

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)
THE DETROIT EDISON COMPANY for)
reconciliation of its power supply cost) Case No. U-14275-R
recovery plan for the 12-month period ending)
December 31, 2005.)
_____)

In the matter of the application of)
THE DETROIT EDISON COMPANY to) Case No. U-14817
reconcile its pension equalization mechanism)
for the years 2004 and 2005.)
_____)

At the May 22, 2007 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

1. Procedural History

On March 30, 2006, The Detroit Edison Company (Detroit Edison) filed applications, with supporting testimony and exhibits, for approval of its power supply cost recovery (PSCR) reconciliation for the 12-month period ended December 31, 2005 (Case No. U-14275-R), and reconciliation of its pension equalization mechanism (PEM) for the years 2004 and 2005 (Case

No. U-14817).¹ On April 18, 2006, the two cases were consolidated. All filings were made in Case No. U-14275-R.

Pursuant to due notice, a prehearing conference was held on May 11, 2006 before Administrative Law Judge Daniel E. Nickerson, Jr. (ALJ). Intervention was granted to Attorney General Michael A. Cox (Attorney General), the Michigan Environmental Council and the Public Interest Research Group in Michigan (MEC/PIRGIM), the Association of Businesses Advocating Tariff Equity (ABATE), the Michigan Retailers Association, and Energy Michigan. The Commission Staff (Staff) also participated. Detroit Edison and the Attorney General filed testimony and exhibits, and Detroit Edison thereafter filed rebuttal testimony and revised exhibits.²

An evidentiary hearing was held on October 11, 2006. The parties waived cross-examination and bound in the testimony and exhibits. Timely briefs and reply briefs were filed by Detroit Edison, Staff, MEC/PIRGIM, and the Attorney General. The record consists of 200 pages of transcript and 29 exhibits.

The ALJ issued a Proposal for Decision (PFD) on March 2, 2007. On March 16, 2007, the Attorney General, ABATE, and MEC/PIRGIM filed exceptions. On March 23, 2007, the Staff and Detroit Edison filed replies to exceptions.

2. The 2005 PSCR Reconciliation

Detroit Edison presented evidence that its 2005 actual net system output (NSO) was 50,669 gigawatt-hours (GWh), which was 1,295 GWh above the forecast. The average cost of 2005

¹See, September 26, 2006 order in Case No. U-13808-R/U-14474, p. 24, authorizing Detroit Edison's 2004 PEM expenses (covering 38 days) to be rolled into the company's 2005 PEM reconciliation.

²Energy Michigan withdrew its filed testimony, and, with the exception of Exhibit EM-1, its exhibits.

system generation was \$14.99 per megawatt-hour (MWh), which was \$35 per MWh below the market price of power. Sources of energy production were 79% from coal, 18% from nuclear power, and the remaining 3% from oil and gas. The company managed its emissions of oxides of nitrogen by purchasing trading allowances.

After credits and adjustments, Detroit Edison's fuel and purchased power was 47,485 GWh, and actual PSCR expenses were \$1,055,032,000. *See*, Exhibit A-1 revised. Despite the historically high fuel market in 2005, fuel expenditures deviated less than 10% from forecast. There were no unplanned plant outages in 2005. Scheduled work during planned outages was achieved. Net transmission expenses were \$157,677,148. Revenues generated from third party wholesale sales were almost \$134 million over the forecast, due to increased market prices. *See*, Exhibit A-5 revised. These revenues were applied as an offset to PSCR costs.

Detroit Edison presented evidence that before considering interest, the 2004 PSCR overrecovery rollover, and the residential adjustment, the company underrecovered its 2005 PSCR costs by a total of \$244,005,293. *See*, Exhibit A-17 revised. Residential customers were allocated \$29,577,490, or 39%, of the 2004 overrecovery, based on the proportion of residential PSCR sales to all PSCR sales for 2004. The cumulative underrecovery from residential customers was \$40,581,813, which includes an interest credit of \$917,204. *See*, Exhibit A-18 revised. In a similar manner, the company allocated \$46,275,202 of the 2004 overrecovery to commercial and industrial (C&I) customers. After deducting the underrecovered expense from residential customers and providing an allocation to C&I customers for the 2004 PSCR overrecovery, the net underrecovery for C&I customers was \$93,755,051, which includes an interest credit of \$448,116. *See*, Exhibit A-17 revised. Due to the statutory rate caps contained in MCL 460.10d(2), which were in effect for the residential class until January 1, 2006, Detroit Edison proposes no

reconciliation billing factor for residential PSCR customers. Exhibit A-19 revised presents the PSCR reconciliation surcharge for C&I customers, depending on the beginning surcharge month and length of surcharge period. To avoid rate shock, Detroit Edison proposes to implement the surcharge over a period of at least six months, or up to 18 months.

The ALJ found the company's proposed reconciliation to be reasonable and prudent and recommended its adoption.

The only objection to Detroit Edison's proposed reconciliation came from the Attorney General, who has, on several occasions, argued that the Commission lacks subject matter jurisdiction to implement Detroit Edison's PSCR surcharges under MCL 460.6j(18), which is the section of 1982 PA 304 (Act 304) that governs PSCR factors that are set in a general rate case and remain in effect for 48 months. The Attorney General argued that the PSCR factors in this case were set in a general rate case according to Detroit Edison's original request in Case No. U-13808, and therefore must cover a period of 48 months without change, thus requiring deferral of any underrecovery. The ALJ noted that the Commission has duly considered and rejected this argument in at least two previous cases. The Attorney General renews this objection in his exceptions.

In its exceptions, ABATE notes that the ALJ failed to recommend how long the reconciliation surcharge should be in effect, and argues for a 12-month period. In its replies to exceptions, the Staff also supports a 12-month period. In its replies to exceptions, Detroit Edison supports the 12-month period, with a factor of 3.50 mills per kilowatt-hour (kWh). *See*, Exhibit A-19 revised.

The Commission agrees with the ALJ's recommendations with respect to both the Attorney General's jurisdictional argument, and the reconciliation. *See*, June 30, 2005 order in Case No. U-13808, pp. 18-20; and June 30, 2005 order in Case No. U-14275, pp. 2-3. The Commission

finds Detroit Edison's 2005 PSCR reconciliation to be reasonable and prudent, and approves the plan. Consistent with the most current calculations provided by Detroit Edison, the Commission finds that a reconciliation surcharge of 3.50 mills per kWh for C&I customers should be imposed over a 12-month period beginning with the first billing cycle after issuance of this order. *See*, Exhibit A-19 revised.

3. The 2004-2005 PEM Reconciliation Plan

Detroit Edison presented evidence that the actual 2004 PEM expense was \$4.4 million; and that \$5.5 million was collected, creating a regulatory liability of \$1.092 million before interest. Exhibit A-22. For 2005, the company incurred a similar regulatory liability of \$10.229 million. Exhibit A-23. Detroit Edison proposed to apply its short-term borrowing rate, which ranged from 2.6405% to 4.4386% during 2004-2005, to these amounts, with annual compounding, for a total of \$11,560,007 as of January 1, 2006, and a short-term interest rate of 4.6793% to that amount after that date. Exhibits A-20, A-21 revised. Detroit Edison proposed to issue the PEM credit to full service C&I customers, choice customers, and certain full service unmetered customers, because these customers were not subject to the rate caps during the relevant time period.

a. Adoption of the PEM

As in past cases, the Attorney General argued that the Commission lacks express statutory authority to adopt a PEM, and that the PEM is, in effect, retroactive ratemaking. Detroit Edison and the Staff argued that the Commission's broad ratemaking authority empowers it to adopt such equalization mechanisms, and that they do not amount to retroactive ratemaking. The ALJ agreed. *See*, MCL 460.6; *Michigan Bell Telephone Co v Public Service Comm*, 332 Mich 7, 37; 50 NW2d 826 (1952).

The Attorney General renews this objection in his exceptions, arguing that there is no clear and unmistakable statutory language empowering the Commission to adopt a PEM.

The Commission has previously addressed this issue, and sees no reason to deviate from its previous holdings rejecting the Attorney General's position. The Commission finds that it has authority to reconcile the PEM. *See*, November 23, 2004 order in Case No. U-13808; September 26, 2006 order in Case No. U-13808-R/U-14474. *See, also, ABATE v Public Service Comm*, 208 Mich App 248, 261; 527 NW2d 533 (1994); *Detroit Edison v Public Service Comm*, 221 Mich App 370; 562 NW2d 224 (1997).

b. Interest Rate and Compounding

The Attorney General argued that the interest rate on the PEM overcollection should be 9.74%, which is Detroit Edison's weighted cost of capital, because it is the most reasonable measure of the time value of money; and that monthly compounding should be required.

The Staff argued in favor of the use of short-term interest rates for both PEM over- and underrecoveries, so that customers would incur less expense in the case of an underrecovery. The Staff also preferred annual compounding of interest because it is consistent with past Commission practice and less burdensome than monthly compounding.

The ALJ agreed with the Staff, finding that Commission precedent favors annual compounding and the use of the short-term interest rate, since the PEM is reconciled annually. *See*, October 24, 2000 order in Case No. U-11955/U-11956, p. 11.

The Attorney General renews his argument for the higher interest rate in his exceptions, contending that the Commission should adopt an interest rate differential (between over- and underrecoveries) to reflect the difference between the costs of capital for ratepayers and the company. The Attorney General argues that the Commission should adopt monthly compounding

because the over- and underrecoveries are calculated on a monthly basis. In its replies to exceptions, the Staff continues to support the short-term interest rate with annual compounding. Detroit Edison also argues that annual compounding is consistent with PSCR over- and underrecovery cases. Detroit Edison urges the Commission to use the same interest rate, in any case, in both over- and underrecovery cases.

Consistent with past Commission practice, the Commission approves the use of short-term interest rates and annual compounding as reflected on Detroit Edison's Exhibit A-21 revised.

c. Issuance of PEM Credits

MEC/PIRGIM opposed the exclusion of the residential ratepayer class from the PEM credit, arguing that residential customers paid for pension expenses through base rates throughout 2004 and 2005, and that therefore Detroit Edison is receiving a double recovery of these amounts if they are not credited back to residential customers.

Detroit Edison argued that its proposal comports with the Commission decision in Case No. U-13808, which concluded that to the extent that the Commission reduces PSCR rates for customers subject to the rate caps, the Commission may increase those customers' base rates by the same amounts, as long as the applicable rate cap is not exceeded. *See*, February 20, 2004 order, pp. 59-60, and November 23, 2004 order, p. 77, Case No. U-13808. Detroit Edison argues that this customer class has already received the rate cap "credit," and to allow residential customers a PEM credit would amount to a double recovery.

The Staff argued that, because Detroit Edison underrecovered its PSCR costs from residential customers as a result of the rate caps during this time period, it would be inequitable to require a credit to be given to these customers.

The ALJ agreed with the Staff and Detroit Edison, finding that the company in fact underrecovered PSCR costs from the residential ratepayer class as a result of the rate caps. The ALJ recommended that the Commission adopt Detroit Edison's proposed PEM reconciliation plan.

In his exceptions, the Attorney General argues that to rely upon the fact that an underrecovery resulted from the rate cap as a reason for denying residential customers a share of the PEM credit violates the rate cap. The Attorney General contends that the withholding of the credit amounts to a hidden rate increase.

MEC/PIRGIM also takes exception to the exclusion of residential customers from the PEM credit. MEC/PIRGIM argues that Detroit Edison's PSCR underrecovery has nothing to do with PEM expenses and these issues should be separated. Like the Attorney General, MEC/PIRGIM argues that withholding the credit from the residential class violates the rate cap, and allows the credit to be used for overall revenue enhancement. MEC/PIRGIM points out that pension expense is reflected in base rates, not in PSCR expenses. MEC/PIRGIM maintains that the residential class constitutes 39% of PSCR sales, and that portion of the PEM overcollection should go back to residential customers. Finally, MEC/PIRGIM requests the Commission to order the Staff to "conduct a study and file a report concerning the ratemaking treatment of pension cases and the operation of the PEM." MEC/PIRGIM Exceptions, p. 15.

In its replies to exceptions, the Staff argues in favor of the ALJ's recommendation. The Staff points out that the rate caps meant that Detroit Edison failed to collect all of its costs of doing business during the 2004-2005 time period, particularly its power costs. The Staff also argues that the requested review and report is unnecessary, as a review was accomplished in the last Detroit Edison rate case, and will effectively be done again in the company's upcoming 2007 rate case. *See*, Case No. U-15244.

In its replies to exceptions, Detroit Edison argues that residential customers have already effectively received a refund through the rate caps. Detroit Edison argues that any refund at this point would give the residential class a base rate reduction greater than the 5% mandated by Act 141.

The Commission is persuaded that, because residential base rates were not increased during this time period to reflect any PEM expenses, the residential class is not eligible for the PEM credit. The Commission authorizes refund of the PEM overcollection to full service C&I, choice, and certain unmetered customers, as reflected on Detroit Edison's Exhibit A-21 revised.

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. The Detroit Edison Company's proposed 2005 power supply cost recovery reconciliation and 2004-2005 pension equalization mechanism reconciliation are reasonable and prudent, and should be approved.

THEREFORE, IT IS ORDERED that The Detroit Edison Company's 2005 power supply cost recovery reconciliation, and 2004-2005 pension equalization mechanism reconciliation are approved.

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 May 22, 2007.

/s/ Mary Jo Kunkle
Its Executive Secretary

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MICHIGAN PUBLIC SERVICE COMMISSION

Chairman

Commissioner

Commissioner

By its action of May 22, 2007.

Its Executive Secretary