

STATE OF MICHIGAN  
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of	)	
<b>THE DETROIT EDISON COMPANY</b>	)	
to unbundle and realign its rate schedules	)	Case No. U-14399
for jurisdictional retail sales of electricity.	)	
_____	)	

At the December 22, 2005 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. J. Peter Lark, Chairman  
Hon. Laura Chappelle, Commissioner  
Hon. Monica Martinez, Commissioner

**ORDER**

**I.**

**HISTORY OF PROCEEDINGS**

On February 4, 2005, The Detroit Edison Company (Detroit Edison) filed an application to unbundle and realign its electric rates for commercial, industrial, and residential ratepayers, along with supporting testimony and exhibits, in accordance with Section 10b(2) of 2000 PA 141 (Act 141), MCL 460.10b(2). In its November 23, 2004 order in Case No. U-13808 (November 23 order), pp. 79-80, the Commission ordered Detroit Edison to file, within 120 days of that date, a new application to unbundle its rates.<sup>1</sup> In its November 23, 2004 order in Case No. U-13286, p. 3, the Commission noted that Detroit Edison should base its unbundling proposal on fully allocated

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<sup>1</sup>The Commission indicated that the application could be combined with a request to adjust rates to remove rate subsidies inherent in its current rate structure. November 23 order, p. 79.

embedded costs, and the scope of unbundling need not be greater than unbundling transmission, distribution, and generation. In its application, Detroit Edison proposes to unbundle its existing tariff rates into their cost-based functional components of power supply and distribution. In addition, Detroit Edison proposes to eliminate inter-class subsidies and eliminate current rate inequalities and imbalances associated with the development of retail open access (ROA or choice).

On March 4, 2005, a prehearing conference was held before Administrative Law Judge James N. Rigas (ALJ). On that date, the ALJ recognized Attorney General Michael A. Cox (Attorney General), the Association of Businesses Advocating Tariff Equity (ABATE), Energy Michigan, The Kroger Co. (Kroger), Wal-Mart Stores, East, LP, Sam's East, Inc., and Kohl's Department Stores, Inc. (collectively Wal-Mart), and Constellation NewEnergy, Inc. (NewEnergy) as intervenors. The Commission Staff (Staff) also participated.

On February 22, 2005, Energy Michigan and ABATE filed a joint motion to strike portions of Detroit Edison's prefiled testimony and exhibits. On March 2, 2005, Detroit Edison and the Staff filed responses opposing the motion to strike. At the prehearing conference on March 4, 2005, the ALJ denied the motion. On March 14, 2005, Energy Michigan and ABATE filed an application for leave to appeal the ALJ's ruling. On March 28, 2005, Detroit Edison, the Staff and Wal-Mart filed responses. On June 1, 2005, the Commission issued an order granting leave to appeal and denying the relief requested.

At an evidentiary hearing on July 29, 2005, the direct and/or rebuttal testimony and exhibits of Detroit Edison, the Attorney General, ABATE, Energy Michigan, Kroger, NewEnergy, and Staff witness Ralph Miller were bound into the record without cross-examination. Staff witnesses

Michael Collins and Daniel Blair were both cross-examined on their direct testimony, which was then bound into the record. The record consists of 552 pages of transcript and 70 exhibits.

On September 1, 2005, initial briefs were filed by Detroit Edison, the Attorney General, NewEnergy, Wal-Mart, Energy Michigan, ABATE, Kroger, and the Staff. On September 12, 2005, reply briefs were filed by Detroit Edison, the Attorney General, Wal-Mart, ABATE, NewEnergy, Energy Michigan, and the Staff.

On October 21, 2005, the ALJ issued a Proposal for Decision (PFD). Exceptions to the PFD were filed on October 31, 2005 by Detroit Edison, the Attorney General, the Staff, ABATE, Energy Michigan, and Kroger. Wal-Mart filed a letter indicating that it would not file exceptions. Replies to exceptions were filed on November 10, 2005 by Detroit Edison, the Staff, Kroger, Wal-Mart, NewEnergy, ABATE, and Energy Michigan. The Attorney General did not file replies to exceptions. The Commission also received comments from several schools and from the Michigan Schools Energy Cooperative.

## II.

### **POSITIONS OF THE PARTIES**

#### **Detroit Edison's Proposal**

Along with unbundling rates, Detroit Edison proposes to phase out ratepayer subsidies. Detroit Edison argues that such subsidies send price signals to customers that are not based upon the fully allocated cost to serve those customers. Detroit Edison maintains that these subsidies, over time, have produced a confusing and outdated rate structure in which residential customers and many choice customers pay less than their cost of service, and commercial and industrial (C&I) customers taking bundled service pay more than their cost of service. Detroit Edison's evidence indicates that residential rates are on average 10-20% below their cost to serve, and C&I

rates are about 10-20% above their cost to serve. However, currently this subsidy is embedded only in full service rates, and not in choice rates. Hence, in addition to subsidizing residential customers, Detroit Edison contends that this price differential yields an unbalanced competitive marketplace by creating artificial economic incentives for certain customers (especially in the small and large business sector) to elect an alternative electric supplier (AES) for their power supply service.

Detroit Edison proposes a regulatory adjustment charge (RAC) to be applied to all customers, to address these subsidies, until such time as rates are fully based on the cost to serve. Detroit Edison maintains that the RAC provides a convenient mechanism for the gradual elimination of subsidies, and avoids the one-time rate shock that residential customers would experience if current rate subsidies were immediately removed. In general, the proposed RAC would operate in the following manner: customers will be charged their tariffed rates, which are based on the cost to serve the customer. However, beginning January 1, 2006, residential customers (choice and full service) will see a negative RAC, or a credit, on their bills, reflecting the subsidy that they continue to receive under the revenues approved in the November 23 order. C&I customers (choice and full service) will see a positive RAC, or a charge, to bring their rates up to the level of the approved revenues. Over time (five years under Detroit Edison's proposal), the residential credit will diminish as that class is brought up to its actual cost to serve, and the C&I charge will diminish as that class is brought down to its actual cost to serve.<sup>2</sup>

Detroit Edison also proposes major modifications to the retail access service tariff (RAST). The RAST is the distribution rate customers pay Detroit Edison when they purchase power supply from an AES. Detroit Edison contends that, while the RAST charges were initially based upon a

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<sup>2</sup>This description does not apply to all C&I customers, as each rate class is different. Customers on Rate D7 (primary), for example, will have a negative RAC.

distribution cost of service study (COSS), bundled rates are not based upon the same COSS, resulting in artificially low RAST pricing for choice customers. As a result, Detroit Edison argues, it loses bundled sales not based on the true economics of providing utility service, but rather because of the artificial price advantage available only to customers that participate in the choice program. Detroit Edison contends that, by switching to choice, C&I customers avoid the inter-class rate subsidies inherent in current non-cost-based full service rates, and they receive an intra-class subsidy because the current RAST is priced below the cost of providing distribution service. Detroit Edison maintains that this artificial RAST pricing was a key factor in the company losing approximately 20% of its retail sales to choice.

Detroit Edison proposes deletion of a major portion of the RAST rate. Those customers previously paying the RAST will pay rates for delivery service based on the overlying applicable base rate schedule. In other words, Detroit Edison proposes that full service and choice customers pay the same distribution rate for the same service.

Detroit Edison realizes that immediate implementation of subsidy-free rates, combined with the end of Act 141 residential rate caps, and the collection in January 2006 of certain deferred costs authorized in the November 23 order, would result in a large rate increase for residential customers. Therefore, Detroit Edison proposes to begin phasing out residential subsidies starting January 1, 2007, and complete the phasing out of these subsidies over a five-year period, ending in 2011. Detroit Edison proposes that the RAC be reduced by 20% per annum from 2007 through 2011. Thus, under Detroit Edison's proposal, all Detroit Edison rates will be brought to cost-based levels by January 1, 2011.

Detroit Edison maintains that its proposal is revenue neutral. Detroit Edison states that its proposed unbundled rates are based upon a fully allocated COSS that is based on the overall

revenue requirements adopted by the Commission in the November 23 order. Specifically, Detroit Edison utilized the Commission's approved tariff revenues, jurisdictional rate base, and jurisdictional revenue requirement inherent in that order as the foundation for this application. Detroit Edison states that it made only four reconciliation adjustments, which it considered necessary to match the revenue requirements to the Commission-approved revenues at the level and format required by Detroit Edison's subsequent COSS allocations. Detroit Edison determined that the total tariff revenues and reconciled associated revenue requirements contained in the November 23 order was \$3,572.57 million (Exhibit A-1, line 36), including securitization revenue of \$219.78 million (Exhibit A-1, line 31). This revenue requirement excluding securitization, \$3,352.79 million, was then used in developing the company's COSS. (Exhibit A-15).

Detroit Edison argues that no additional action is necessary to address effects this deskewing case might have, if any, on the level of participation in the choice program. However, should the Commission deem it necessary to put in place a mechanism to address the possibility that this case could have some effect on the level of choice participation (and possibly on Detroit Edison's earnings), Detroit Edison proposes earnings sharing. Detroit Edison's proposed earnings sharing mechanism (ESM) would require Detroit Edison to return to customers 75% of any earnings over its currently authorized rate of return on common equity of 11%. Thus, Detroit Edison argues, the majority of any such earnings would be returned to customers, while continuing to maintain an incentive for the company to effectively manage costs, through retention of 25% of such earnings. Detroit Edison proposes to file an application by April 30th of each year containing its ESM calculation for the prior calendar year.

Detroit Edison further proposes that any earnings sharing should be used to accelerate the phase out of the C&I RACs, by eliminating the last year, or years, of the RAC for those customers.

To the extent that the RACs have expired, any earnings sharing amounts would be returned to customers as a credit to power supply cost recovery (PSCR) costs. Under Detroit Edison's proposal, the ESM will need to be reconciled.

In its COSS, Detroit Edison relied upon the Staff's exhibits and calculations supporting the November 23 order. The company utilized the historic 2002 COSS filed in Case No. U-13808. The major utility functions used in the COSS functionalization analysis are power supply (generation), transmission, and distribution. Power supply includes costs associated with the company's generating plants, fuel, and purchased power. Transmission is comprised of the expense associated with transmission services provided to Detroit Edison by Midwest Independent Transmission System Operator, Inc., and International Transmission Company. Distribution includes the costs associated with the company's distribution system that generally operates at voltages of 40 kilovolt (kV) and below, and includes customer service expenses. Based upon the Uniform System of Accounts, which serves as the basis for categorizing costs as either direct or indirect, Detroit Edison assigned operation and maintenance (O&M) costs in accounts associated with providing customer service to distribution, because they are incurred regardless of whether a customer receives power supply from Detroit Edison or an AES.

Detroit Edison utilized the standard filing requirements set out in the May 10, 1976 order in Case No. U-4771, which established the requirement for allocation of production and transmission plant costs based on 75% of the average of the sum of the 12 monthly coincident peak (CP) demands throughout the year, and 25% energy. Under this cost allocation method, known as 12CP 75/25, production plant is allocated based on a rate class' average of its 12 monthly contributions to the monthly system peaks. Detroit Edison argues that its COSS process presents a fair and reasonable allocation of the costs incurred by it in rendering service to its customers, because it is

based upon the November 23 order, workpapers from the Staff in support of that order, and long-standing cost of service principles.

Detroit Edison proposes to unbundle transmission, distribution, and generation in its cost of service, but has recombined transmission and generation into power supply for purposes of its proposed unbundled rate design. Detroit Edison posits that transmission should be included in power supply because it is no longer offered as a discrete service to the end-user (of any class), and is generally a relatively small portion of the total power supply cost. Detroit Edison avers that most, if not all, power supply service offerings include transmission bundled with the generation price. Including transmission in power supply also makes it easier, Detroit Edison argues, for the customer to compare the power supply price offered by Detroit Edison to that of an AES. Detroit Edison points out that the November 23 order included transmission in PSCR costs.

Detroit Edison proposes that customers who currently are billed under a structure that includes energy only, service charge and energy, combination service charge/demand/energy, time-of-day, etc., will continue to be billed under a similar rate structure under Detroit Edison's proposed unbundled tariffs. Detroit Edison argues that doing so minimizes the adverse rate effects. Unbundled rates will be implemented that maintain the relationships that currently exist, in total, between rates. The company has also applied the same securitization charge and nuclear decommissioning surcharge for all rate classes in its proposal. Following unbundling, all full service customers will pay a power supply charge (including transmission), a PSCR charge (if applicable), and a variety of distribution-related charges (service charge, delivery charge, decommissioning charge, securitization charge, and RAC). Similarly served full service and choice customers will be responsible for the same distribution-related charges. For all residential customers, Detroit Edison has limited the post-subsidy phase out rate change to a 5 percentage

point difference from the class average (e.g., if the class average change is 13%, individual residential tariff changes will range from approximately 8-18%).

Detroit Edison proposes to modify Rate No. D1, which is an inverted residential energy rate, to unbundle it and maintain a flat generation rate and an inverted distribution rate. The company further proposes that, in 2006, a percentage-based revenue requirement adjustment (RRA) will be applied to unmetered bills. The RRA is an adjustment that brings unmetered rates to cost-based levels. A percentage-based RAC will also be applied so that in 2006 the unmetered customers' rate levels will remain unchanged from that adopted in the November 23 order. The percentage-based RAC is proposed to be phased out beginning in 2007 (as with the other RACs). Finally, Detroit Edison proposes to eliminate the current primary pumping rate (Rate E4) because no customers have been served on this rate for the last five years.

Detroit Edison requests that the Commission approve its Exhibit No. A-26, "Summary of U-13808 and Proposed Unbundled Revenue," showing the unbundled revenue of each of Detroit Edison's rate classes; Exhibit No. A-27, "Proposed Regulatory Adjustment Charge (RAC) 2006-2011," showing Detroit Edison's proposed phase out of the RAC over five years; and Exhibit No. A-30, "Proposed Tariff Sheets," showing all the changes Detroit Edison is proposing in order to unbundle its rates and remove subsidies, inequalities, and imbalances. Detroit Edison requests 30 days to implement the unbundling.

#### The Staff's Position

The Staff supports realigning Detroit Edison's traditional rate design, in order to afford head-to-head competition on the power supply component of the purchase of electricity. The Staff argues that this case represents an opportunity for the Commission to level the playing field for Detroit Edison and AESs, without the distractions and complications of a rate case.

The Staff posits that determining the degree of rate skewing is largely dependent on a properly conducted COSS. The Staff argues that aspects of the standard filing requirements set in the May 10, 1976 order in Case No. U-4771 are outdated and should be modified, in order to more accurately reflect each class' cost responsibility, particularly in the area of power supply costs. Additionally, the Staff is asking the Commission to establish a new economic development rate, Rider 9, and to modify Detroit Edison's time-of-day rate to allow more residential customers to take advantage of lower rates in exchange for using less energy during peak periods.

The Staff recommends that Detroit Edison's rates be unbundled in the manner proposed by the company. The Staff also supports the proposal to establish a single RAC for each rate class in order to address skewing, and to apply the RAC to full service and choice customers alike. The Staff supports Detroit Edison's proposal to merge the choice customers with the full service customers for purposes of setting rates, and points out that no party opposes this proposal. The Staff recommends that Detroit Edison be given 30 days to implement unbundling of rates.

The Staff argues that attributing a portion of the RAC to generation costs, as some parties argue, is a fiction designed to allow customers choosing an AES to avoid paying their fair share of the rate skewing. The Staff contends that the RAC is the difference between the costs allocated to a rate class and the revenue generated through the rates charged to that class, and that all parties appear to agree on this definition. Thus, by definition, the Staff argues, the RAC is not associated with an allocated share of generation costs. The Staff argues that customers should only be able to avoid Detroit Edison's power supply costs by choosing an AES. The Staff contends that any claim that the COSS can be used to dissect the skewing is a thinly-veiled attempt to retain an economic advantage for AESs.

The Staff recommends that the Commission address skewing, but does not believe that it should be done as aggressively as the Detroit Edison proposal requires. The Staff proposes a two-step approach to reducing the RAC charges. In the first step, the Commission would reduce the RAC by 10% per year beginning in 2007. In the second step, the Commission would direct Detroit Edison to file another rate realignment case or general rate case in 2007, using 2006 actual operating results. At that time, the Commission could establish a long-term plan to address any remaining rate skewing, based on a COSS that incorporates a revenue requirement utilizing a more current test year (2006, rather than 2002) and sales level. The Staff believes that this more cautious approach allows for gradual change, in the context of the removal of residential rate caps and the relief granted to Detroit Edison in the November 23 order.

Further, the Staff points out that the COSS produced by Detroit Edison in this case does not enjoy universal support among the parties, and that it may be advisable to proceed cautiously while relying on it. The Staff also points out that the sales mix and revenue requirements for this case are not current. The Staff notes that any rate realignment that occurs as a result of this proceeding will also affect the measure of skewing. The Staff points out that Detroit Edison's evidence shows that choice sales have declined following issuance of the November 23 order, and may decline further. The Staff contends that there is simply not enough information in this record to allow the Commission to assess these effects and establish a full deskewing schedule.

The Staff presents an analysis of the potential effect that removal of rate caps and full immediate deskewing would have on most residential customers, showing that Rate D1 rates would increase by 20% under the Staff's analysis, and 22% under Detroit Edison's. (Attachment A to the Staff's brief.) The Staff points out that some skewing is consistent with a policy of ensuring the universality and affordability of utility service to residential customers, and that these

types of increases severely erode that policy. The Staff recommends that Detroit Edison begin to reduce the RAC for each class by 10% in 2007 and continue to do so at the beginning of each calendar year until directed to do otherwise by the Commission.

The Staff further recommends that no ESM be established at this time. The Staff recommends that the Commission direct Detroit Edison to include in its 2007 rate realignment or general rate case a report on the effect of customer migration between full service and choice, including the number of customers and amount of sales volumes that have shifted, and the associated revenue effect. The Staff recommends that the Commission address this issue, if necessary, at that time, with the advantage of having actual results on which to base any decision. If the Commission chooses to adopt the ESM, the Staff recommends a refund of 90% of excess earnings to customers.

The Staff recommends modifications to the COSS, in order to establish the proper cost components for unbundling. The Staff argues that changes in the electric utility industry over the last 30 years – especially the increasing reliance of electric utilities on purchased power and the development of ROA – necessitate changes to the traditional methods for allocating power supply costs in a COSS. The Staff recommends a change from the traditional 12CP 75/25 method of classifying and allocating production and transmission costs to a method described as the multi-hour 4 coincident peak (MH4CP), 25% demand/50% on-peak energy/25% energy method, or MH4CP 25/50/25. *See*, Exhibits S-3, S-7.

First, the Staff advocates a change from the 12CP method for allocating costs classified as demand-related to a multi-hour 4CP method. The period used is the 8 hours from 1:00 p.m. to 9:00 p.m. on the peak day in each of the four summer months, June through September. Second, the Staff recommends that the 75% of production costs currently classified as related to demand should, instead, be classified as 25% related to demand and 50% related to on-peak energy use.

On-peak period average demand for this purpose would be the hours from 7:00 a.m. to 11:00 p.m. This covers approximately 4,000 daytime and evening hours on weekdays. The remaining 25% of generation plant costs would continue to be classified as related to energy, as under the old method. The Staff argues that it is not reasonable to assume that 75% of generation costs are incurred in an effort to meet only peak capacity need. The Staff contends that the peak above base load is not that expensive to meet from a generation or purchased power standpoint. The Staff points out that base load is spread over a very large energy requirement that is there even when system demand is not at its peak. The Staff argues that, out of the 8,760 hours in a year, only a very few hours require Detroit Edison to use its maximum generating capacity, and this is met through relatively inexpensive peakers. The Staff advocates the use of average demands, which it asserts is better reflected in the 25/50/25 mix.

The Staff recommends rejection of ABATE's recommendation to adopt a 4CP 75/25 method, which utilizes the 4 peak hours of the summer months of June through September. The Staff argues that this assigns 75% of Detroit Edison's \$1.8 billion of generation costs to 4 hours out of 8,760 hours of production. The Staff asserts that this is mistaken, because it ignores the low cost of that energy. The Staff advocates a broader measure of class usage, which takes into account the generation plant costs associated with that period of the day.

The Staff also argues that ABATE and Energy Michigan's proposals to allocate securitization and nuclear decommissioning costs among customer classes the same way that generation plant is allocated are unreasonable and unlawful. The Staff points out that both ABATE's and Energy Michigan's proposals would reverse decisions that the Commission has already made with respect to the proper recovery of these costs, and would violate the requirement of Section 10h of 2000 PA

142 (Act 142) that securitization charges are nonbypassable. MCL 460.10h(f). The Staff recommends that these charges be allocated on the basis of total energy.

The Staff recommends that the Commission direct Detroit Edison to participate in a collaborative process with the Staff, Consumers Energy Company (Consumers), and other interested parties, to develop a standardized COSS model to be incorporated into the filing requirements for electric utilities within 12 months of the date of this order. The Staff advocates an electronic format that would allow parties to readily verify complex calculations and exchange information more easily.

The Staff recommends that the Commission approve its proposal for Standard Contract Rider No. 9 – Economic Development Rate (Rider 9). The Staff believes that Rider 9 will help boost job creation in Michigan. Rider 9 would be available for all new load of 1 megawatt (MW) and greater from either existing or new customers who would otherwise be on Detroit Edison’s Rate D6 or Rate D6.1. Rider 9 would be applied for three years beginning on the contract date. The monthly rate charged would be the same as under those rates, discounted or credited by any applicable positive RAC. Each year, as the RAC phases out, the discount to customers on Rider 9 would similarly phase out. Customers on Rider 9 would be required to certify to Detroit Edison that the load to be served was new load not served by the company prior to January 1, 2006,<sup>3</sup> and not resulting from a business closure, sale, or relocation of work from another facility in Michigan. Rider 9, as proposed, would not be available for new or expanded facilities under construction. Load under this rate will be separately metered, with customers paying the additional metering costs. The Staff recommends that the company submit an annual report to the Staff detailing

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<sup>3</sup>The Staff later agreed with ABATE’s recommendation to change this date to January 1, 2005. Detroit Edison requested that the effective date be July 1, 2005.

customer participation and an analysis of the effectiveness of the rate. The Staff suggests that Rider 9 could be reviewed in Detroit Edison's next rate realignment case.

The Staff also proposes that Detroit Edison's residential time-of-day service rate, Rate D1.2, be modified to increase its availability from 5,000 customers to 10,000 customers, so that more residential customers who are willing to modify their energy usage patterns can achieve these savings. The Staff also requests that the Commission require the company to adopt a program to more aggressively inform its residential customers of the existence of this rate.

The Staff disagrees with ABATE's proposal to modify Rider 2 to allow customers to choose to purchase the portions of Detroit Edison's distribution facilities that are installed in order to accommodate Rider 2 customers. In the Staff's opinion, if Detroit Edison were to sell this equipment, both the company and the customer would then own equipment in the same structure, raising problems with maintenance, accessibility, liability, operation, and safety, as well as with potential cost effects on other customers.

The Staff also disagrees with the 'headroom' analysis (referring to the cost savings associated with choice) offered by Energy Michigan. The Staff argues that under the proposed unbundling rate structure, which includes a single RAC for each rate class, it is not necessary for the Commission to undertake a headroom analysis. The Staff views this as an attempt to obtain concessions on either rate design or cost allocation. The Staff recommends that the Commission reject Energy Michigan's proposal to impute revenues for the discounts built into Detroit Edison's Rate D7, arguing that it is simply an attempt to re-litigate an issue that was settled in Case No. U-13808.

### The Attorney General's Position

The Attorney General urges the Commission to apply the same standards in this case as it would in a general rate case, and establish just and reasonable rates. The Attorney General points out that numerous rate changes, causing revenue changes, may occur as a result of this case. The Attorney General contends that this is why Detroit Edison has proposed the ESM, which, the Attorney General argues, would allow the company to earn more than the rate of return authorized in the November 23 order.

The Attorney General contends that Detroit Edison did not perform a traditional COSS in this case, and that, because this case is founded upon the historical 2002 test year used in the November 23 order, the proposed rates are out-dated and will not accurately reflect conditions in 2006. The Attorney General contends that to rely on 2002 data does not constitute just and reasonable ratemaking. The Attorney General requests the Commission to restrict rates approved in this case to 2006 and 2007 only, and order a new rate case review commencing after the close of 2006.

The Attorney General contends that full deskewing is not justified, and that the Commission should adjust the amounts reflected in Exhibits A-15 and A-26 through A-30 to reflect the whole record regarding cost allocation. The Attorney General identifies approximately \$83 million less in skewing than the company does, but does not support raising residential rates to deskew any of that amount. The Attorney General argues that public policy supports maintaining affordable and universally available electric service for residential customers (who will already be facing increased rates in 2006), and that residential customers present a lower business risk than C&I load. The Attorney General urges the Commission to look beyond cost-causation when setting rates, and argues that policy reasons support shifting any difference between current rate revenues

and cost-based rate revenues from power supply rates to distribution rates. The Attorney General opposes any other skewing adjustment.

The Attorney General argues that Detroit Edison's COSS ignores many ratemaking factors. With respect to the allocation of generation costs, the Attorney General proposes a new method, which allocates Detroit Edison's non-fuel generating costs using allocators for production plant investment that are a composite of 70.2% energy, 25.5% CP, and 4.3% four summer CPs. Production plant O&M costs would be allocated by plant category, which results in 71.4% base load, 27.5% cycling allocated by 12 CPs, and 1.1% peaking allocated on the basis of summer CPs. *See*, Exhibit AG-1, Schedule 1. Like the Staff, the Attorney General maintains that Detroit Edison's traditional 12 CP 75/25 method ignores the size and nature of the company's generation costs, and the nature of how customers receive and use electricity from the various power plants. The Attorney General recommends that the Commission adopt either his or the Staff's proposed COSS method.<sup>4</sup>

In reply to ABATE's and Energy Michigan's arguments regarding the allocation of nuclear decommissioning costs, the Attorney General points out that Detroit Edison, the Staff, the Attorney General, and the Commission's previous orders have all adopted the per-kilowatt hour (kWh) method. ABATE and Energy Michigan argue that these costs should be treated and allocated in the same manner as generation costs. The Attorney General points out that no evidence shows that decommissioning costs vary significantly in proportion to demand or capacity, and that the main value received by customers for the Fermi 2 plant is the amount of reliable electricity that

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<sup>4</sup>The amounts allocated to generation costs by the various COSS methods do not differ greatly. Detroit Edison proposes to allocate \$734,327,000 to generation costs (Exhibit A-15, p. 5); the Attorney General proposes to allocate \$717,487,000 (Exhibit AG-1, Schedule 11); and the Staff proposes to allocate \$697,716,000 (Exhibit S-3, p. 1, col. (d)).

it can produce at very low cost. The Attorney General argues that these facts justify continuing the per-kWh allocation of these costs.

With respect to ABATE's and Energy Michigan's proposed reallocation of securitization costs, the Attorney General points out that securitization costs have been removed from Detroit Edison's rate base, and are not included in the company's net operating income; therefore, they are not part of the company's cost of service/revenue requirements. The Attorney General argues that once a cost has been securitized, Sections 10h(f), 10h(i), and 10i(4) of Act 142 make that charge nonbypassable, which is defined as a charge payable by a customer regardless of the identity of the customer's electric generation supplier. MCL 460.10h(f), 460.10h(i), and 460.10i(4). The Attorney General asserts that this is a bar to applying cost of service principles to securitization charge revenue requirements in a COSS.

As to the allocation of distribution costs, the Attorney General argues that cost causation should be measured by determining to what extent critical variables (such as number of customers, energy consumption, diversified peak demands, and class contribution to system peak demand) affect a utility's costs. The Attorney General claims that the voltage level at which customers take power and the geographic distribution of customers overwhelmingly account for the level of distribution costs that Detroit Edison incurs, with the principle cost driver being the distance that a line must cover. The Attorney General recommends allocating most distribution costs to customer classes on the basis of the value of service that is measured by the kWh of energy billed. The Attorney General supports the generation allocations presented by the Staff in Exhibit S-3, or by himself in Exhibit AG-1, but contends that the Commission should reduce that amount of skewing to reflect the distribution cost reallocation. This would reduce the residential skewing by \$64,460,000, from \$172,442,000 to \$107,982,000.

The Attorney General opposes the adoption of any ESM in this case, contending that the Commission should restrict the rates that it approves in this case, and should order Detroit Edison to file a new general rate case as soon as possible after 2006.

### Energy Michigan's Position

Energy Michigan contends that the proposed RAC is nothing more than a mechanism to recover above-cost revenue that would otherwise be lost if retail customers moved to choice service. Energy Michigan contends that this "lost revenue" approach to eliminating competition has been repeatedly rejected by the Commission. Energy Michigan contends that the proposed RAC charges are not stranded costs, are not based on cost of service, and will create uneconomic incentives for choice customers to abandon choice service. Energy Michigan contends that Detroit Edison's proposed RAC charges are so large (Energy Michigan estimates them to be about 6-20% of a choice bill) that choice customers could not pay these new fees and still save money. Energy Michigan contends that this is partly because choice customers are already paying generation-related securitization and nuclear decommissioning costs that add 5-10% to the total choice bill. Application of the RAC to choice customers, in addition to securitization and nuclear decommissioning costs, would therefore increase, Energy Michigan argues, the subsidy paid by choice customers to cover costs of retail generation. Energy Michigan argues that this reveals that the Commission is biased towards subsidies that advantage retail service against choice service.

With respect to rate structure, Energy Michigan asserts that there is widespread agreement regarding the need for an unbundled rate structure that would provide one uniform set of distribution charges applicable to all full service and choice customers. Energy Michigan proposes that distribution and generation rates should include separate RACs in the amount by which the current separate generation and distribution rates exceed costs of service. Energy Michigan asserts

that choice customers should pay the same distribution charges (including any distribution RAC) paid by full service customers; and the generation RAC should be billed only to full service customers.

Energy Michigan asserts that recent dramatic swings in Commission policy on calculation of stranded costs and assessment of new charges has been damaging to retail and choice service options alike. Energy Michigan presents a new concept to resolve these uncertainties, which it argues will stabilize and rationalize the calculation of stranded costs.

Energy Michigan's stranded cost concept requires allocation of all generation-related costs, including generation, the generation-only RAC, securitization, nuclear decommissioning, and PSCR costs, to the generation rate charged to retail customers. Under Energy Michigan's proposal, all of these generation revenue requirements would be removed from the distribution service rates charged to full service and choice customers. Rates would be set to collect these generation costs from full service customers assuming the levels of full service and choice sales adopted in the November 23 order. Energy Michigan proposes that, if generation revenues from full service rates, full service RACs, nuclear decommissioning, securitization, and PSCR sources are insufficient to cover the Detroit Edison generation revenue requirement, the balance would be collected from choice customers in future PSCR cases as a stranded cost. Energy Michigan opines that such a situation would occur if choice sales increased above rate levels set in the November 23 order, PSCR revenue declined, or full service sales declined.

If its proposal is not adopted, Energy Michigan urges the Commission to order that all revenue from third party sales, net of PSCR costs, be used as an offset to the generation-related charges (which it describes as securitization, stranded cost, and nuclear decommissioning charges) assessed to choice customers.

Energy Michigan urges the Commission to either disapprove the Staff's below-cost existing D7 rate and the Staff's proposed new economic development rate, or require that all discounts granted be recovered from shareholders rather than customers, by imputing revenue to these rates at retail levels. Energy Michigan asserts that it would be totally illogical for the Commission to continue subsidized rates while at the same time applying RAC charges to choice customers to eliminate unproven subsidies and drive choice competitors out of business.

Energy Michigan recommends that RAST Section 5.3.1 be revised to give choice customers four months after issuance of an order in this matter to notify the utility of their intent to return to bundled retail service and allow 30 days notice thereafter. Energy Michigan further suggests that Detroit Edison's choice load profiling charges should be eliminated because they are not justified by cost. Energy Michigan recommends that the approaches discussed in the Case No. U-13808 metering collaborative should be implemented for Detroit Edison in this case, and new load profiles and imbalance settlement procedures should be adopted.

Energy Michigan urges the Commission to reject Detroit Edison's proposed inverted residential distribution charge. Energy Michigan argues that the inverted rate proposal increases the cost of residential distribution service and artificially lowers generation charges. Energy Michigan asserts that, by shifting the generation costs paid by full service residential customers to distribution costs paid by full service and choice customers, Detroit Edison's proposal would permanently make choice residential service uneconomic. Finally, Energy Michigan urges the Commission to require new uniform COSS methods to be developed in a collaborative incorporating input from AESs.

### NewEnergy's Position

NewEnergy supports the 12CP methodology proposed by Detroit Edison, because it was used in setting the rates that are now being unbundled, and because change would lead to inconsistency and confusion. NewEnergy also supports the proposal for uniform distribution charges to be applied to choice and full service customers. However, NewEnergy urges the Commission to reject the single RAC. NewEnergy asserts that the RAC, as proposed, overcorrects the rate-skewing problem, and contains generation-related costs that should not be applied to choice customers. NewEnergy argues that the RAC will result in choice customers subsidizing full service customers. NewEnergy suggests that the proposals of ABATE and Energy Michigan, which include the development of two distinct RACs (one for generation and one for distribution), provide a better solution. If a RAC is adopted, NewEnergy supports the Staff's proposal to phase out the RAC in 10 years, rather than the shorter periods suggested by other parties. NewEnergy argues that a longer transition period will protect customers from rate shock.

Finally, NewEnergy urges the Commission to take careful note of Detroit Edison's collection of securitization and nuclear decommissioning surcharges from choice customers. NewEnergy argues that it is inequitable to require choice customers to subsidize generation costs because they do not purchase generation from Detroit Edison and because both securitization and nuclear decommissioning costs are associated with the provision of generation service to full service customers. NewEnergy urges the Commission to consider an offset for these charges for choice customers.

### Kroger's Position

Kroger supports Detroit Edison's proposal to deskew rates, with some adjustments. Kroger seeks a three-year time period to complete deskewing. Kroger asks the Commission to bear in

mind that commercial customers such as itself, who are paying the subsidy that results in the skewing, have already experienced the end of their rate cap period and are paying higher rates. Kroger argues that relief to these customers should not be delayed simply because residential customers experience the end of their rate cap at a later date. Kroger recommends reducing the gross amount of the inter-class subsidy by 22% at the beginning of 2006. Kroger recommends phasing out the subsidy in three years by reducing the remaining subsidy by one-third in 2007 and 2008, and eliminating it entirely in 2009.

Kroger recommends setting the RAC for choice customers at a rate that recovers only the distribution-related portion of the subsidy. Kroger argues that the proposed RAC is in effect a new stranded cost charge because some portion of the RAC proposed for choice customers includes generation costs. Using Detroit Edison's COSS, Kroger calculates that the distribution-related portion of the subsidy is 51% of the otherwise applicable RAC for full service customers.

Kroger urges the Commission to reject any change to the cost of service methodology, which has been in place for nearly 30 years. Kroger asserts that the Staff has failed to show that a new allocation is warranted. Kroger contends that the Staff has not shown how the development of a competitive market and the increased use of purchased power make the new allocation more reasonable than the established one. Kroger argues that the new method is based upon the false assumption that rather than having assembled its current generation fleet, a utility just as easily could have opted to serve its highest maximum loads using combustion turbines. Kroger asserts that this is a simplification that ignores the realities of planning.

#### Wal-Mart's Position

Wal-Mart also proposes a shorter timetable for moving to full cost of service rates. Wal-Mart contends that rate skewing has a negative effect on Michigan's business climate. Wal-Mart urges

the Commission to phase out 50% of the remaining residential skewing in January 2007, and the other 50% in January 2008. Under this plan, all inter-class rate subsidies would be eliminated by January 1, 2009. Wal-Mart also supports the merging of choice customers' distribution rates with full service customers' rates, so that distribution pricing and the distribution RAC are the same for both full service and choice, but suggests that this merger be phased in over the same three-year time period in which skewing is phased out. Wal-Mart argues that equity requires that choice customers be given the same time to adjust to a change in costs as those customers who will experience rate changes as a result of deskewing.

Wal-Mart also advocates the bifurcation of the RAC into a generation RAC and a distribution RAC. Wal-Mart asserts that Detroit Edison's proposed RAC has generation costs embedded in it, which choice customers should not be paying. Wal-Mart also supports retention of the standard filing requirement of 12CP 75/25 for the allocation of fixed generation costs, because the Commission has many years of experience with it. Wal-Mart asserts that the Staff has not made a compelling case for change.

#### ABATE's Position

ABATE recommends allocating fixed production costs in the COSS using a 4CP 75/25 method (June to September). ABATE argues that the method of allocating fixed costs associated with generation and bulk power transmission should be based on the load characteristics of the utility. ABATE points out that Detroit Edison is a summer peaking utility and the demands that occur during this period cause the need to add capacity and energy. ABATE points out that Detroit Edison's proposed rates, such as Rates D6.1, D7, and D8, contain explicit demand charges and ratchets that provide that the on-peak billing demand in any month cannot fall below 65% of the highest demand created during the June through September period, and that the company's

COSS should recognize this fact. ABATE argues that the 4CP method is preferable because it provides a better indication of current cost-causation on Detroit Edison's system, is conservative, covers the entire summer, will send more accurate price signals, and will be relatively stable.

ABATE argues that securitization and nuclear decommissioning costs should be allocated using a 75/25 allocator rather than on an energy-only basis, since they represent fixed generation-related costs. ABATE points out that nearly 85% of the securitized costs are directly related to the investment in Fermi 2, and had these costs not been securitized, they would have been allocated using a 75/25 allocator.

ABATE argues that the RAC should be phased out over a three-year period, rather than the five years recommended by Detroit Edison, or the longer period recommended by the Staff. ABATE argues that eliminating residential subsidies over a three-year period will only increase residential rates by approximately 6% per year, based on ABATE's proposed 4CP 75/25 method. ABATE characterizes this amount as manageable, in light of the residential subsidy that has been enjoyed for years. ABATE also argues that the RAC should be separated into generation service and distribution service. ABATE charges that the RAC as proposed, rather than leveling the playing field, will require choice customers to subsidize full service customers. ABATE argues that generation accounts for 56% of the total cost to serve and distribution accounts for 44%. ABATE argues that choice customers currently support Detroit Edison's generation costs through the securitization charges, and to place the proposed RAC on choice customers would require them to pay even more generation-related costs. ABATE supports the concept of having both the base distribution charge and the distribution-only RAC be the same for both full service and choice customers.

ABATE contends that the level of choice sales is declining, and that the RAC, as proposed, will cause it to decline further. ABATE argues that a migration of choice customers to full service could reward Detroit Edison with excess revenues of approximately \$243 million. ABATE proposes that such increased revenue be used to reduce the RAC for those classes that have a positive RAC. ABATE proposes that the company file a report on its choice sales load by the end of September of each year for rates D3, D4, and D6, and if choice sales are less than the level assumed in Case No. U-13808, then the fixed power supply charges associated with the returning choice customers should be utilized to reduce the RAC for the next calendar year, thereby moving the C&I rate classes to cost of service sooner.

ABATE proposes changing Rider 2, to allow customers to purchase the additional equipment provided for under Rider 2 at the original cost, less depreciation.

ABATE supports the concept of Rider 9 as proposed by the Staff, but opposes the availability criteria first proposed. ABATE proposes that the new rate be available to all customers who add load after January 1, 2005, and that new loads need not be separately metered, but rather Detroit Edison and its customers could negotiate the energy or demand usage that would be excluded for that RAC for service taken under Rider 9.

ABATE urges the Commission not to approve the Staff's proposed change to the COSS, arguing that the Staff's method relies on marginal costs rather than fully embedded costs. ABATE argues that there is no reason to depart from the sound, fundamental ratemaking method used by the Commission for 30 years (however, ABATE proposes its own change). ABATE contends that the energy allocation contained in the Staff's proposal sends a message that Michigan intends to overcharge industrial customers.

Finally, ABATE contends that Detroit Edison's proposed distribution rates for Rates D6, D6.1, D7, and R10 are excessive for transmission and subtransmission service. ABATE points out that the rate design for these rate classes is driven in large part by the direct assignment of the industrial substations; but that a review of the COSS indicates that these classes were not allocated any Rider 2 revenue offsets, although the Rider 2 revenues are paid by customers to support the investment in the substations. ABATE recommends use of the charges proposed in its Exhibit AB-4.

#### Exceptions and Replies to Exceptions

Detroit Edison proposes to eliminate skewing over a five-year time period, by imposing a single RAC on each rate class. The RAC represents the difference between the revenue currently generated by that class and the actual cost to serve that class. The RAC, as proposed by the company, would begin on January 1, 2006, and would be phased out by 20% per year beginning each calendar year, until the RAC is eliminated on January 1, 2011.

The Staff and Detroit Edison propose that a single RAC should be calculated for each rate class and should be applied equally to both choice and full service customers within that class. The intervenors (with the exception of the Attorney General) charge that the RAC, as proposed, must necessarily have both a generation and distribution component, and that it is unfair to burden any choice customer with a RAC that contains a generation component. These intervenors agree that the present subsidization of choice customers by full service customers with respect to distribution charges should cease, but argue that the proposed RAC simply imposes a new subsidy flowing in the other direction. The intervenors advocate a RAC for choice customers that includes only a distribution component, with the entire generation-related RAC borne by full service customers.

The ALJ was not persuaded by the Staff's characterization of the RAC as simply a measure of skewing not associated with any particular type of cost. The ALJ found that the cost to serve necessarily contains a generation component, and the existing revenue levels set in the November 23 order also necessarily contain a generation component. Hence, the ALJ found, any RAC based upon the gross residential subsidy and charged to a choice customer unfairly burdens the choice customer with a generation-related cost. The ALJ also expressed the opinion that choice customers currently indirectly subsidize service to full service customers at some level through the imposition of securitization charges. The ALJ held that choice and full service customers should not be charged the same RAC. The ALJ found the allocation prepared by ABATE to be the most straightforward and simple for purposes of this case. The ALJ found that a generation RAC and a distribution RAC should be determined by using the 56% generation/44% distribution allocation produced by ABATE, and recommended that this allocation be revisited in future proceedings.

Detroit Edison takes exception to the ALJ's bifurcation of the RAC, and disagrees with the proposed 56/44 allocation between generation and distribution. Detroit Edison argues that, if the RAC is to be bifurcated, ABATE provided no evidence on which to base its simplistic assumptions about allocation. Detroit Edison also insists that any bifurcation of the RAC will lead to an undercollection of revenues because of the resulting incentive to switch to choice service, and will constitute a new subsidy for the choice program. Detroit Edison argues that if the Commission chooses to bifurcate the RAC, it must correct ABATE's allocation method by removing PSCR costs, securitization, and nuclear decommissioning charges from the allocation. Doing so renders, according to the company, a generation allocation of 45.6% and a distribution allocation of 54.4%, which must be applied to the RAC revenue. Detroit Edison argues that a

three-year phase out period must be adopted rather than the five-year period it first proposed. The company also takes exception to the ALJ's characterization of choice customers' payment of securitization charges as a form of subsidy to full service customers, pointing out that rates based upon that principle would be illegal in Michigan.

In its exceptions, Energy Michigan argues that the last few years have seen an unbroken series of rate increases for choice customers, and states that the addition of a RAC containing a generation charge will kill the choice program. This, in turn, Energy Michigan argues, will cause substantial rate increases for full service customers, because Detroit Edison will have to make unanticipated additional capacity purchases at higher prices to serve the migrating choice customers.

Energy Michigan supports the ALJ's finding that the RAC should be bifurcated, but disagrees with the allocation of generation/distribution recommended by the ALJ. Energy Michigan contends that setting a uniform allocation across the board will produce inaccurate rates for larger customers. Energy Michigan insists that separate choice distribution RACs should be calculated for each rate by multiplying the total generation and distribution RAC by a percentage based on the portion that distribution costs comprise of total power and distribution costs for each rate class. For example, distribution costs are a greater percentage of rates for residential customers than they are for large C&I customers, and Energy Michigan contends that this difference should be taken into account in designing each bifurcated RAC charge. Citing to Exhibit A-14R, Energy Michigan points out that, for example, for Rate D3 (small commercial), total distribution costs are about

52% of total costs, but for Rate D6 (large industrial), they are about 31%. Thus, Energy Michigan argues that the ABATE calculation adopted by the ALJ unfairly penalizes large customers.<sup>5</sup>

In their replies to exceptions, Kroger, Wal-Mart, ABATE, and NewEnergy support Energy Michigan's recommended revisions to the ABATE proposal.

In its replies to exceptions, the Staff disagrees with the ALJ's bifurcation of the RAC. However, the Staff argues that if the Commission orders a bifurcated RAC along the lines of generation (power supply) and distribution costs, then it should be based on the ratios inherent in residential customers' generation and distribution costs. The Staff argues that, since the vast majority of the subsidies associated with skewing are due to the residential customers' rates being set below their fully allocated cost of service, then the generation and distribution RAC components should be established in proportion to the residential customers' generation non-fuel<sup>6</sup> and distribution costs, rather than in proportion to the company's total jurisdictional components as presented by Detroit Edison, or as separate RACs for separate rate classes as presented by Energy Michigan. The Staff offers an analysis of the various generation/distribution components of the RAC, depending on whether the Staff's or Detroit Edison's recommended COSS is used. Relying on residential customers' costs only, and applying the Staff's proposed COSS method, the Staff finds that the correct allocation is 34.2% generation/65.8% distribution. *See*, Commission Staff's Replies to Exceptions, Attachment A, column (3).

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<sup>5</sup>*See*, Energy Michigan's replies to exceptions, p. 7, Chart #1, column (3) (revision of ABATE proposal). Energy Michigan reached its proposed allocations by taking total costs of service for each rate and excluding nuclear decommissioning and securitization costs, and then comparing total costs to total distribution costs to develop a percentage of distribution costs for each rate. Energy Michigan offers a different allocation if fuel costs are excluded as well. *See*, Energy Michigan's replies to exceptions, p. 10, Chart #2, column (4) (revision of Detroit Edison proposal). Both charts include transmission costs.

<sup>6</sup>Residential customers pay 100% of their fuel charges.

In its replies to exceptions, Detroit Edison argues against separate RACs for each rate class. The company argues that Energy Michigan's proposal wrongly incorporates PSCR costs, including transmission costs, and that both of these should be excluded. Detroit Edison argues that setting distribution RACs by rate class only perpetuates choice customers' artificial economic advantage.

Energy Michigan further recommends, in its exceptions, that choice customers are entitled to the same start date (2007) for phase in of this new RAC increase and the same duration of phase in (five years) as full service customers. Energy Michigan asserts that the PFD failed to address the issue of the phase in/out of the choice RAC, and requests that the Commission provide clarity on this point. Energy Michigan asserts that choice customers cannot afford to pay 100% of the distribution RAC plus 100% of the distribution rate increase caused by shifting from the current subsidized RAST charge to the actual charge. Therefore, Energy Michigan contends that the distribution RAC should be phased in, in the same manner that it is phased in/phased out for other customers. Energy Michigan further contends that, even if this recommendation is followed, rate imbalances between choice and full service customers will follow shortly. Energy Michigan suggests that the Commission address this potential problem by either looking at rates again in 2007, or by adopting a distribution RAC for choice customers starting in 2007 that represents the average RAC that would be imposed from 2007 to 2011 under a five year phase in schedule, in this order. The other intervenors (with the exception of the Attorney General) support this proposal.

In its replies to exceptions, the Staff argues that nowhere in Energy Michigan's proposal is the issue of keeping the rate design balanced addressed. The Staff contends that a phase in approach could be considered if the Commission is concerned that full implementation of RAC charges on

choice customers will result in rate shock for that class, or if the Commission believes that adoption of equal distribution charges for full service and choice customers will end the choice program.

In its replies to exceptions, Detroit Edison points out that, under its rate design proposal, the RAC for choice customers is exactly the same as the RAC for full service customers and is phased out or phased in over the same period of years. Detroit Edison argues that any different treatment of the RAC for the sub-class of choice C&I customers would upset the revenue neutrality of this case, and would transfer some of the responsibility for the residential subsidy to Detroit Edison. The company also argues that it would necessitate increasing the RAC for full service customers, which will again result in full service customers paying a higher distribution rate than choice customers, thus defeating one of the purposes of this case.

### **III.**

#### **DISCUSSION**

##### **Rate Design**

Detroit Edison's current full service rates reflect the Commission's long-standing policy of having C&I customers provide residential customers with an inter-class subsidy. Recently, this inter-class subsidy has been exacerbated by the additional choice rate subsidies included in the RAST. These inter- and intra-class subsidies result in skewed rates, which particularly affect full service C&I customers. In general, C&I full service customers are paying both the skewing subsidy for residential and choice customers, and their full distribution cost. C&I choice customers do not currently participate in paying the residential subsidy; nor do they pay their full distribution cost.

The Commission is not convinced that all customers should eventually pay rates that are based solely on the cost to serve them. Other factors need to be weighed when setting rates. The current rates are the product of numerous prior Commission decisions that should not be undone too quickly. Certain rate classes such as senior citizens may continue to receive a subsidy as needed to keep the service affordable.

The Commission is persuaded that ROA customers should be brought to parity with full service customers by having their distribution rates based on cost of service. However, the Commission is not persuaded that the RAC, as proposed by Detroit Edison, should be instituted at this time. The responsibility for the residential subsidy will remain with C&I full service customers; however, the Commission finds that the subsidy should be reflected only in distribution rates for C&I full service customers and not in their generation rates. C&I full service customers will generally see a net decrease in rates as a result of bringing all choice customers up to cost-based distribution rates. Any additional movement towards cost-of-service-based rates must be undertaken in a cautious and deliberate manner. Our order today will result in more reasonable and prudent ratemaking, and will ease the transition for residential and choice customers. The Commission notes that all parties agree that the distribution service charges should be moved from the RAST and included in the full service tariffs. The Commission adopts this recommendation. The Commission does not, by this order, change any of the terms and conditions of the choice program. However, this case represents a significant movement towards addressing Detroit Edison's concern that ROA customers have historically enjoyed a rate advantage over bundled customers.

The Commission rejects Wal-Mart's proposal that choice customers' distribution charges be brought up to cost-based amounts over a three-year phase in period. The Commission finds that,

given the unanimous agreement among the parties that this subsidy should cease, and the fact that no party other than Wal-Mart believes that a phase in period is required, the choice and full service distribution charges for comparable service, excluding any residential rate subsidies, should be brought into parity with the implementation of the unbundled rates approved by this order.

#### Cost of Service Study Method

In its May 10, 1976 order in Case No. U-4771, the Commission adopted a method for allocating costs to be used in preparing cost of service studies, which became the standard filing requirement. This method relies on the 12CP 75/25 allocation method for production plant costs.

The Staff proposes a change to the standard filing requirements that would shift 50% of generation plant costs away from the system peak demands, and reclassify them as related to on-peak energy or average demand. The Staff's proposal of the MH4CP 25/50/25 method is intended to refine the allocation of production plant costs in the COSS, by recognizing that more of the demand that Detroit Edison is responding to is constant demand, rather than peak demand. The ALJ found that the Staff's proposed new method effectively shifts some cost responsibility from low load factor residential customers to higher load factor C&I customers. The ALJ further found that ABATE's proposed alternative methodology of 4CP 75/25 would shift a total of \$108 million from C&I customers to the residential class.

The Staff's approach looks at the peak day on the four peak months of the year, June through September, and identifies an eight-hour period, from 1:00 p.m. to 9:00 p.m., as encompassing the high-demand part of the day. The Staff contends that these 32 hours better reflect the basis for establishing the coincident maximum demand responsibility of each customer than the 12 hours encompassed by looking only at the peak hour in each of the 12 months of the year.

ABATE proposes a 4CP 75/25 method, which it argues is more reflective of current cost causation. The Attorney General supports the Staff's method, if his own proffered method is not adopted. The other parties oppose the Staff's proposal to change the COSS cost allocation method, primarily on the basis that the old method is tried-and-true, and that the Staff has failed to make the case for the necessity of the new method.

The ALJ found that none of the proposed methods should be adopted at this time. The ALJ found that 12CP 75/25 is a well-settled method that allows for the comparison of the results of this COSS to prior COSSs. The ALJ found that the Staff had not made a compelling case for changing a long-standing Commission method, and noted the lack of references in the record to either acceptance of the MH4CP 25/50/25 method within the utility or regulatory communities, or to professional/technical studies or published articles or reports supporting the proposed alternative method. Noting also the relatively small difference in costs resulting from either change, the ALJ recommended that the Commission reject these proposed changes at this time. The ALJ also recommended that the Commission reject the Attorney General's distribution cost allocation, noting that both the National Association of Regulatory Utility Commissioners and the Edison Electric Institute classify distribution plant as being either demand related or customer related.

Peak demand allocations typically assign more costs to residential customers than average demand or energy allocations because residential average use is low compared to that class' peak use. Thus, any shift away from peak demand to average demand or energy allocations will shift some cost burden from residential to C&I customers. In this case, the shift caused by the Staff's proposal is relatively small (less than 1.5% or about \$24 million). Conversely, ABATE's proposal would result in a shift of costs from C&I to residential customers of about 5.1%, or about \$85 million.

The ALJ suggested that this issue be addressed in the COSS collaborative proposed by the Staff and authorized by this order. The Staff took exception to this recommendation and requested the Commission make a finding on the Staff's proposed COSS method based on its merits. The Commission agrees with the Staff and adopts its proposed method. The Commission finds that, while the standard filing requirements have worked well in the past, that does not preclude the possibility of improvement. Based upon the evidence and analysis presented by the Staff, the Commission finds that it is appropriate to initiate this change. While the total amount of generation capacity needed by Detroit Edison is based on peak demand, the greatest amount of investment is incurred to serve base load and intermediate load. For the purposes of this case, the Commission is persuaded that it is appropriate to increase the weight given to average demand in the allocation of the production plant costs relative to peak demand, and to expand the number of hours used for this calculation. The Commission directs Detroit Edison to set the unbundled rates resulting from this order on the basis of the Staff's COSS method. Further, Detroit Edison is ordered to file a COSS and rate design proposal in its next rate proceeding based upon the Staff's method.<sup>7</sup>

#### Securitization and Nuclear Decommissioning Costs

The Commission agrees with the ALJ, and rejects the recommendations of ABATE and Energy Michigan to change the manner in which securitization and nuclear decommissioning costs are allocated to the various rate classes. These two intervenors argue that these charges are unfairly imposed on choice customers and should be allocated using the same method used to allocate generation plant costs. This argument has been previously addressed, and the

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<sup>7</sup>Because there was no consensus on this issue, the Commission reserves the right to revisit this issue in the future when more information is available.

Commission sees no reason to deviate from its previous rulings. Act 142 provides that securitization charges are nonbypassable, and, thus, must be imposed on all customers. MCL 460.10(f), 460.10h(i), and 460.10i(4). *See, also*, October 24, 2000 order in Case No. U-12505; and November 2, 2000 order in Case No. U-12478. The Commission has likewise had a long-standing policy that nuclear decommissioning charges should be paid by all customers. *See*, January 14, 1998 order in Case No. U-11290; and December 16, 1999 order in Case No. U-11662.

Further, regarding Energy Michigan's stranded cost calculation and alternative proposal, the Commission agrees with the ALJ's finding that the method by which the proceeds from third party wholesale power sales will offset stranded costs is to be determined in Case Nos. U-13808-R and U-14474 (Detroit Edison's 2004 PSCR reconciliation and stranded cost cases), and these issues are therefore not appropriately before the Commission in this unbundling case.

#### Cost of Service Study Collaborative

The Staff requests that the Commission open a collaborative for the purpose of modernizing the rate case process for major electric utilities by developing a standardized COSS model that will not be proprietary, and will take advantage of the electronic data processing capabilities of all parties, in order to allow COSS data to be submitted and analyzed on a desktop personal computer. The Commission is persuaded that it has become vital for the parties to major rate cases to be able to exchange information electronically. The Staff is directed to work with Detroit Edison, Consumers, and other interested parties to develop a standardized COSS model that can be exchanged electronically and that provides sufficient flexibility to allow all parties to understand the bases for the data underlying the COSS.

### The Next Rate Case

The Commission agrees with the ALJ and the Staff, and directs Detroit Edison to file a general rate case by July 1, 2007 based on 2006 actual operating results. This will give Detroit Edison sufficient time to collect and analyze the data that will be made available at the conclusion of 2006, and will allow further rate decisions to be based on more current data than the 2002 data that provides the basis for the projected numbers that underlie the November 23 order. A rate case proceeding will allow the Commission and others to review issues that are changing more rapidly than in the past, while balancing that need with the need of customers for a degree of certainty regarding both the reasonableness of rates and the stability of the rate structure, and allows customers to make informed choices over a reasonable planning horizon.

### Rider 9, Rider 2, Rate D1.2, and Inverted Rate Proposal

The Commission agrees with the ALJ and the Staff, and approves Rider 9 as proposed by the Staff, with the modifications to which Detroit Edison has agreed. Rider 9 will apply to new load commenced after January 1, 2005. Detroit Edison accepted the suggested modifications allowing for negotiation of the amount of energy or demand usage under Rider 9 as reasonable for those situations where it may be cost prohibitive to separately meter the new load, and making Rider 9 available to choice customers.

Further, the Commission adopts the Staff's proposal to double the number of customers who may take advantage of Rate D1.2 and directs Detroit Edison to adopt a program to inform its residential customers of the existence of this rate. Given the imminent loss of rate caps, customers may show new interest in this energy-saving rate.

Finally, the Commission rejects ABATE's proposal to modify Rider 2 to require Detroit Edison to sell its equipment to customers. The Commission finds that it is unreasonable to require

the company to sell equipment that shares space with, and is connected to, equipment that is operated and maintained by the company. The Commission finds that ABATE presented no evidence indicating that Rider 2 is not operating properly at the present time.

Energy Michigan also introduced issues into this case regarding electric choice profiling and metering (currently being addressed in the metering collaborative), and the residential minimum charge. The Commission declines to address these issues in this unbundling proceeding.

Likewise, the Commission agrees with the ALJ that ABATE's proposal to reallocate approximately \$3 million of Rider 2 revenue offsets upsets the revenue neutrality of this case, and is not justified.

Because generation costs tend to be more sensitive to daily variations in usage than distribution costs, the Commission is not persuaded that it should adopt Detroit Edison's proposal to shift the inverted-block component of its residential rates to the unbundled distribution charge. It therefore finds that the rate inversion should be placed in the generation charge. However, the Commission wholeheartedly agrees that conservation is a worthwhile endeavor and expects all suppliers of retail power, whether full-service utilities or alternative electric suppliers, to pursue conservation and energy efficiency through the development of innovative product offerings.

#### The Timing of Return to Service Decisions

The return to service provisions of the RAST were recently decided in the November 23 order and reaffirmed in the June 30, 2005 orders on rehearing in Case No. U-13808. Regarding the timing of the annual return to service deadline for this case, this was addressed in the Commission's October 18, 2005 order in Case No. U-14662, which approved a temporary waiver of the deadline in that tariff provision until 60 days after issuance of this order or March 1, 2006, whichever comes first.

In its exceptions, Energy Michigan argues that this timing will not give choice customers sufficient time to make a decision about switching services. Energy Michigan argues that, while the Commission may grant Detroit Edison its requested 30 days to implement a complete new set of unbundled tariffs, the Commission should also require Detroit Edison to provide all participants in this case the specific competitive tariff rates (Rates D3, D4, and D6) for both choice and full service customers which will result from this order within ten days of the issuance of this order, and, further, that the Commission should allow choice customers 60 days from the date of release of the new rates to provide notice of return to full service. In its replies to exceptions, the Staff argues that, if an order is issued in this case prior to the end of 2005, choice customers will be on notice that their rates will be changing and they will have time to respond before the March 1 deadline. The Staff supports granting Detroit Edison 30 days to implement the unbundled rates approved in this case, to ensure adequate time for a smooth transition.

Detroit Edison is directed to file redesigned rates and modified tariff sheets by January 10, 2006 that conform to the Commission's findings in this order. The rates shall be designed with power supply charges and distribution charges unbundled. The bundled and choice distribution charges shall be based on the cost of service, except that the full service distribution charges shall be adjusted to include the inter-class subsidy, to bring the revenues for the class to the level approved by this order. No RAC will be included in choice customers' rates. The redesigned rates should not separately identify any RAC; instead the inter-class subsidy should be included in the distribution charges for full service C&I customers. The RAC charges to be incorporated into the bundled service distribution charges shall be calculated by comparing the approved revenue requirement for each rate class to its cost of service. The COSS should be based on the methodology in the Staff's study, shown on Exhibit S-3.

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.*; 1982 PA 304, as amended, MCL 460.6h *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 proposal to unbundle and realign its rates, as modified by this order, should be approved. Detroit Edison should prepare tariffs in accordance with this order that should be filed in this docket and served on the parties no later than January 10, 2006. Absent a Commission order to the contrary, Detroit Edison's new tariffs should be implemented on a bills-rendered basis commencing with the first billing cycle in February 2006.

THEREFORE, IT IS ORDERED that:

A. The Detroit Edison Company's proposal to unbundle and realign its rates, as modified by this order, is approved.

B. The Detroit Edison Company shall prepare tariffs in accordance with this order that will be filed in this docket and served on the parties no later than January 10, 2006. Absent a Commission order to the contrary, The Detroit Edison Company's new tariffs shall be implemented on a bills-rendered basis commencing with the first billing cycle in February 2006.

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/ J. Peter Lark  
Chairman

( S E A L )

/s/ Laura Chappelle  
Commissioner

/s/ Monica Martinez  
Commissioner

By its action of December 22, 2005.

/s/ Mary Jo Kunkle  
Its Executive Secretary

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

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Chairman

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Commissioner

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Commissioner

By its action of December 22, 2005.

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Its Executive Secretary