Case No. U-10685 approved base electric rates for Consumers.

open access. The conditions imposed in approving the contracts call for a cost of service study that would provide a basis for comparing the special contract revenues with the costs allocated to those customers. As noted, the study used in Case No. U-10685 predates most or all of Consumers' current special contracts and did not account for them.

Although Consumers claims that all of its customers benefit from its success in preserving special contracts' revenue contribution to fixed costs, it does not quantify that benefit. The primary objective of the contract approved in Case No. U-10961 was to retain a customer that may have been considering competitive alternatives other than retail open access; for example, the construction of customer-specific generation facilities. The Commission deemed the possibility of that load loss to be harmful to the interests of other ratepayers because it compromised the recovery of all of Consumers' fixed costs, not only its production costs. Since that time, Consumers has signed other contracts subject to the same conditions. It is doubtful that Consumers could continue to claim that retaining the generation load under those contracts provides legitimate benefits to its customer base if the effect of the discounts is to make alternative electric suppliers less attractive to prospective candidates for retail open access or to impede the development of retail markets for unbundled generation services.

The same reasoning applies to the treatment of the discounts in Detroit Edison's special contracts. Although Detroit Edison claims that the net effect of load retention is to reduce its stranded cost exposure by more than \$100 million, it did not make a meaningful attempt to meet the standard imposed in Case No. U-10646 for recovery of the discounts. It did not prepare a cost-of-service study or other cost justification.

Although Detroit Edison prepared Exhibit A-15, which purports to show that the loads retained through the special contracts saved it from incurring additional stranded costs in 2001, the computation is dubious. It is not consistent with the stranded cost methodology used in this case, it uses a lost revenues method to determine the special contracts' revenue contribution, it does not distinguish fixed costs from fuel and other variable costs, it assumes that all existing special contract sales would have been served, kilowatt-hour for kilowatt-hour, by customer choice, and it uses other questionable numerical values and assumptions.

Moreover, the scenario that Detroit Edison describes regarding customers duplicating the benefits of special contracts, once by taking discounted service and then again by switching to customer choice, assumes that it is appropriate to increase the transition charges those customers would pay in order to recoup the discounts that they previously received. Not only would Detroit Edison's expressed desire to remediate this scenario lack any policy justification, but it is also blatantly anticompetitive.

It is not necessary to decide the merits of Energy Michigan's proposal to designate all of the imputed revenues as a contribution toward the recovery of fixed production costs. For purposes of Detroit Edison's computations in this case, the imputed revenues would be added to the revenue total shown on Exhibit A-18, line 23, under the "Total Electric" column. The computation then allocates the revenue balance on the basis of Detroit Edison's percentage split of 40.2%/59.8% between the combined transmission and distribution function and the production function, respectively.

### Third-Party Wholesale Revenues

The stranded cost methodology mitigates stranded costs with the net revenues from the wholesale interconnection sales that Detroit Edison makes with third parties. To determine its sales margins from such transactions in 2001, Detroit Edison reduced the wholesale revenues booked in Account 447, "Sales for Resale,"<sup>10</sup> by the following: (1) revenues from sales to nonjurisdictional full requirements customers, hedging transactions that do not entail the physical interchange of electricity, the resale of summer forward and option contracts, and buy/resale transactions with Ontario Power Generation; (2) the fuel and purchased power costs attributable to

---

<sup>10</sup> Uniform System of Accounts for Major and Nonmajor Electric Utilities, 1999 AC, R 460.9001.

the remaining sales; and (3) a credit for third-party sales already reflected in current base rates that are frozen pursuant to MCL 460.10d. The resulting sales margin for 2001 was \$26.2 million.

Ex. A-1. When allocated over 50,000,000 megawatt-hours (MWh) of total retail sales, it produced a credit rate of \$0.52 per MWh, which Detroit Edison rounded up to \$1.00 per MWh. Ex. A-9. To compute the stranded cost reduction attributable to net third-party sales, Detroit Edison multiplied the credit rate by a net sales amount that it calculated as each year's customer choice sales, less the year's load growth in retail bundled sales. This approach produced a credit of \$1 million in 2001 (993,000 MWh x \$1.00 per MWh). *Id.* at 1.

Notwithstanding its computation of the credit, Detroit Edison questions whether any credit would serve its intended purpose of reflecting the opportunity to make wholesale sales with the production capacity that it had used to serve choice customers before they left bundled service. Detroit Edison claims that there is little actual correlation between customer choice and third-party sales revenues, but that opportunities to make wholesale sales are subject to any number of market, cost, and operational circumstances that drive the real-time economic dispatch of its system. It adds that the costs of making those transactions are not the utility's average power supply costs incurred over the course of a year, but that they are the incremental fuel, purchased power, and O&M related costs of operating the system at any given moment.

Energy Michigan contends that the revenues related to Detroit Edison's hedges, calls, options, and other financial transactions in power markets should be included in the credit computation, although it concedes that the nonjurisdictional full requirements sales may be excluded. Energy Michigan claims that Detroit Edison dealt in hedges and other financial instruments in order to reduce the effects of market volatility on its power supply costs, that it used ratepayer funds to acquire the hedges, and that it earned substantial revenues when market and load conditions

allowed it to close out some of those positions. It claims that the very substantial costs of acquiring the hedges pass through Detroit Edison's power supply cost recovery (PSCR) factor.

In response, Detroit Edison contends that its frozen rates, including a power supply component based on the 2000 PSCR plan year in Case No. U-12121, does not recover anything for the cost of financial hedges. It says that it books the revenues from closing out such positions to defray partially the considerable expenses it incurs in acquiring those positions, not to reap windfall profits.

Energy Michigan, Kroger, and the Staff further propose to use the entire amount of net margin from third-party sales as a direct offset against stranded costs, instead of computing a credit rate per unit of customer choice sales. Kroger observes that the effect of Detroit Edison's development of the \$1.00 per MWh credit is to reduce the amount of the credit actually included in the stranded cost computation from \$26.2 million to \$1 million. Kroger and the Staff add that because Detroit Edison's rates are now frozen, the exclusion of all but a fraction of the third-party sales margin would create a windfall in favor of Detroit Edison's shareholders. The Staff also argues that using the entire net margin as a credit is appropriate under the stranded cost methodology approved in Case No. U-12639. It developed Exhibit S-43, which uses the net revenue credit calculated by Detroit Edison in Exhibit A-1 to offset net stranded costs for 2000 and 2001.

For purposes of resolving this case, the Commission finds that the Staff's approach is reasonable. Detroit Edison's alternative entails a complicated series of additional steps that it attempts to justify by claiming that the revenues computed in Exhibit A-1 do not mitigate stranded costs in their entirety. As established in Case No. U-12639, the purpose of the stranded cost methodology is to identify and assign cost responsibility on the basis of the utility's inability, if any, to recover its embedded system-wide fixed production costs through its current rate structure.

Detroit Edison's approach isolates one component of its revenues—the wholesale sales that use its production resources—and attempts to allocate only a small fraction of those revenues for the benefit of unbundled customers, attributing the remainder to bundled service (which directly boosts its net income during the rate freeze). This approach is inconsistent with the stranded cost methodology, and the Commission therefore rejects it. Moreover, the approach adopted in this order maintains consistency with the treatment of Consumers' third-party wholesale revenues in the December 20, 2002 order in Case No. U-13380. As with previously discussed adjustments that produce a negative transition charge, the Commission is not indicating by its decision on this issue whether or not it would have validity in some future proceeding.

This order does not resolve whether or not to adopt Energy Michigan's additional proposal to include other wholesale revenues that Detroit Edison booked in Account 447, but excluded from the credit computation. The record in this case does not provide much insight into the role that financial hedging and other types of relatively novel transactions play in managing power supply costs or the extent to which those instruments are related to the utility's obligations to provide adequate generation resources at a reasonable cost in light of prevailing market conditions. Even if there was no physical exchange of electricity, that would not be dispositive if the transactions are adequately related to those obligations. Although Detroit Edison contends that it does not currently recover the costs of those transactions through its rates, the present and future rate implications are not that clear. As Detroit Edison acknowledges, its current rate provisions related to power supply costs are a product of a PSCR factor that it implemented for plan year 2000 pursuant to Case No. U-12121. The Commission closed the docket in that case once the Legislature enacted Public Act 141 of 2000 (Act 141), which imposed the current rate freeze. Order dated June 19, 2000, Case No. U-12121, aff'd sub nom Attorney General v Michigan Public

Service Comm, 249 Mich App 424; 642 NW2d 691 (2002). Because the Commission did not adjudicate the 2000 PSCR plan on its merits or conduct a reconciliation, it remains unclear exactly what Detroit Edison does, and does not, recover through its frozen rates.<sup>11</sup>

### Rouge Complex Sales

Detroit Edison made an adjustment to remove \$31 million in revenues from the sales it made in 2000 to the Ford Motor Company and Rouge Steel Company at the Rouge Complex, an industrial site located in Dearborn. Ex. A-21, col. e. The rationale for the adjustment was that the electric service provided that year was temporary and the revenues are therefore nonrecurring.<sup>12</sup> (Because Detroit Edison computes its fixed production cost revenue contribution at the rate of 1.25¢ per kWh based on 2000 revenues, Ex. A-5, the adjustment effectively carries forward to 2001 and future years under its methodology.)

Energy Michigan and the Staff oppose this adjustment, arguing that Detroit Edison made sales to the Rouge Complex in both 2000 and 2001<sup>13</sup> that did in fact recover fixed production costs. Because the sales do not continue after 2001, the Staff concedes that they should not be used in future stranded cost calculations.

The Commission rejects Detroit Edison's adjustments for 2000 and 2001 Rouge Complex sales. As a historical matter, the sales did occur and, as such, they affect stranded cost computations for those years. Moreover, fluctuations in a utility's overall sales, both up and

---

<sup>11</sup> However, there are references to the summer call and option contracts in the 2000 plan that Detroit Edison filed. Case No. U-12121, Prefiled Test. of James H. Byron at 18-19, 28-29 & Ex. JHB-3.

<sup>12</sup> As discussed in the March 12, 2003 order in Case No. U-12980, the Rouge Complex currently receives power through a combination of self-service generation and retail open access.

<sup>13</sup> Sales to the Rouge Complex in 2001 were \$6.4 million. Ex. I-47, at 2.

down, routinely occur from year to year, as customers come and go and alter their usage, for any number of reasons. The loss of Rouge Complex sales<sup>14</sup> after 2001 is different from other changes in customer loads only with respect to the size of the load, but that by itself does not merit a different treatment.

### Transition Charge

In view of the findings set forth above, the net stranded cost computation produces negative balances for both 2000 and 2001. The Commission will therefore retain the zero transition charge that it approved for retail open access service in the December 20, 2001 order in Case No. U-12639. The charge will remain in effect until modified by a future Commission order. A number of the arguments raised by various parties with respect to the transition charge are thus moot in light of the determination that it is appropriate to retain a zero charge and will not be addressed in this order.

Detroit Edison argues that the Commission should state that zero is always the floor for a transition charge, even if the annual computation produces a negative result. It contends that the loss of customers cannot confer a stranded benefit upon the utility. It further argues that a carryforward of a negative balance beyond the expiration of the rate freeze imposed by Section 10d would violate the statute and would be retroactive ratemaking.

Energy Michigan proposes to use the negative balances it computed for 2000 and 2001 to offset securitization surcharges otherwise owed by choice customers. It says that the remaining balances should be carried forward as a reserve against future securitization charges or to fund

---

<sup>14</sup> Detroit Edison continues to receive retail open access revenues from serving the Rouge Complex. It is not clear whether it provides standby or other forms of generation services.

future rate reductions. The Attorney General also supports deferral of negative balances until after the expiration of the rate freeze.

In this order, the Commission will not make findings beyond its determination that the zero transition charge will continue. In view of the record, the Commission is not in a position to compute an exact balance. The findings are necessarily imprecise. To the extent that any of the parties' proposals could affect the future recovery of potential stranded costs, the Commission is not persuaded that it should grant any further relief related to the stranded cost computations for 2000 and 2001. The Commission's treatment of these issues is consistent with similar issues raised in Consumers' stranded cost computation in Case No. U-13380.

Detroit Edison proposes a more fundamental change to the transition charge mechanism. Its proposal would set the transition charge to recover projected costs for 2002, thus eliminating much of the lag in recovery. It contends that a two-year lag between the period when it incurs the costs (2000-01) and it imposes the transition charge (2003) distorts the price signals sent to customers that are considering the economics of unbundled service. Because choice customers may return to bundled service, it says, the lag also jeopardizes the eventual recovery of the costs even on a deferred basis. Detroit Edison also requests that the Commission consider measures that would ensure that choice customers pay transition charges, even if they revert to bundled service.

The Commission is not persuaded that Detroit Edison's proposal to set a transition charge on a projected basis justifies sacrificing the accuracy of reviewing costs after-the-fact. Projections can vary widely on the basis of changes in circumstances that may be unforeseeable from year to year. To require customers to pay projected costs that might be well out of line with actual costs could inflict harm on the development of customer choice. However, the Commission is open to the

possibility of improving the mechanism and would be willing to consider additional modifications or proposals in future stranded cost cases.

#### Securitization and Rate Reduction Equalization

As required by the December 20, 2001 order in Case No. U-12639, Detroit Edison is currently offsetting the securitization and tax surcharges on its customers' bills with an equal credit, so that the net amount of the securitization surcharges and credits they now pay is zero.<sup>15</sup> In addition, retail open access customers are receiving rate reduction equalization credits.<sup>16</sup> Detroit Edison proposes to eliminate the credits related to securitization and rate reduction equalization from its retail access service tariff.

Detroit Edison says that those credits should have expired on January 1, 2002 as provided in the January 4, 2001 order on rehearing in Case No. U-12478, at 5-6. It asserts that there is no justification for extending the credits to choice customers, as they already benefit once from securitization in the form of reduced stranded costs. As such, it continues, the credits discriminate against bundled customers by providing a less favorable treatment of their distribution services and further reallocate cost responsibility among customer classes contrary to MCL 460.10d(6). Detroit Edison contends that if the Commission uses the credits to reduce the charges below zero, it would be engaging in an unconstitutional confiscation of Detroit Edison's property.

Energy Michigan maintains that the negative stranded cost balances are more than enough to cover choice customers' securitization surcharges. It proposes to fund the continuation of rate reduction equalization through accumulations of excess securitization savings and negative net stranded costs. It says that the Commission has the right under Section 10d(6) to use the

---

<sup>15</sup> See supra note 5.

<sup>16</sup> See supra note 6.

securitization savings to fund the credits. It adds that withholding the rate reduction equalization credits could effect a reallocation of cost responsibility among rate classes, contrary to Section 10d(6), by denying choice customers the same rate reduction that their bundled counterparts receive (i.e., equal to a 5% reduction in bundled rates). It asserts that Detroit Edison has no right under Section 10d(6) to retain the excess securitization savings for its own benefit, so that any credit based on them would not qualify as an unconstitutional taking of property.<sup>17</sup>

Kroger and NEMA also support the continuation of the securitization and rate reduction equalization credits. Kroger says that the sources of the funding could be excess securitization savings and the accumulated carryforward of negative stranded cost balances. Contrary to Detroit Edison's claim that choice customers already benefit from securitization, Kroger argues, Detroit Edison serves only its bundled customers with the generation assets that it securitized. Kroger argues that there are no constitutional ramifications, as nothing proposed in this case would destroy the utility's financial integrity or impair its ability to attract capital.

The Staff supports the concept of using excess securitization savings pursuant to Section 10d(6) to offset the charges otherwise payable by choice customers.

The Commission is persuaded that the securitization offsets should be accorded a similar treatment as in Case No. U-13380. In other words, the offsets will be funded by securitization savings pursuant to Section 10d(6). The Commission is also persuaded that the rate reduction equalization credits should remain in effect and should be funded in the same manner. The

---

<sup>17</sup> Energy Michigan also asserts that Detroit Edison diverted \$24 million of the excess securitization savings by impermissibly using them to fund pre-securitization residential rate reductions. However, it does not explain how the available savings shown by Detroit Edison in Exhibit A-24 are inconsistent with the January 4, 2001 order in Case No. U-12478, at 3-5, which authorized Detroit Edison to use the savings to fund the 5% residential rate reduction for the period from the issuance of the financing order in Case No. U-12478 on November 2, 2000 until the issuance of securitization bonds on March 9, 2001.

original rationale articulated for rate reduction equalization in the November 2, 2000 order in Case No. U-12478, at 32-33—to ensure that choice customers receive the same benefit from the rate reduction that bundled customers received when Section 10d of Act 141 became operative—is no less valid at this time.

Securitization savings, to the extent they are available, will provide the funding mechanism for both types of credit. If the excess securitization savings are sufficient to offset the securitization and tax surcharges and to fund the rate reduction equalization credits in their entirety (together with the transition charge, if any), the net charge to retail open access customers will be zero. Any excess savings allocated to reduce stranded costs, but remaining after funding these credits, should be deferred as a carryforward item in future stranded cost determinations. In a case in which the savings are not sufficient to fund the offsets and credits fully, retail open access customers would make up the difference.

In this case, Exhibits A-24 and A-25 indicate that there are \$63.8 million of actual and estimated securitization savings from 2001 through 2003 that have not been designated for other statutorily permissible purposes. (Detroit Edison had proposed to use those savings to bridge the lag in stranded costs incurred two years beforehand and begin collecting a transition charge based on projected 2003 costs and revenues. This proposal is moot in light of the Commission's determination that Detroit Edison did not attain a positive balance of net stranded costs in 2000 or 2001.) The savings are adequate to provide the offsets required in this case to zero out the securitization and tax surcharges and fund the credits required to continue rate reduction equaliza-

tion. Therefore, this order approves an offset in an amount equal to those amounts, with a carryforward of the remaining savings to future years' stranded cost determinations.<sup>18</sup>

Because both bundled and unbundled customers are currently receiving securitization offsets through their rate structures, it is difficult to see merit in Detroit Edison's contention that continuing the offsets for unbundled customers perpetuates discrimination or reallocates cost responsibility. Both types of customers are required to pay in equal measure for the costs of servicing the securitization bonds, even though only the service provided to bundled customers makes direct operational use of the bulk of assets that Detroit Edison securitized. Moreover, the rate reduction equalization credit enables choice customers to receive rate benefits that are comparable to bundled customers.

Although the original intent in Case No. U-12478 had been to sunset the securitization offsets for choice customers after 2001, the Commission extended them into 2002 in the December 20, 2001 order in Case No. U-12639, at 24-26. In that order, the Commission explained that the effects of securitization had yet to be fully reflected in the transition charge and that Detroit Edison had not shown that securitization had benefited choice customers to the same degree as bundled customers. On this record, the Commission continues to lack confidence in the reliability of the stranded cost computations. Thus, it cannot use the methodology as a basis for determining whether any stranded cost balance that it might produce (whether positive, negative, or zero) reflects securitization appropriately. Nor can it determine that the offsets should be abolished on

---

<sup>18</sup> Based on Detroit Edison's projected retail open access load in 2003 (of 6,500,000 MWh), the excess securitization savings necessary to fund the securitization offsets (of 4.24 mills per kWh, see supra note 5) and the rate reduction equalization credits (2.8 mills per kWh for commercial and industrial primary class customers, 4.8 mills per kWh for the secondary class, see supra note 6) would range between \$46 million and \$59 million. The carryforward would be the difference between the estimated available savings of \$63.8 million shown in Exhibit A-25 and the savings used to fund the credits in 2003.

the ground that securitization is demonstrably providing choice customers with the same level of benefits as bundled customers. Moreover, Section 10d(6) empowers the Commission to fund the offsets and credits through securitization savings. Because it is allocating some of those savings for that purpose, Detroit Edison does not incur any financial harm.

The Commission FINDS that:

- a. Jurisdiction is pursuant to 1909 PA 106, as amended, MCL 460.551 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1999 AC, R 460.17101 et seq.
- b. Detroit Edison's retail access service transition charge for 2003 should be zero.
- c. Detroit Edison's retail open access customers should receive a credit in 2003 for excess securitization savings that is equal to the sum of their securitization and tax surcharges and the amount necessary to fund the continuation of rate reduction equalization pursuant to Section 10d(6) of Act 141.
- d. Excess securitization savings remaining after funding retail open access customers' securitization and tax surcharges and rate reduction equalization in 2003 should be deferred as provided in this order.

THEREFORE, IT IS ORDERED that:

A. The retail access service transition charge authorized for The Detroit Edison Company in 2003 shall be zero.

B. The Detroit Edison Company shall issue credits to its retail open access customers for excess securitization savings that are equal to the sum of their securitization and tax surcharges and the amount necessary to fund the continuation of rate reduction equalization in 2003.

C. Excess securitization savings remaining after discharging retail open access customers' responsibility for securitization and tax surcharges and funding their rate reduction equalization credits in 2003 shall be deferred as provided in this order.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

( S E A L )

/s/ Laura Chappelle  
Chairman

By its action of July 31, 2003.

/s/ David A. Svanda  
Commissioner

/s/ Robert W. Kehres  
Its Acting Executive Secretary

/s/ Robert B. Nelson  
Commissioner

THEREFORE, IT IS ORDERED that:

A. The retail access service transition charge authorized for The Detroit Edison Company in 2003 shall be zero.

B. The Detroit Edison Company shall issue credits to its retail open access customers for excess securitization savings that are equal to the sum of their securitization and tax surcharges and the amount necessary to fund the continuation of rate reduction equalization in 2003.

C. Excess securitization savings remaining after discharging retail open access customers' responsibility for securitization and tax surcharges and funding their rate reduction equalization credits in 2003 shall be deferred as provided in this order.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

\_\_\_\_\_  
Chairman

By its action of July 31, 2003.

\_\_\_\_\_  
Commissioner

\_\_\_\_\_  
Its Acting Executive Secretary

\_\_\_\_\_  
Commissioner

In the matter of the application of )  
**THE DETROIT EDISON COMPANY** to )  
implement the Commission's stranded cost recovery )  
procedure and for approval of net stranded cost )  
recovery charges. )  
\_\_\_\_\_ )

Case No. U-13350

Suggested Minute:

“Adopt and issue order dated July 31, 2003 approving a zero transition charge for The Detroit Edison Company in 2003, as set forth in the order.”