S T A T E   O F   M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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

At the November 23, 2004 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. J. Peter Lark, Chair
Hon. Robert B. Nelson, Commissioner
Hon. Laura Chappelle, Commissioner

OPINION AND ORDER

I. Preface

This order is the culmination of the efforts of eighteen parties and countless individuals. It represents the end product of an investigation into the operations of the largest electric utility in this state whose rates have not been subject to similar scrutiny in over a decade.

Earlier, the Commission recognized that this proceeding was "among the most complex cases ever considered." November 4, 2003 order, Case No. U-13808, p. 8. It affects not only the operations of the utility, but also the finances of over two million of its residential and business customers in ways that no proceeding brought before this agency has ever done. In addition to resetting the utility's rates on both an interim and a final basis, the application requested approval

of a regulatory asset recovery surcharge, reinstatement of the company's power supply cost recovery (PSCR) mechanism, a determination of the utility's stranded costs, and implementation of a novel "mitigation adjustment" designed to allow the utility "to retain the economic benefit associated with the mitigation of generation contribution margin loss when customers leave bundled tariff service." Application, ¶14, p. 5. The application also sought approval of an earnings-sharing mechanism, termination of securitization and transition charges for electric choice customers, and authorization for use of excess securitization savings to recover previously deferred and unrecovered net stranded costs.

Despite having so much at stake, the parties engaged in their various adversarial roles in a professional manner. For that, the Commission is thankful. Moreover, all participants, including the Commission's employees, should be commended for completing this enormous undertaking in so timely a manner.

II. History of Proceedings

On June 20, 2003, The Detroit Edison Company (Detroit Edison) filed an application for an increase in its rate schedules governing distribution and supply of electric energy, determination of its stranded costs, implementation of its PSCR clause, and other various accounting and regulatory matters.[1]

On July 28, 2003, Administrative Law Judge Daniel E. Nickerson, Jr. (ALJ) conducted a prehearing conference, which was attended by Detroit Edison, the National Energy Marketers Association (NEMA), Constellation NewEnergy (CNE), Energy Michigan, the Association of Businesses Advocating Tariff Equity (ABATE), The Kroger Co. (Kroger), Energy Conversions

[1]Prior to filing this proceeding, Detroit Edison's rates were last comprehensively reviewed and determined by the Commission in its January 21, 1994 order in Case No. U-10102.

LLC., Mackinaw Power LLC (Mackinaw), North American Wind Energy LLC (NAWE), the Michigan Environmental Council and the Public Interest Research Group in Michigan (MEC/PIRGIM), the Residential Ratepayers Consortium (RRC), Utility Workers Local 223, Pietro Zebri, Douglas Moore, Nordic Marketing LLC (Nordic), Attorney General Michael A. Cox (Attorney General), and the Commission Staff (Staff). The ALJ granted petitions to intervene filed by NEMA, CNE, Energy Michigan, ABATE, Kroger, Energy Conversions, Mackinaw, NAWE, MEC/PIRGIM, the RRC, Utility Workers Local 223, Mr. Zebri, Mr. Moore, Nordic, and the Attorney General.[2] Then, the ALJ granted a motion by ABATE, Energy Michigan, and Kroger to suspend the proceeding pending Detroit Edison's decision to make a possible securitization filing. Detroit Edison applied for leave to appeal the ALJ's ruling to the Commission.

A second prehearing was held on August 8, 2003. At that time, Detroit Edison informed the ALJ that it had decided not to file a securitization case until after the filing of reply briefs and that the company would be withdrawing its application for leave to appeal. Accordingly, the ALJ set a schedule for the interim rate relief hearing.

On August 18, 2003, the Commission ordered the parties to brief the issue concerning Detroit Edison's reinstatement of its PSCR clause.[3]

On August 19, 2003, Detroit Edison filed an application for leave to appeal the schedule set by the ALJ. On November 4, 2003, the Commission issued an order changing the deadlines for filing briefs and reply briefs in the interim relief schedule. Hearings were conducted on the interim relief portion of the case on January 5-13, 2004.

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[2]On March 5, 2004, United Utilities, L.L.C., filed a petition for late intervention, which was denied by the ALJ at 11 Tr. 1833. United Utilities did not appeal this ruling, but it did submit comments by letter on April 26, 2004.

[3]On December 18, 2003, an order was issued by the Commission reinstating Detroit Edison's PSCR clause. Detroit Edison filed an appeal of the Commission order with the Court of Appeals.

On February 4, 2004, briefs regarding interim relief were filed by Detroit Edison, the Staff, MEC/PIRGIM, ABATE, the Attorney General, Kroger, the RRC, and Energy Michigan. Reply briefs were filed by Detroit Edison, the Staff, CNE, ABATE, the Attorney General, Kroger, the RRC, and Energy Michigan on February 10, 2004.

On February 20, 2004, the Commission issued its order granting, in part, Detroit Edison's request for interim relief, which authorized Detroit Edison to increase its rates by $248,430,000 on an annual basis and to place into effect certain interim surcharges. Several parties sought rehearing of the February 20 order.

The ALJ conducted hearings on the final relief portion of the case on April 12-21, 2004. The record consists of 15 volumes of transcript totaling 3,239 pages. In addition, 235 exhibits were admitted into evidence. Briefs and reply briefs were filed on May 14, 2004 and May 28, 2004 by Detroit Edison, the Staff, the Attorney General, ABATE, MEC/PIRGIM, Energy Michigan, Kroger, the RRC, Mackinaw, CNE, and NAWE.

On August 26, 2004, the ALJ issued his Proposal for Decision (PFD). Exceptions and replies to exceptions were timely filed by Detroit Edison, the Staff, the Attorney General, ABATE, MEC/PIRGIM, Energy Michigan, Kroger, the RRC, and CNE on September 16 and October 7, 2004, respectively.[4]

III. Descriptions of the Major Components of the June 20, 2003 Filing

1. The Rate Case

Detroit Edison's application originally sought to increase rates by not less than $416,000,000 above the level of its then frozen rates based upon a 2004 test year. Detroit Edison also requested

[4]Together, the documents contained in the docket of this case encompass nearly 13,000 pages of testimony, exhibits, comments, and legal pleadings. All of this information may be viewed at http://efile.mpsc.cis.state.mi.us/cgi-bin/efile/viewcase.pl?casenum=13808.

an additional rate surcharge designed to collect amounts associated with its proposal for the recovery of various regulatory assets. Detroit Edison proposed to charge new rates in a manner consistent with the freeze and cap provisions of 2000 PA 141 (Act 141), MCL 460.10 et seq., which means that, based on their peak demands, some of the utility's customers would receive adjustments to their rates in periods different than others. For customers receiving electric service under capped rates, Detroit Edison requested authority to increase their rates to the lesser of the maximum permitted under the cap or the maximum authorized by the Commission in the event that the company were to be ordered to reduce its billed PSCR factor. Detroit Edison requested approval to amend its rate schedules and its Retail Access Service Tariff (RAST) to reflect increases in revenue requirements, implementation costs, and transition charges. The utility also proposed to continue funding the Low Income and Energy Efficiency Fund (LIEEF), to the extent that it is collected in its rates. Finally, Detroit Edison proposed a symmetrical earnings sharing mechanism (ESM) for those customers no longer capped by Act 141.[5]

During the course of the proceedings, the amount of relief sought by Detroit Edison became a moving target. For example, in its Revised Schedule A1-2, Exhibit A-9, which was filed January 12, 2004, Detroit Edison's request for rate relief increased to $553 million. Subsequently, there were other adjustments that altered Detroit Edison's rate request from $553 million to $583 million. These changes included items such as a $13.1 million revenue requirement reduction associated with the removal of certain regulatory asset amounts from the rate base for capped customers. Detroit Edison also agreed to capitalize certain expenditures that increased its 2004 rate base but decreased its administrative and general (A&G) expenses. The 2004 reduction of $16.3 million was offset by a return on the increased rate base for the increased A&G capitali-

[5]Subsequently, Detroit Edison abandoned it request for an ESM. See, 13 Tr. 2613.

zation of $2.6 million. Other variations included changes to the amount of the proposed merger control premium and pension expense changes. Finally, the Commission notes that as filed, Detroit Edison's original case projected 8,940 gigawatt-hours (GWh) of choice sales, which it associated with a $140 million revenue deficiency. However, Detroit Edison updated its projected choice sales losses during the course of the hearing. According to Detroit Edison, the updated data supports a new projection of 9,250 GWh of choice sales and an additional $77 million of revenue deficiency.

Detroit Edison's final adjusted base rate revenue request involves a $582,837,000 rate increase. In addition, Detroit Edison seeks (a) immediate authorization to begin charging customers having a load of 15 kilowatts (kW) or more a regulatory asset surcharge of 0.91559 mills per kilowatt-hour (kWh),[6] (b) authorization to begin charging customers having a load of less that 15 kW a regulatory asset surcharge of 0.67051 mills per kWh[7] as of January 1, 2005, and (c) authorization to begin charging residential customers a regulatory asset surcharge of 2.64295 mills per kWh[8] as of January 1, 2006. Detroit Edison also seeks authority to commence charging customers for customer choice implementation costs of $28,240,000 at the rate of 0.5 mills per kWh starting in 2006.

2. The PSCR Case

Detroit Edison filed its 2004 PSCR plan and 5-year forecast (2004-2008) in this proceeding pursuant to MCL 460.6j(18), which permits an electric utility to conduct its PSCR proceedings in the context of a general rate case. Similarly, Detroit Edison originally proposed that its 2005

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[6]On an annual basis this surcharge would collect $16,460,000.

[7]On an annual basis this surcharge would collect $7,377,000.

[8]On an annual basis this surcharge would collect $40,411,000.

PSCR plan and factor should also be established in this docket.[9] However, Detroit Edison indicated its intent to file its 2005 PSCR reconciliation as a "stand alone" proceedings because its filing is not due until after the expiration of the Act 141 rate cap period. See, MCL 460.6j(3),(4), and (12); Detroit Edison's June 20, 2003 application in Case No. U-13808, pp. 4-5.

Detroit Edison's load forecast was presented by Dr. Aldo F. Colandrea, its Manager of Corporate Energy Forecasting. Dr. Colandrea described the current net demonstrated summer operating capability of his company's owned generation resources, the planned changes in capacity shown on Schedule F1 of Exhibit A-6, and the long-term purchased capacity that Detroit Edison has under contract. Dr. Colandrea stated that service area sales were forecast to increase from 52,038 GWh in 2002 to 62,232 GWh in 2012, which represents a 1.8% average annual increase in sales. However, he stated that bundled sales were expected to decrease from 49,047 GWh in 2002 to 43,266 GWh in 2012-- a 1.2% average annual decline. Dr. Colandrea went on to explain that service area residential sales should increase at 1.3% annually through 2012. He predicted average increases for both commercial and industrial sales of 2.5% through 2012. According to him, service area system peak demand is forecast to increase from 12,085 Megawatts (MW) in 2002 to 14,038 MW in 2012, an average compound annual growth rate of 1.5%. Bundled peak demand was forecast to decline from 11,423 MW in 2002 to 10,833 MW in 2012, a decline of 0.5% per year.

Gary E. Lapplander, Detroit Edison's Director of Fuel Supply, presented estimates of total unit fuel cost and fuel expense for fossil fuel plants, projections for coal, oil, and gas prices for 2002, and the forecast of prices for those fuels in the years 2003 through 2008 as set forth in

[9]Subsequently, Detroit Edison abandoned this approach and determined that it should separately file a 2005 PSCR plan in another docket, which it did on September 30, 2004 in Case No. U-14275.

Exhibit A-3, Schedule C11 and Exhibit A-16, Schedules F3-2, F5-2, F5-15, F8-1 through F8-7, Schedule F10, and Schedule F11-1. Mr. Lapplander testified that Detroit Edison expects to supply its projected coal requirements for the forecast period through a combination of long-term and spot market purchases. According to him, this mixture of purchases would provide reliability of supply with sufficient flexibility to meet the needs of Detroit Edison's electric generating plants. He stated that the fuel supply plan described in his testimony meets Detroit Edison's requirements, is consistent with both the company's policy and objectives, delivers electric generation to its customers at a reasonable price consistent with reliable supply, and is otherwise both reasonable and prudent.

Wayne A. Colonnello, Detroit Edison's Manager of Nuclear Strategic Planning, testified regarding his company's nuclear fuel expense and nuclear generation volumes. Mr. Colonnello explained that nuclear fuel expenses directly tied to projected generation use are shown on Line 16 of Exhibit A-16, Schedule F5-1.1a. According to him, Fermi fuel expenses are directly dependent on expected generation targets and include the compulsory annual fee and disposal fees paid to the Department of Energy (DOE). 4 Tr. 208-209. He also stated that relatively small additional fuel expenses are anticipated in connection with the economic extended power uprate project to increase Fermi's net generation. Mr. Colonnello believed that the company's nuclear fuel expenses will be equal to or better than industry median performance.

James H. Byron, Detroit Edison's Manager of Generation Optimization-Power Supply Planning, testified that Detroit Edison's power supply actions and costs were reasonable and prudent in light of the significant and ongoing changes in the electric industry in Michigan and throughout the nation. Mr. Byron described his company's plans to supply its summer bundled rate adjusted peak demand with existing resources and additional summer purchased power as required for the years 2003 through 2012.

Edward L. Falletich, the Manager of Pricing in Detroit Edison's Regulatory Affairs Department, proposed that the existing PSCR base, factor, and loss factor included in his company's Tariff Rule B-4.6 be revised to reflect not only the level of the forecasted 2004 PSCR expenses, but also the recovery of transmission expenses associated with the procurement of transmission services from the International Transmission Company (ITC) and the Midwest Independent Transmission System Operator, Inc., (MISO). He also emphasized that Detroit Edison's PSCR expense levels were based on the costs supported by Mr. Byron and included fuel costs, power purchases, interconnection revenue, transmission costs, and emission allowance costs for sulfur dioxide (SO2) and oxides of nitrogen (NOx). Mr. Falletich proposed that the existing PSCR base of 15.49 mills per kWh be revised to 16.98 mills per kWh if the Commission approves the recovery of transmission costs through the PSCR mechanism. If transmission costs are not included, Mr. Falletich stated that the proposed PSCR base would be 14.14 mills per kWh. In addition, Mr. Falletich proposed that Detroit Edison's PSCR factor be reset to 0.00 mills per kWh and the existing Rule B-4.6 loss factor of 7.8% be revised to 7.2%.

3. The Stranded Cost Case

Detroit Edison maintains that many of its current financial difficulties are due to the rapid growth, severe margin effect, and success of the choice program. According to Detroit Edison, over 16,400 customer meters are enrolled in the choice program, with nearly 14,000 of those in service as choice customers. As of March 22, 2004, 2,518 MW of load were enrolled in the choice program and 2,337 MW were taking service as choice customers, which represents 9,214 GWh or 18% of Detroit Edison's total sales. Another 622 GWh of enrollments were in process. See, 13 Tr. 2745 and Exhibit A-93.

Detroit Edison insists that it should be authorized to collect its stranded costs, which it contends are directly attributable to lost sales volumes. Detroit Edison also requests that the Commission authorize the use of an electric choice mitigation adjustment to adjust costs associated with customers leaving under electric choice, which it proposed should operate in tandem with its PSCR mechanism. Detroit Edison argues that it has incurred and continues to incur significant costs associated with the movement of customers to electric choice. Detroit Edison maintains that the revenue deficiency effect of choice sales loss is easy to calculate and is similar to the revenue deficiency attributable to other sales volume changes or weather normalization. According to Detroit Edison, stranded costs simply represent that part of the utility's approved revenue requirement that is no longer recovered when customers leave for choice. Further, Detroit Edison asserts that the concept of wholesale market mitigation is merely recognition that as the utility's load is lost to alternative suppliers, the resale of the power supply capacity to serve that load should be used to offset the retail margin loss, thereby reducing its stranded costs.

Detroit Edison states that there are two fundamental ratemaking methods to determine the net revenue deficiency due to choice sales losses. According to Detroit Edison, one method, which it maintains was adopted by the Commission in the interim order, focuses on the traditional operation of the PSCR clause in conjunction with a base rate increase. Detroit Edison insists that under this approach the economic benefit of the choice-driven wholesale market mitigation actions are credited to full service customers pursuant to traditional operation of the PSCR clause in the form of a revenue credit in the case of additional interconnection sales and lower purchased power costs in the case of reduced purchased power. Detroit Edison represents that base rates must be set to reflect the full base rate revenue deficiency and the PSCR factor must reflect the lower net power

supply costs. Detroit Edison contends that the net rate increase will equal the net revenue deficiency effect of choice sales losses.

The other method identified by Detroit Edison involves reducing the base rate revenue deficiency by an amount equal to the expected economic value of the wholesale market mitigation activity to determine the net revenue deficiency. According to Detroit Edison, base rates would be set to reflect this reduced base rate revenue deficiency. In addition, Detroit Edison asserts that the PSCR mechanism must be modified to remove the "revenue credit" effect of wholesale market mitigation to ensure that the benefits of mitigation are not credited to customers twice – first in the form of lower base rates and a second time in the form of a lower PSCR factor. Under this method, Detroit Edison States, base rates would be set at a lower level to directly reflect the value of wholesale market mitigation and the PSCR factor would exclude the mitigation credit. However, the net rate increase (lower base rate increase and higher PSCR factor) would still equal the net revenue deficiency impact of choice sales losses. Detroit Edison stresses that the latter method is predicated upon a portion of the generation system being allocated to the utility to be used to make choice mitigation sales. Detroit Edison emphasizes that if full service customers are paying for only 80 percent of the generation non-fuel revenue requirements, then they should be entitled to the fuel savings benefits from only 80 percent of Edison's generation system. According to Detroit Edison, the remaining 20 percent "slice" of the system should be assigned to Detroit Edison to be used to mitigate the retail margin loss due to choice sales loss. Detroit Edison believes that the critical issue facing the Commission is to determine how much of the revenue deficiency should be recovered from tariff customers versus choice customers. The recovery of the revenue deficiency due to choice sales loss is therefore, a cost allocation/rate design issue.

Detroit Edison maintains that future stranded costs should be recovered through a transition charge that does not burden bundled customers.

Detroit Edison insists that it cannot be expected to subsidize customer choice by accepting a less than reasonable and equitable return on its operations. Likewise, Detroit Edison contends that allocating 100% of the $217 million choice-driven deficiency to its full service tariff customers would result in almost a 7% rate increase solely attributed to customer choice. According to Detroit Edison, it is essential that class-specific transition charges based on prospective stranded costs be adopted as part of the final order in this case. Detroit Edison maintains that customers who opted for choice in 2002 and 2003 did so without the benefit of full timely price information, unaware of future transition charges and removal of choice credits. Detroit Edison believes that the presence of timely and complete price signals is essential in order to have a choice program based on sound economic principles and avoid financial harm to Detroit Edison.

IV. Proposal for Decision

The starting point for consideration of Detroit Edison's request for final rate relief is the PFD. The ALJ recommended use of a historical test year. In so doing, he found that the Staff's proposed historical test year was more reliable and reasonable than Detroit Edison's projected test year. However, recognizing the upward pressure on the costs in generation expense, the ALJ specifically recommended modification of the Staff's historical test year to reflect certain operation and maintenance (O&M) expenses proposed by Detroit Edison.

The ALJ found that Detroit Edison's rate base should be set at $7,123,562,000, which reflects several changes to the Staff's originally proposed rate base of $7,118,061,000. The ALJ also recommended adoption of the Staff's proposed capital structure of 46% equity to 54% debt. In

making this determination, the ALJ noted that the Staff's proposed capital structure reflects historical norms adjusted for known and measurable changes.

The ALJ approved Detroit Edison's proposed cost of long-term debt at 6.31%, which was determined by the Staff to be reasonable. The ALJ recommended adoption of the Staff's proposal to include $279 million of short term debt in Detroit Edison's capital structure at a 2% cost rate.

The ALJ found that Detroit Edison should be authorized a rate of return on common equity in the mid to high end of the 10% to 11% range recommended by the Staff. In so doing, the ALJ noted that the Staff's analysis showed that the range it recommends was consistent among the various methodologies. In addition, he observed that independent sources showed that in 2003 the average authorized return on common equity was 10.97 for 22 electric utilities.

The ALJ adopted the Staff's calculations of Detroit Edison's adjusted net operating income (NOI) of $293,827,000. In so doing, he found that the Staff's proposal includes appropriate adjustments to Detroit Edison's sales revenue and O&M expense.

The ALJ agreed with the Staff's assessments regarding the continued rate of choice sales, noting that elimination of the securitization credits and imposition of the transition charge will likely slow the rate of customers selecting choice. Further, the ALJ noted that the Staff's proposal demonstrated the correlation of headroom to the rate of migration to choice. The ALJ also adopted the interconnection revenue adjustment proposed by the Staff, namely, removal of $58 million, which was not opposed by Detroit Edison.

The ALJ agreed with the Staff's recommendation to limit O&M expenses to the expected rate of inflation for 2003 and 2004 under the known and measurable method, with exceptions for pension expenses and other post employment benefits (OPEB) expenses. The ALJ noted that Detroit Edison senior management had not approved the proposed forecasted amounts as a budget

number, and therefore, he concluded that they did not warrant a finding of reasonableness. The ALJ concurred with the Staff's proposed A&G capitalized adjustment that reduced O&M expenses by $14.8 million, which was not opposed by Detroit Edison. The ALJ also concurred with an adjustment on additional pension and OPEB expenses, which will be capitalized in 2004.

The ALJ found that the Commission should allow Detroit Edison to recover most of the acquisition control premium paid by DTE Energy Company (DTE) to acquire MCN Energy Group, Inc., (MCN).[10] According to the ALJ, Detroit Edison demonstrated real and substantial savings from the acquisition of MCN that justify the pass through of the control premium, with two exceptions. First, the ALJ found that the 40-year recovery period proposed by Detroit Edison was too long a period over which to project savings. Second, the ALJ found that the Staff's $160 million control premium reduction due to the MCN tax losses acquired in the merger was reasonable, and should be adopted. The ALJ also recommended that the Commission approve the pension equalization mechanism that was proposed by Detroit Edison and supported by the Staff. In making this recommendation, the ALJ notes that the pension equalization mechanism would insulate the company and ratepayers from any future volatility in pension expense. In addition, the ALJ adopted the Staff's proposed changes to Detroit Edison's proposed recovery of its regulatory assets. In so doing, the ALJ noted that these adjustments reflect the intent of Act 141 and previous Commission orders. He further recommended that Detroit Edison's pre-tax rate of return be applied to the recovery of its regulatory assets.

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[10]MCN was the corporate parent of Michigan Consolidated Gas Company (Mich Con).

Based on these determinations, the ALJ adopted the Staff's proposed calculation of revenue deficiency of $253,836,000.[11] The ALJ found that Staff's proposal to apportion the revenue deficiency equally among all rate classes consistent with the Commission's interim order and Act 141's prohibition against any attempt to reallocate a revenue deficiency among rate classes.

With regard to the rate design and tariff issues, the ALJ recommended adoption of the Staff's proposed tariff rates, which includes a proposed transitional primary supply rate (TPSR) designed to address expected rate shock. The ALJ further found that the TPSR should be limited to current special manufacturing contracts (SMC) contract customers. The ALJ noted that Detroit Edison has been inundated with demand for choice and that the utility has had problems enrolling new customers within the 45-day period required by the tariffs. Therefore, the ALJ recommended approval of the Staff's proposal to have Detroit Edison prepare a report in collaboration with other interested parties on this matter. In addition, the ALJ saw no reason to reject CNE's proposal for interval metering to be switched immediately, with profiling for a short period. The ALJ found that Detroit Edison's proposal to require that all service at a location be provided by an alternative electric supplier (AES) by a revision to Section 2.4 of the RAST to be vague and subject to interpretation. In addition, the ALJ found that Detroit Edison had not demonstrated an adequate need to revise the tariff, in light of concerns raised about it by Energy Michigan.

With regard to the recovery of stranded costs, the ALJ stated that the Staff's stranded costs proposal, which called for a total recovery of $43,613,000, was the most reasonable approach both historically and prospectively. The ALJ was persuaded that Detroit Edison's revenue deficiency was greater as a result of choice. Citing Act 141, the ALJ found that choice customers should bear

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[11]At page 11 of its exceptions, the Staff indicates that the ALJ's calculation of the revenue deficiency is incorrect. According to the Staff, the corrected revenue deficiency based on the PFD's recommendations should be $254,372,000.

some of the responsibility for the utility's revenue deficiency. According to the ALJ, the Staff's proposal offers a balanced approach by recommending that both bundled and choice customers pay for Detroit Edison's stranded costs. Further, the ALJ concurred with the Staff's proposal to terminate choice customers' obligation for Detroit Edison investment in production plant with the issuance of the interim order in this case.

On the issue of return to service, the ALJ noted that it was not the intent of Act 141 to unduly restrict movement from regulated to unregulated service. Accordingly, the ALJ recommended that CNE's return-to-service proposal be adopted. The ALJ stated that CNE's proposal, which would require customers returning to regulated service to pay the higher of the market rates or the bundled rate on a monthly basis, most closely met the statutory requirements. Under this approach, customers could leave regulated service at any time without a minimum stay requirement. However, the ALJ noted that the market-based rate had to be inclusive of all market costs to serve the customers.[12]

Regarding Detroit Edison's proposal to continue the Low Income and Energy Efficiency Fund (LIEEF), the ALJ states that Detroit Edison's customers should not have to shoulder the burden of funding LIEEF spending for the entire state. In addition, the ALJ believed that limiting LIEEF's scope to only Detroit Edison's service territory would not affect the ability of non-Detroit Edison customers to apply for other low-income assistance. The ALJ recommended that LIEEF funding continue until Detroit Edison files its next rate case. In a related matter, the ALJ found that the Staff failed to quantify any direct correlation in the Pay As You Save™ utility tariff, or PAYS® proposal to any purported benefit and that its interest in establishing a LIEEF endowment lacks form and substance at this time.

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[12]CNE proposed that discussions take place to determine an appropriate market-based calculation.

The ALJ also recommended that the Commission reject MEC/PIRGIM's position regarding spent nuclear fuel (SNF) in its entirety, noting that the Commission had rejected similar arguments in previous cases. Further, the ALJ expressed his belief that no policy changes were warranted to justify the relief sought by MEC/PIRGIM. Therefore, the ALJ recommended that Detroit Edison be authorized to continue the collection of SNF fees and costs in accordance with the federal Nuclear Waste Policy Act of 1982, 42 USC 10101 et seq. (NWPA).

With regard to the proposals by the Staff, Mackinaw, and NAWE for establishment of a renewable energy program (REP), the ALJ found that the Commission has authority to order Michigan utilities to establish a REP. He also determined that the Staff's position regarding the long-term economic rationale for the adoption of a REP is correct. Further, he found that the only reasonable route for utilities to mitigate costs for compliance with current and future pollution regulations would be through immediate creation of a REP. Accordingly, the ALJ recommended that Detroit Edison should be ordered to prepare a survey outlining all available renewable energy opportunities in its service territory by the end of 2004. In addition, the ALJ recommended that Detroit Edison be ordered to commence implementation of a REP that shall accommodate at least 1% of its residential sales by the end of 2005 and continue growth to accommodate at least 2% to 3% of the its total residential sales by the end of 2008. Moreover, the ALJ recommended that the Commission authorize Detroit Edison to implement a REP funding mechanism, as well as authorization to recover any REP costs not covered by the premium paid by participating customers.

Finally, the ALJ found that Detroit Edison had effectively withdrawn its request to conduct a PSCR plan in the context of its general rate case. For this reason, the ALJ did not address Detroit Edison's proposed PSCR case in the PFD.

V. Rate Case Issues

1. Test Year Period

In each rate case, a test year period must be selected. Detroit Edison proposed using calendar year 2004 as its test year. No one objected to this proposal.

2. Test Year Methodology

Detroit Edison presented a fully projected 2004 test year. The company's test year is built from proposed operating plans, budgets, and capital additions. These projections were used to arrive at Detroit Edison's test year. The Staff presented a 2004 test year based upon a historical 2002 year adjusted for known and measurable changes. After review of the evidence, the ALJ recommended use of the Staff's proposed test year. The ALJ was persuaded that the Staff's proposed test year was more reliable and more reasonable than the fully projected test year proposed by Detroit Edison. The ALJ found that many of Detroit Edison's projections contained significant deficiencies that, in the ALJ's view, were too numerous to overcome, some of which were the company's failure to recognize known and measurable changes, as well as the actual credibility of (and probability of) many of the projections located throughout the company's evidence.

Detroit Edison excepts to the ALJ recommendation to use the Staff's proposed test year. The company argues that its presentation of a fully projected test year provides the best representation of Detroit Edison's future business activity. In the company's view, its presentation is based upon competent and knowledgeable testimony detailing all of the varied expenses and capital outlays needed to run the Detroit Edison system in a cost efficient and reliable manner. Detroit Edison argues that its test period properly captures the rapidly evolving costs, the impact of escalating Electric Choice sales losses, and the changing regulatory structure, all of which are important

because significant changes in the company's business activities, expenditures, and investment will occur in 2004 and beyond. In the company's view, only a fully projected test year can illustrate this complex and changing world. The company stresses that the Commission's objective when selecting an appropriate test period is to establish the proper level of investment on which shareholders are entitled to earn a reasonable rate of return and the levels of expenditures that the utility will be allowed the opportunity to recover in the year in which rates will become effective. The company states that its proposed fully projected test period most appropriately achieves this end.

The Attorney General supports the ALJ's recommendation to use the Staff's proposed test period. He contends that the ALJ's recommendation correctly reflects precedent and the competing evidence presented within this proceeding. He argues that the use of historical test year data supplemented by known and measurable changes has a great deal of merit. This approach simplifies the rate case proceeding because it relies upon data that is more readily verifiable. In the Attorney General's view, adopting Detroit Edison's budgetary projections may adversely influence rates when those budgetary projections prove to be erroneous, or if they are not carried through on. The Attorney General stresses that Detroit Edison did not base its test year data on quantified, known and measurable changes. Rather, he continues, the company's data is based on projections of possible events and expenditures.

The Attorney General cautions the Commission to carefully consider the propriety and credibility of the evidence supporting many of these projections. In the Attorney General's view, if a substantial number of the company's projections do not come to fruition, then the company will earn much more than its requested rate of return. He notes that, through similar evidence in Case No. U-10102, Detroit Edison sought a large increase in rates; however, the company's rates

were decreased by the Commission—typically thereafter the company earned in excess of its authorized rate of return. In the Attorney General's view, the Commission should be mindful of this past history when judging the credibility of the company's projected data and be cautious of setting rates with the expectation that the utility will actually incur the projected expenses.

ABATE supports the ALJ's recommendation to use the Staff's proposed test year. ABATE argues that Detroit Edison's projected test year is built entirely upon a significant number of assumptions that (in all probability) will not turn out to be correct. ABATE states that the company's projected sales forecast is very flawed. In ABATE's view, the Staff's proposed test year uses Detroit Edison's historical audited books and records, adjusted for known and measurable changes, which will yield a more reliable revenue deficiency calculation.

The Staff supports its proposed test year. The Staff agrees that the objective of a test year is reasonableness and fairness. In the Staff's view, its use of a historical test year adjusted for known and measurable changes provides that result. The Staff argues that Detroit Edison's projections present nothing more than a prioritized list of projects by department — budgeted projects that had not been approved by the company's senior management. The Staff maintains that the company's projected 2004 expenditures greatly exceed the levels of costs actually incurred in the recent past. Moreover, the Staff notes, during the period of the company's recent rate-freeze, maintenance expenses were postponed, but Detroit Edison now argues for an immediate and expansive increase in maintenance expense for its aging generation fleet.

In each rate case a test year must be established, and that test year is the starting point for establishing just and reasonable rates for both the regulated utility and its customers. In its December 7, 1989 order in Cases Nos. U-8678, U-8924, and U-9197, the Commission discussed the importance and the objective of an appropriate test year. There the Commission noted that a

test year is a necessary device employed to establish representative levels of revenues, expenses, rate base, and capital structure for use in the rate-setting formula. The Commission further noted that because Michigan has no statutory mandate to utilize a particular type of test year, the selection of an appropriate test year is within the Commission's broad ratemaking power and expertise. The Commission is free to select any reasonable methodology that is consistent with the objective of determining: 1) the level of investment on which the shareholders of the utility are entitled the opportunity to earn a fair rate of return, and 2) the level of expenditures that the utility is entitled the opportunity to recover. In judging the validity of the test-year data, the question to be asked is whether the methodology and the result are reasonable, not whether a more accurate or complex method can be created. The economic judgments required in a rate proceeding are complex and rest on the soundness of the underlying data, the Commission's confidence in that data, and the probability of projected future events. Those judgments do not point to a single correct answer; rather, the overall objective is fairness, not devotion to a particular methodology. The question to be asked is whether the methodology and the result are reasonable. While noting the usefulness of projections, the Commission has cautioned that a reliance on projections can adversely influence rates if those projections prove to be erroneous, and that judicious use of historical data provides a clear view of the utility's cost of providing service and of its expected revenues in the chosen future period. Thus, the data used to establish that test year must provide the Commission with sufficient confidence that the result is reasonable, fair, and equitable to both the utility and its ratepayers.

The Commission is persuaded that the Staff's proposed test year is the most appropriate of the two presented. The test period is based upon Detroit Edison's 2002 audited books and records. That base is then inflated for 2003 and 2004 additions and expenses, with necessary specific

adjustments for known and measurable changes and probable future events. Detroit Edison's projected test year relies on many assumptions and a significant number of possible budget proposals, many of which had not been approved by the company's upper management — leaving significant risk that the final budgets and expenditures actually will not resemble those proposals.[13] In the Commission's view, an appropriately adjusted historical test year is the proper base from which to set Detroit Edison's rates for electric service in this proceeding. The Commission finds that the Staff's proposed test year is reasonable and that it should be utilized.

3. Rate Base

The Staff proposed a rate base of $7,123,562,000.[14] That rate base was established by the Staff from Detroit Edison's historical books and records, with certain adjustments. To create the 2004 test year, the Staff adjusted the 2002 historical base to include average historical construction expenditures. As noted by Don M. Stanczak, Director, Regulatory Affairs, Detroit Edison, the Staff's approach can be a very reliable forecasting tool if the appropriate adjustments are made.[15] The Commission has reviewed the record and the Staff's adjustments to the historical base. The Staff adjusted Detroit Edison's rate base to reflect capitalization of certain administrative and general (A&G) expenses for 2003 and 2004. During the course of the hearings, Detroit Edison stated that it agreed with the adjustment and that the company had begun to capitalize a portion of its A&G expense during 2003.[16] The Staff also removed from working capital the regulatory

[13]4 Tr. 231-233 and 14 Tr. 3020.

[14]The Staff initially presented a rate base of $7,118,061000. However, in its reply brief, Detroit Edison noted a computational error on the Staff's Exhibit S-119. In its exceptions, the Staff accepted the Detroit Edison correction, which will be utilized in this rate case.

[15]13 Tr. 2568-2569.

[16]13 Tr. 2570.

assets that are to be recovered through surcharges for net stranded costs, customer choice implementation, and regulatory asset recovery. Similar to the A&G adjustment, the parties have agreed to the working capital adjustment.

The Staff also adjusted Detroit Edison's 2002 historical rate base for additions to plant during 2003 and 2004. The Staff did so using a five-year historical average of capital additions. In the Staff's view, this historical average is a reasonable spending limit. Detroit Edison argued that the Staff's five-year average of historical capital additions would not take into account the present state of affairs facing the company. Rather, the company proposed a projected capital addition figure. The Commission has reviewed the testimony, and is persuaded that the Staff's adjustments are appropriate and should be implemented. Much of Detroit Edison's projected expense is predicated upon budgets that had not been approved by the company's upper management and substantial proposed increased expenses for projects that had not begun. For these reasons, the Commission finds that Detroit Edison's jurisdictional electric rate base for purposes of this case is: $7,123,562,000.

4. Rate of Return

To calculate Detroit Edison's revenue requirement, it is necessary to find the rate of return to be applied to the utility's rate base. Establishing a rate of return requires the Commission to determine Detroit Edison's capital structure as well as its cost of capital.

As part of its application, Detroit Edison filed testimony in support of its recommended capital structure, cost of equity, and overall rate of return. Naif Khouri, Vice President and Treasurer of Detroit Edison, filed testimony supporting Detroit Edison's recommended capital structure and cost of capital to be used in computing Detroit Edison's overall rate of return. Roger Marin, Finance Professor at the Georgia State University College of Business, presented testimony on

Detroit Edison's cost of equity recommendation. Michael G. VanHaerents, Detroit Edison's Manager of Revenue Requirements, submitted testimony supporting the cost of capital and the capital structure. In addition, Detroit Edison filed the rebuttal testimony of Steven M. Fetter, President of an energy advisory firm, in response to testimony filed by the Staff and ABATE.

The Staff presented the testimony of two witnesses in this area. Brian Ballinger, then Supervisor of the Market Monitoring and Enforcement Section of the Commission Operations Division, testified regarding the Staff's cost of equity recommendation for Detroit Edison. Kirk Megginson, the then Department Analyst in the Market Monitoring and Enforcement Section within the Commission Operations Division, provided testimony on the Staff's recommendation for Detroit Edison's permanent capital structure, ratemaking capital structure, cost of long-term and short-term debt, and the Staff's overall cost of capital recommendation.

Interveners presented testimony in this area as well. The Attorney General presented the testimony of Charles W. King, President of an economic consulting firm, in response to the Staff's witness Ballinger's cost of equity determination for Detroit Edison. ABATE filed the testimony of Michael Goreman, a consultant with Brubaker & Associates, on a reasonable capital structure and cost of common equity for Detroit Edison.

5. Capital Structure

In his testimony, Mr. Khouri recommends a capital structure of 50% debt and 50% equity for test year 2004. This recommendation is consistent with Detroit Edison's recent historical capital structure and its current 50.1% equity ratio. Mr. Khouri, however, expresses a desire to increase the Company's equity to 52.5%, and even to 55% equity, in order to maintain and improve Detroit Edison's existing credit rating in an environment of increased business risk. Detroit Edison also

represents that its parent, DTE is committed to improving its capital structure as evidenced by the hundreds of millions of dollar recently infused into Detroit Edison's capital structure.

Mr. Khouri testifies that Detroit Edison must improve its capital structure for several reasons. He testifies that the electric industry environment is dynamic and uncertain, which requires a stronger capital structure in order to offset unforeseen events. Detroit Edison points to electric competition as a significant uncertainty that increases its perceived risk among investors. Another reason is to maintain Detroit Edison's present credit rating and avoid a downgrade. Detroit Edison's BBB+ bond rating has been placed on a negative outlook which suggests a possible downgrade. Detroit Edison also notes that in 2002, it experienced a reduction in its credit line from $300 million to $200 million coupled with a decline in the number of banks offering it credit from 24 to 17. Detroit Edison also contends that a strong capital structure is needed to compensate shareholders for higher risk. The Company argues that its proposed 11.5% return on equity is related to its proposed 50-50 equity to debt capital structure and that less equity in its capital structure would require a higher return on equity.

Mr. Khouri testifies that a strong capital structure is necessary to ensure adequate capital is available at a reasonable cost. He indicates that inadequate access to capital will impede investment in infrastructure needed to provide safe and reliable electric service. Moreover, since Detroit Edison has over $3.5 billion in debt, even small changes in the cost of capital can have significant impact on the company's annual expenses and revenues. Additionally, Detroit Edison expects to have approximately $200 million in financing needs in 2004 with a considerable amount of additional financing and refinancing needs over the next several years. Consequently, Detroit Edison advocates having a higher percentage of equity to debt resulting in a stronger financial position when accessing the capital market.

Mr. Megginson, on behalf of the Staff, however, proposes a permanent capital structure of approximately 46% equity and 54% debt. The Staff contend that this is the most reasonable proposal for this rate case while maintaining investor confidence. The Staff's analysis consisted of reviewing Detroit Edison's historical capital structure, analyzing Detroit Edison's credit rating, and the capital structures of comparable electric companies. From 1999-2003, Detroit Edison's historical capital structure hovered around 45% equity and 55% debt. In its analysis, the Staff took an average of the figures and made adjustments for 2004 to both equity and debt. For debt, the Staff took the average 2003 amount of $3,384.1 million and increased it by $210 million in projected debt for 2004. For equity, the Staff took the average 2003 equity of $2,752.8 million and increased it by approximately $300 million in projected equity infusion from DTE for 2004. Exhibit S-132.

The Staff also reviewed a number of other factors in making its recommendation. For instance, the Staff reviewed broker forecasts from Morgan Stanley and UBS Investments. Both brokers forecasted that Detroit Edison would receive about a 46% equity based capital structure from this rate case coupled with an approximate 11% return on equity. The Staff also looked at 13 comparable electric companies and found that there was an average of 45% equity to 55% debt capital structure among them.

The Staff also presented testimony evaluating Detroit Edison's proposed 50-50 equity to debt capital structure. The Staff argues that the company's proposal would inflate the company's overall cost of capital and is based upon flawed logic. The Staff has three arguments against adopting Detroit Edison's proposed structure. First, the Staff claims that Detroit Edison adopts a point in time recommendation rather than an average historical capital structure. Second, the Staff argues that Detroit Edison used an unusually low amount of $49 million in long-term bonds in

2003 compared to a typical year where $200 million - $500 million in new debt is usually issued. The Staff contends that the abnormally low debt issuance combined with the capital infusion from DTE resulted in an atypical 50-50 equity to debt ratio for 2003. Third, Detroit Edison's current corporate bond rating is BBB+, the same as in Detroit Edison's last rate case where the Commission approved a 40% equity to 60% debt capital structure. The Staff argues that the negative outlook raised by the credit agencies has more to do with electric choice and DTE's ventures into unregulated enterprises than it does capital structure.

The Attorney General supports the Staff's proposed capital structure noting that equity is more costly than debt. Consequently, less equity will result in a lower overall cost of capital to customers.

ABATE initially supported Detroit Edison's 50-50 ratio between equity and debt. ABATE, however, argues that with Detroit Edison's proposed capital structure, the rate of return on common equity should be reduced. As discussed further below, ABATE argues in favor of a 10% rate of return on common equity.

In his PFD, the ALJ took into consideration Detroit Edison credit ratings, which he determined are independent measures of Detroit Edison's credit strength. The ALJ opined that credit ratings are the single most factors in determining the cost and availability of capital, and that it is easier to lose a good credit rating than to regain one. The ALJ noted that Detroit Edison has been placed on a negative outlook, which often precipitates a downgrade. The ALJ opines that much of Detroit Edison's negative outlook seems to pertain to electric choice and the lack of rate relief to offset the loss of margin as customers migrate to competitive suppliers. He notes that Detroit Edison contends that without rate relief, credit rating downgrades are quite possible which will result in less available capital at higher costs.

Nevertheless, the ALJ finds that Detroit Edison's criticisms of the Staff's evaluation are unfounded. For instance, the ALJ cites Detroit Edison's claim that for nearly 10 years Detroit Edison's capital structure has hovered at almost 50% equity. The ALJ says that there is nothing to substantiate this claim, while the Staff has presented data that concretely supports the Staff's position that since 1996 Detroit Edison's total average equity to debt has been 47% to 53%.

Consequently, the ALJ found the Staff's case more compelling and recommended the Staff's proposed capital structure of 46% equity to 54% debt. The ALJ argued that the Staff took historical norms and made adjustments for known and measurable changes. The ALJ also found the timing of DTE's capital infusions suspect in a year coupled with extraordinarily low debt issuance. The ALJ found the timing of these events to be significantly beneficial for Detroit Edison to claim a 50-50 equity to debt ratio. The ALJ found that the Staff's efforts to normalize the data over time were more reasonable.

The ALJ was also convinced that Detroit Edison's bond rating negative outlook has more to do with electric choice and DTE's unregulated ventures, than Detroit Edison's capital structure. The ALJ also found it unlikely that Detroit Edison could avoid a possible downgrade in its bond rating by going to a 50-50 capital structure ratio. A 50-50 capital structure is also rather unobtainable for 2004. The Staff suggested in its testimony that Detroit Edison would need an equity infusion of $500 million -$600 million in 2004 to establish a 50-50 capital structure ratio. The Staff testified that this is a highly unlikely occurrence, particularly in light of Detroit Edison's testimony that its parent is only planning to infuse about $368 million in equity in 2004. In light of this, the Staff argued that it would be imprudent to recommend a 50-50 capital structure at this time.

Detroit Edison takes exception to the PFD's recommended capital structure. Detroit Edison argues that the PFD should not rely upon the Staff's recommendations. In its exceptions, Detroit Edison contends that the Staff's evaluation fails to take into account known and measurable changes and that the Staff's data is inaccurate and inconsistent.

To begin with, Detroit Edison argues that the Staff ignores its own analysis of the company's historical capital structure. Detroit Edison argues that the Staff's own analysis shows that the company's average equity ratio from 1996 to 2003 was 47% and that the average equity ratio for 2003 is 44%. Detroit Edison contends that Staff's own historical analysis produces an equity ratio higher than the recommended 46%. Moreover, Detroit Edison contends that the Staff's data for 2003 are simply wrong. Additionally, Detroit Edison also takes issue with the Staff's representation that a $500 million - $600 million equity infusion from its parent is unlikely and therefore a 50-50 capital structure is unobtainable. Detroit Edison contends that since February 2003, DTE has already infused $640 million in equity and has reached the 50% equity the Staff believed unobtainable.

Detroit Edison also argues that its bond rating is too weak. While the ALJ seems to recognize the importance of a strong bond rating, Detroit Edison argues that the ALJ contradicts his own reasoning when suggesting that Detroit Edison's circumstances have improved. While Detroit Edison's situation is improving, the ALJ proposes a negative trend when he recommends a 46% equity ratio. Detroit Edison asserts that the company has already achieved a 50.1% equity ratio. The 46% equity ratio recommended by the ALJ, Detroit Edison argues, is lower than the Staff's calculated historical average, lower than the current ratio, and lower than the 2003 year –end actual. Detroit Edison argues that if the Staff's recommendation is adopted, the financial condition of Detroit Edison would actually deteriorate, lead to a credit downgrade, and place the company

closer to being below investment grade. The company sees the ALJ recommendation of a 46% equity ratio not so much as a 6% improvement over the 1994 authorized ratio, but a 1% reduction in the company's current position. The company argues that a decline in the company's financial position would be detrimental to both ratepayers and shareholders.

The company also continues to support its position that it needs to move towards an optimal credit rating. Detroit Edison argues that an optimal rating would be a strong "A" rating and that this is in the long-run best interests of both ratepayers and shareholders.

Detroit Edison also takes issue with the ALJ's concerns over the timing of DTE's equity infusion. Detroit Edison contends that any concern that the timing of DTE's infusion reflects ratemaking gamesmanship is inconsistent with the facts. Detroit Edison agrees that the capital infusion coupled with the low debt issuance were significantly beneficial to attaining a 50% equity ratio, but argues that these actions were in response to the credit rating agencies placement of a negative outlook on Detroit Edison's bond rating and the threat of a possible downgrade. Detroit Edison contends that its behavior was a logical and correct response to improve and stabilize the equity to capital ratio.

In short, Detroit Edison argues that times have changed. Detroit Edison argues that it is subject to increased financial pressures. Detroit Edison says that it is a mistake to assume that the negative outlook is only a result of electric choice and DTE's unregulated activities and not the result of Detroit Edison's capital structure and cash flows. The company continues to support a 50-50 capital structure.

The Staff filed replies to Detroit Edison's exceptions. The Staff contends that the ALJ's recommended capital structure is reasonable and based on solid evidence using accurate data. The Staff argues that the ALJ's recommendation is consistent with its analysis of Detroit Edison's

capital structure in 2003 and reflects the capital structure of peer electric utilities and analysts' estimates of Detroit Edison's capital structure in the future test year. Moreover, the Staff contends that the ALJ did not err in adopting the Staff's analysis of Detroit Edison's bond rating risk.

The Commission finds that the Staff's proposal for a capital structure based upon 46% equity and 54% debt should be adopted. Detroit Edison's proposed capital structure would impose added costs on ratepayers without providing benefits that would justify those costs. In the final analysis, adopting a capital structure for ratemaking purposes is a matter of judgment where the Commission must balance the interests of ratepayers with the interests of the company's shareholders. The Commission finds that the Staff's proposed 46% equity ratio represents a significant improvement over the 40% equity ratio approved in Detroit Edison's last electric rate case and is consistent with the company's present needs. A capital structure with a common equity ratio of 46% is reasonable for setting rates in this case because it strikes a proper balance between the interests of ratepayers and the company's shareholders.

6. Capital Costs

a. Long-Term Debt Costs

The ALJ found that Detroit Edison's proposed long-term debt cost of 6.31% was supported by the Staff and is reasonable. No exceptions were filed. The Commission agrees with the ALJ's finding and determines Detroit Edison's long-term debt costs to be 6.31%.

b. Short-Term Debt Costs

The ALJ observed that there is a dispute between Detroit Edison and the Staff concerning both the amount and the cost of Detroit Edison's short-term debt. Detroit Edison claims $98.969 million in short-term debt at an interest rate of 2.30%. Exhibit A-12, Schedule D1-2. The Staff asserts that Detroit Edison has $279 million in short-term debt at an interest rate of 2.0%. The

ALJ notes that the Staff originally agreed with Detroit Edison's proposed amount of short-term debt, but that the Staff can no longer support Detroit Edison's figures in light of recent disclosures.

i. Level of Short-Term Debt.

The Staff calculated Detroit Edison's short-term debt and determined that the company's 12-month average is $425.25 million. The Staff, however, believes that Detroit Edison's more recent 6-month average of $279 million is more consistent with 2004 short-term debt amounts and recommends that the Commission use the more recent data. Detroit Edison argues that the Staff's recommendation is inconsistent and that it did not use annual average of year-end data as it did for other balances in the calculations for capital structure. Detroit Edison argues that if the Staff had calculated its short-term debt in a manner consistent with its other calculations, the Staff would have determined Detroit Edison's short-term debt to be $50 million. Detroit Edison further argues that the Staff ignores the requirement to use the balance sheet method for determining working capital in rate cases.

After considering the arguments, the ALJ rejected Detroit Edison's position. The ALJ determined that the Staff's 6-month calculation of short-term debt is reasonable and not inconsistent with other capital structure calculations. The ALJ notes that the Commission considers the balance sheet method to be fair and equitable and is based upon the assumption that for every asset there is a corresponding liability. The ALJ determined that the Staff's calculation here is consistent with the balance sheet methodology in that the Staff recognized Detroit Edison's short-term debt along with the accompanying assets. Consequently, the ALJ adopted the Staff's calculation of short-term debt at $279 million.

Detroit Edison filed exceptions to the ALJ's recommendations for short-term debt. Detroit Edison argues that the Staff's approach in calculating both the amount and cost of short-term debt

contains “fatal inconsistencies, and understates forecasted short-term interest rates.” Detroit Edison Exceptions, p. 33.

Detroit Edison argues that the Staff used an inconsistent analysis in calculating Detroit Edison’s amount of short-term debt. By way of example, Detroit Edison points out that the Staff’s recommended equity ratio was based on annual averages of year-end data. However, the Staff changed its approach when calculating the amount of Detroit Edison’s short-term debt by using monthly data, not annual. Detroit Edison argues that the Staff should have used the year-end short-term debt at December 31, 2002 and December 31, 2003 and averaged them. Because Detroit Edison’s year-end short-term debt for 2002 was $0 and $100 million for 2003, Detroit Edison’s argues that a consistent approach by the Staff should have resulting in a $50 million recommendation for short-term debt.

Detroit Edison also reiterates its position that the Staff overlooks the Commission’s requirement to use the balance sheet method for determining working capital in all rate case. Detroit Edison cites the Commission’s June 11, 1985 order in Case No. U-7350, p. 12, for this position. Detroit Edison notes that the ALJ recognized that for every asset there must be a corresponding liability. Arguably, where rate base exceeds capital funds, it is unfair to ratepayers. Similarly, where rate base falls short of capital funds, it is unfair to the utility and its investors. Detroit Edison argues, however, that the Staff has, in fact, not satisfied this requirement. Detroit Edison argues that the Staff’s total capitalization of $7,674,955,000 exceeds it 2004 uses of capital by over $125,000,000. Detroit Edison’s Exception, pp. 34-35. Detroit Edison contends that to be consistent and correct, the Staff must either reduce short-term debt or increase working capital so that total capitalization and total rate base match.

In the Staff's replies to Detroit Edison's exceptions, the Staff argues that its approach and recommendation is not inconsistent. The Staff contends that its rationale for both short-term debt amount and cost was straightforward and clear. The Staff states that Detroit Edison is not being reasonable when criticizing the Staff for using a different approach when short-term debt clearly operates in a different manner than common equity and long-term debt. The Staff argues that Detroit Edison's short-term debt can fluctuate dramatically from month to month, as well as year to year. The Staff argues that common equity and long-term debt are far more stable. The Staff also points out that Detroit Edison's short-term debt level for second quarter 2004 was $250 million, bolstering its position that its $279 million recommendation for the 2004 test year was reasonable.

The Commission finds the ALJ's recommendations to be well-reasoned and supported by the record. The Commission finds that the amount of Detroit Edison's short-term debt should be set at $279 million.

ii. Cost of Short-Term Debt.

The Staff and Detroit Edison also disagree on the proper interest rate for short-term debt. Detroit Edison recommends a short-term debt rate of 2.3%. The Staff changed its support for 2.3% to its now recommended short-term interest rate of 2.0%. The Staff calculated its new recommendation by taking the average cost of short-term debt for the more recent 6-month period with adjustments for commitment fees, origination fees, and administration & legal fees. Exhibit S-335.

The ALJ recommends using 2.0% interest for short-term debt. The ALJ determined that Detroit Edison readily admits that its 2.3% recommendation is projected. Detroit Edison based its recommendation on the average of data to support its proposal from 2003 and 2004. Exhibit A-12,

Schedule D5. The Staff, however, calculated its recommendation by using data from October 2003 to March 2004 and making appropriate adjustments for known and measurable changes. Exhibit S-335. The ALJ found that the Staff's method was a better indicator of future interest rates.

Detroit Edison also filed exceptions on the ALJ's recommended cost of short-term debt. Detroit Edison expressed disagreement with the ALJ's statement that a large factor explaining the difference between the Staff's and Detroit Edison's recommendations was the fact that the Staff did not believe that the Federal Reserve Bank would increase interest rates anytime soon. Detroit Edison argues that the Commission should take administrative notice of the fact that the Federal Reserve Bank has increased short-term interest rates twice, 25 basis points on June 30, 2004 and another 25 basis points on August 10, 2004. Detroit Edison argues that even its recommended 2.3% interest rate is conservatively low in light of these recent increases.

In its replies to exceptions, the Staff concedes that the Federal Reserve Bank has increased short-term interest rates by 50 basis points since the close of the record in this case. The Staff, however, argues that if the Commission finds it appropriate to award Detroit Edison a higher rate than recommended in the ALJ's PFD, then the Commission should still not exceed the 2.3% rate that was supported by Detroit Edison's testimony in this case.

The Commission finds that Detroit Edison's short-term interest rate should be set at 2.3%. The Commission takes administrative notice of the Federal Reserve Bank's actions in raising its short-term rates by 50 basis points since the close of the record in this proceeding. The record, however, does not support awarding a short-term debt interest rate higher than the requested 2.3%. Consequently, Detroit Edison's short-term debt interest rate is set at 2.3%.

c. Rate of Return on Common Equity

Detroit Edison requests an 11.5% return on equity. The company's recommendation is based upon analyses performed using the Capital Asset Pricing Model (CAPM), Empirical CAPM (ECAPM), Risk Premium, and Discounted Cash Flow (DCF) models.

The Staff recommends that the Commission use Detroit Edison's current authorized rate of return on common equity of 11% to calculate the Company's overall rate of return. The Staff asserts that the 11% cost of equity was authorized in Detroit Edison's last electric rate proceeding, Case No. U-10102, in an order dated January 21, 1994. After performing a cost of equity analysis, Mr. Ballinger concludes that 11% is on the upper end of the 10% - 11% range of a fair and reasonable return on common equity for the electric operations of Detroit Edison in the projected 2004 test year. Mr. Ballinger cites historically low interest rates and inflation as important factors in his analysis. In conducting his analysis, Mr. Ballinger used several approaches: The DCF formula, the CAPM, and the Risk Premium Approach.

The Attorney General recommends a 10.5% return on equity. The Attorney General's witness, Mr. King, testifies that the Staff's proposed 11% return on equity was too generous to Detroit Edison in light of the Staff's total analysis. Instead, the Attorney General argues that the midpoint of the range selected by Mr. Ballinger is 10.5%, while the midpoint of the range Mr. Ballinger actually found is 10.33%. The Attorney General contends that an 11% return on equity it too high in light of the much lower capital costs found today than in 1994, when the Commission last approved an 11% return on equity for the company. Moreover, the Attorney General contends that securitization has reduced Detroit Edison's overall financial risk since 1994, and the Staff's proposed increase from the 40% equity level approved in 1994 to 46% proposed in this proceeding further reduces Detroit Edison's overall risk. Consequently, the Attorney General

argues that Detroit Edison's return on equity should be fixed at 10.5%, the midpoint of the Staff's recommended range.

ABATE recommends a 10% return on equity for Detroit Edison, which it argues is on the high end of the range developed by its expert, Michael Goreman. ABATE concedes, however, that the calculation of a return on equity is not an exact science and that there are reasoned analyses that result in different results. Nevertheless, ABATE contends that its witness and the Staff took a more traditional approach and argue that Detroit Edison's approach has upward biases. ABATE also used the CAPM, the Risk Premium, and the DCF methodologies.

The ALJ summarized each of the models used by each witness testifying on return on common equity. In sum, Detroit Edison's calculation of the CAPM produced a range for return on equity of 10.2% - 11.5% without flotation costs, and 10.5% - 11.8% with flotation costs. (Flotation costs are intended to cover the expense of issuing equity and are an area of dispute among the parties, as discussed below.) Using a variety of inputs, the Staff's CAPM analyses resulted in numbers ranging from a low of 9.43% up to 11.02%. ABATE's CAPM analysis resulting in a range of 10.1% to 10.7%.

The ECAPM approach adjusts for perceived biases of the CAPM model which produces a downward-bias estimate for companies with a beta of less than 1.00. In conducting its ECAPM analysis, Detroit Edison developed a return on equity without flotation costs of 10.7% to 12.0% and 11.0% - 12.3% with flotation costs.

The Risk Premium analysis uses a risk free interest rate and adds a risk premium to develop a return on equity. Detroit Edison conducted several studies using varying inputs resulting in a range of 10.6% to 12.0% without flotation costs, and 10.9% to 12.3% with flotation costs. Applying the Risk Premium approach, the Staff found a 4.17% risk premium, resulting in a cost of

common equity range of 10.8% to 10.95%. ABATE's risk premium analysis resulted in a range of 10.45% to 11.6%.

The DCF model assumes that an equity investor's expected rate of return is the sum of an expected dividend yield plus the expected growth rate for future dividends and stock price appreciation. The cost of common equity is the discount rate used to reduce future dividends and appreciation to present value. Detroit Edison's application of the model produced a range of 8.9% to 12.5% without flotation costs, and 9.2% to 12.8% with flotation costs. The Staff's DCF approach resulted in a 10.8% cost of common equity for Detroit Edison. ABATE's analysis resulted in a 9.1% cost.

In addition to disputes over the proper return on equity, the parties disagreed over whether flotation costs should be included. Detroit Edison argues that many states and provincial regulatory bodies permit recovery for costs associated with bond and stock issuance. The direct costs include compensation to the security underwriter for marketing and consulting services, and for distribution and operating expenses. Indirect costs are the downward pressure on the stock price because of the increased supply of stock. Detroit Edison's flotation costs are about 5%. Detroit Edison argues that it would be unfair to pass these costs on to its parent company.

The Staff and ABATE oppose the inclusion of flotation costs. The Staff argue that it is DTE that actually issues the new equity. DTE is able to subtract these expenses as an adjustment to the cost of equity. The Staff oppose the inclusion of indirect costs because these costs do not actually exist on DTE's or Detroit Edison's books. In the alternative, however, the Staff suggests that no more than 11 to 14 basis points in total flotation expense be added on the rate of return for common equity. ABATE argues that flotation costs are unsupported. Moreover, ABATE argues that Detroit Edison is not a publicly traded company and therefore incurs no flotation costs.

After reviewing the myriad of studies, the ALJ concluded that Detroit Edison should be authorized a rate of return on common equity in the range of 10%-11%, as recommended by the Staff. The ALJ was convinced that a rate of return for Detroit Edison in the mid to high-end of the range was appropriate. Additionally, the ALJ rejected Detroit Edison's inclusion of flotation costs. The ALJ determined that the cost of issuing equity is born by DTE and that DTE expenses these costs. Consequently, Detroit Edison does not incur flotation expenses. The ALJ concluded by indicating that there was no empirical or legal support for the inclusion of flotation costs.

Detroit Edison filed exceptions for this issue. Detroit Edison stands by its requested 11.5% return on equity. The Company argues that its witnesses analyses are the most thorough, tested, and academically justified in the record. Detroit Edison goes through a rather lengthy description of its witness's analysis and concludes that his 11.5% recommended return on equity is the most appropriate. Detroit Edison also takes issue with the ALJ's recommendation to exclude flotation costs. Again, Detroit Edison summarizes its witness's testimony and argues that it is unfair to make the shareholders of DTE bear this expense.

In its replies, the Staff supports the ALJ's recommendation. The Staff contends that the ALJ's review of the record and evidence was complete and his decision to adopt 11%, the high-end of the Staff's range, for Detroit Edison's return on common equity was reasonable. Moreover, the Staff points out that Detroit Edison's own witness actually testified to a reasonable range of 11% to 11.5%. The Staff argues that Detroit Edison's witness testimony supports an 11% return on equity just as much as it supports the high-end of his recommended range of 11.5%. The Staff claims that it runs contrary to Detroit Edison's own witness testimony for Detroit Edison to assert that 11% is unfair and unreasonable. The Staff continues to support the use of 11%. The Staff also supports the ALJ's recommendation to exclude flotation costs from the calculation of the cost of

equity. The Staff reiterates its position that these are costs incurred by Detroit Edison's parent company and not Detroit Edison.

While the Attorney General does not take exception to the PFD's recommendations concerning capital structure, long-term debt, or short-term debt, the Attorney General does take exception with the PFD's recommended return on common equity. The Attorney General reiterates his recommendation that Detroit Edison should receive a 10.5% return on equity. The Attorney General argues that the Staff's proposed 11% return on equity is too generous. Instead, the Attorney General argues that the midpoint of the range selected by Mr. Ballinger is 10.5%, while the midpoint of the range Mr. Ballinger actually found is 10.33%. The Attorney General repeats its contention that an 11% return on equity is too high in light of the much lower capital costs found today, that securitization has reduced Detroit Edison's overall financial risk, and that the Staff's proposed increase from the 40% equity level to 46% in this proceeding further reduces Detroit Edison's overall risk. Consequently, the Attorney General argues that Detroit Edison's return on equity should be fixed at 10.5%, the midpoint of the Staff's recommended range. The Attorney General reiterates this position in its replies to exceptions.

ABATE also argues that the ALJ erred in finding that Detroit Edison's return on equity should be set at 11%. ABATE notes that the PFD does not explicitly pick a number for Detroit Edison's return on equity, but rather recommends a return on equity in the range recommended by the Staff of 10% - 11%. ABATE also notes that the PFD recommends that the return on equity be set at the mid to the high-end of the range and uses 11% for the calculations in the PFD.

ABATE argues that the Commission set Detroit Edison's return on equity at 11% in Detroit Edison's last rate case when the company's capital structure was much more costly. Since Detroit Edison's last rate case, ABATE argues that interest rates have dropped, the utility has refinanced it

debt, and has transferred its risk for paying for its nuclear investments from shareholders to customers when it issued securitization bonds. ABATE argues that it is counter-intuitive that Detroit Edison should retain an 11% return on common equity.

ABATE also notes that out of the several methodologies the Staff used to compute a range for a return on common equity, only the CAPM methodology resulted in a range as high as 11%. Consequently, if the Commission accepts the Staff's ranges, ABATE argues that the Commission should set the return on equity at the midpoint, or 10.5%. ABATE argues that this is more consistent with the Staff's findings and recognizes less business risk and today's lower interest rate environment. ABATE also argues that the midpoint would also reflect the increase in equity in Detroit Edison's capital structure, from 40% equity approved in 1994 to the 46% recommended in this proceeding.

In its replies to exceptions, ABATE responds to Detroit Edison's exceptions specifically. ABATE notes that while its witness supports Detroit Edison's proposed capital structure of 50% equity and 50% debt, its witness indicates that this structure would only support a return on common equity at the mid-end of his range, or 10%. ABATE's witness testified that a 10% return on equity is consistent with Standard & Poor's benchmarks to maintain Detroit Edison's current BBB+ bond rating. ABATE asserts that if Detroit Edison's equity ratio is increased, then the return on equity component should decrease.

ABATE also outlines a number of problems its witness found with Detroit Edison's analysis in support of its 11.5% return on equity request. ABATE argues that Detroit Edison's witness used outdated data and that more current data would support a lower return on equity, that Detroit Edison's witness unnecessarily adjusted beta data in the CAPM, that his return on utility stocks

should be given little weight, that his calculation of equity risk premium is based on limited data, that his DCF analysis was based on stale data and that flotation costs should be rejected.

The Commission determines that Detroit Edison's return on equity should be set at 11%. The Commission finds that a return on equity of 11% is consistent with both the Staff's and Detroit Edison's recommended ranges in this proceeding. While 11% is at the high-end of the Staff's range, it is also within the reasonable range presented by Detroit Edison's witness. The Commission also determines that an 11% return on equity, the high-end of the Staff's range, is appropriate in light of the 46% equity ratio adopted above. The Commission is well aware of the interplay between a company's capital structure and return on equity and establishes an appropriate balance here.

The Commission also finds that the exclusion of flotation costs is appropriate. The Commission is persuaded that these costs are not costs incurred by the regulated utility. Consequently, it is not appropriate to include these costs in the calculation of Detroit Edison's return on equity.

In summary, Detroit Edison's overall rate of return should be calculated as shown on the following table:

Description	Amount	Ratio	Cost Rate	Weighted Cost	Cost of Debt	Multiplier	Pre-tax overall rate of return
Long Term Debt	$3,432,800,000	54.01%	6.31%	3.41%			
Common Equity	$2,922,800,000	45.99%	11.00%	5.06%			
Total Permanent Capital	$6,355,600,000	100.00%		8.47%			
Capital Structure							
Long Term Debt	$3,432,800,000	44.73%	6.31%	2.82%	2.82%	1.0194	2.88%
Short term debt	$279,000,000	3.64%	2.30%	0.08%	0.08%	1.0194	0.09%
Common Equity	$2,922,800,000	38.08%	11.00%	4.19%		1.5728	6.59%
Investment Tax Credit	$739,000	0.01%	0.00%	0.00%		0	0.00%
Deferred FIT	$910,232,000	11.86%	0.00%	0.00%		0	0.00%
JDITC	$129,384,000						
Def JDITC Long Term Debt	$69,883,157	0.91%	6.31%	0.06%	0.06%	1.0194	0.06%
Def JDITC Common Equity	$59,500,843	0.78%	11.00%	0.09%		1.5728	0.13%
Total JDITC	$129,384,000	1.69%		0.14%			
TOTAL	$7,674,955,000	100.00%		7.24%	2.96%		9.74%

Summary

With a rate base of $7,123,562,000 and an overall rate of return of 7.24% Detroit Edison's rates need to be reset in order to provide the utility with an opportunity to earn $515,581,000 in income. To determine the amount by which Detroit Edison's rates must be altered to accomplish this goal, the Commission must examine Detroit Edison's expected operating revenues and expenses for 2004.

7. Adjusted Net Operating Income

Reduced to its essence, adjusted net operating income (NOI) constitutes the difference between a company's operating revenue and its operating expenses. Exhibit A-11 details the

components of Detroit Edison's adjusted NOI for 2004. Detroit Edison calculated its 2004 adjusted NOI to be $331,157,000 by starting with its projected 2004 jurisdictional electric revenue of $3,347,134,000 and adjusting for operating expenses, operating income adjustments, and capped customer deferrals. See, Exhibit A-11, Schedule C1-1. However, having already expressed its preference for use of an historical test year methodology as adjusted for known and measurable changes, the Commission turns to the Staff's approach.

The Staff sponsored a detailed explanation of the components of its proposed adjusted NOI for 2004. See, Exhibit S-120, Schedule C-1. An overview of the Staff's position was presented by William G. Aldrich, who was then Manager of the Rate Section of the Commission's Energy Operations Division. Mr. Aldrich explained that the Staff made several adjustments to Detroit Edison's sales revenue. First, the Staff used a lower choice sales volume than Detroit Edison, thereby increasing revenue by $34 million. Second, the Staff removed $58 million of interconnection revenue. According to Mr. Aldrich, the effect of these two adjustments reduces Detroit Edison's sales revenue by $24 million.[17]

Another difference between Detroit Edison and the Staff with regard to sales revenue involves the imputation of revenue associated with special contracts. Under Detroit Edison's approach, the discounts for special marketing contract (SMC) and large customer contract (LCC) customers, which totaled $40,601,000 ($37,845,000 for SMC customers and $2.756,000 for LCC customers), were factored in as a component of the utility's revenue deficiency. On the other hand, the Staff increased Detroit Edison's sales revenue by $40,601,000 so as to avoid requiring the utility's other customers to contribute to the revenue shortfall caused by the SMC and LCC discounts.

[17]The change in choice sales volumes necessitated an increase in fuel and purchased power costs of $27 million, as shown on Exhibit S-120, Schedule C-3, line 11.

Mr. Aldrich also testified that the Staff made several changes to Detroit Edison's O&M expense calculation. First, the Staff limited O&M increases (other than pension and OPEB expenses[18]) to the expected inflation rate for 2003 and 2004. Second, the Staff reduced O&M expenses for certain A&G expenses that the Staff believed that Detroit Edison should capitalize.[19] Third, Staff removed $37,747,000 from O&M expense, consisting of interest on the control premium associated with the Staff's $160 million tax loss adjustment and removed the 40-year amortization of the control premium.[20] The Staff also adjusted depreciation expense downward by $4,822,000 to $457,689,000 for the reduced plant levels in Staff's case as shown on Exhibit S-120, Schedule C-5.

The effect of the Staff's revenue and expense adjustments is summarized in Exhibit S-120, Schedule C-1, which sets the adjusted NOI for Detroit Edison for 2004 at $293,081,000. The Staff subsequently revised its adjusted NOI figure to $293,827,000. See, the Staff's reply brief, attachment 1, p. 6.

The ALJ adopted the Staff's 2004 adjusted NOI of $293,827,000. As previously noted, the ALJ found that the Staff's proposal included appropriate adjustments to Detroit Edison's sales revenue and O&M expenses.

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[18]The Staff included the 2004 level of these expenses projected by Detroit Edison in its O&M expenses because the cost of these items had increased significantly from 2002 and because the Staff believed that these costs are largely beyond Detroit Edison's direct control.

[19]At page 111 of its reply brief, Detroit Edison agreed with the Staff's position on this issue. According to Detroit Edison, the 2004 reduction of A&G expense is $16.3 million. Further, Detroit Edison maintains that the increase in its rate base associated with the capitalization of those A&G costs carries with it a return of $2.6 million.

[20]Two other non-controversial O&M adjustments of $1.5 million and $420,000 were also made by the Staff.

Detroit Edison stresses that acceptance of the Staff's adjusted NOI amount is tantamount to rejection of several adjustments supported by the company. Specifically, Detroit Edison takes issue with the exclusion of the increased merger control premium adjustment ($15,365,000), increased generation O&M expenses ($45,359,000), and reflection of the higher level of choice sales penetration resulting in a revenue reduction ($99,146,000). Also, implicit in its request for a rate increase is its position that the Commission should not impute $40,601,000 in special contract discounts. Based on the PFD's recommendations regarding rate base, overall weighted cost of capital, and the adjustments to the PFD, Detroit Edison maintains that it is experiencing a revenue deficiency of $582,837,000.[21] Other issues concerning aspects of Detroit Edison's NOI calculation have been raised by the Attorney General, ABATE , and MEC/PIRGIM. The Commission will consider the few remaining issues that continue to be controversial seriatim.

a. Control Premium

In the September 29, 1990 order in Case No. U-9323, which involved among other things Michigan Gas Company's request for recovery of an acquisition premium adjustment[22] of $7.4 million associated with Southeastern Michigan Gas Enterprises' August 31, 1987 purchase from Michigan Power Company of the utility assets that became Michigan Gas, the Commission stated that: "…public policy dictates that we allow recovery of and on acquisition adjustments only where ratepayers receive a net benefit from the change in ownership."[23] Order, Case No. U-9323, p. 30.

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[21]Detroit Edison's reply to exceptions, p. 96.

[22]The Commission defined an acquisition premium adjustment as "the amount paid above 'book cost' or 'depreciation original cost' to acquire utility property previously devoted to public service." June 29, 1990 order, Case No. U-9323, p. 19.

[23]Michigan Gas's request for recovery of its acquisition premium adjustment was rejected.

Relying on this statement, Detroit Edison seeks to recover its allocated share of the control premium arising from DTE's May 31, 2001 acquisition of MCN, which Detroit Edison originally calculated to be $85.2 million for test year 2004 on the basis of a straight-line amortization approach. 7 Tr. 893.

In the rebuttal phase, Detroit Edison presented the testimony of Don M. Stanczak, its Director of Regulatory Affairs. Mr. Stanczak testified that although Detroit Edison originally proposed a straight-line amortization of the control premium, the proposal should be revised to include an amortization based on an annuitized approach. According to Mr. Stanczak, the annuity method results in a reduction of the cost of the control premium in the early years and, thus, provides a better matching of the merger synergies with the annual costs. He explained that the straight-line amortization of the control premium would have resulted in a higher cost in the first year, which would mean that customers would realize the smallest synergy savings at the same time the control premium costs were the greatest. Mr. Stanczak maintained that a better matching would be achieved by setting the control premium at a levelized amount that would allow for the greatest customer realization of the net merger savings in this case. In subsequent years, with flat costs and increasing merger synergies, he insisted that customers would realize an increasing benefit from the merger.

According to Mr. Stanczak, the levelized payment necessary to amortize the principal amount of the control premium (based on the Staff's pretax cost of capital of 9.99%) would be $60.2 million. Because the principal amortization inherent in the first year's payment amounts to $1.3 million, Mr. Stanczak proposed that the $60.2 million figure be increased to recognize that the

$1.3 million amortization (adjusted for tax effects) be included in the revenue requirement. With Mr. Stanczak's revisions, the total 2004 cost of the control premium is $61 million.[24]

The evidence shows that DTE paid $2.488 billion for MCN, which amounts to $1.478 billion over MCN's book value. The difference between MCN's market value immediately before announcement of the proposed merger and the purchase price paid by DTE was $893 million.

Detroit Edison did not include the entire $1.478 billion amount in calculating its proposed control premium. Instead, Detroit Edison focused on the $893 million difference between the pre-merger market value and the sales price. Further, Detroit Edison proposed recovery of only the portion of the $893 million that it identified as related to "synergy savings" that are expected to lower Detroit Edison's future costs. Detroit Edison estimated that its portion of the control premium should be 66% of the $893 million, or $589 million. Detroit Edison proposed to amortize recovery of this amount over 40 years.

Detroit Edison stated that average annual savings could reach, on average, $150 million per year in perpetuity and asserted that anticipated savings by Detroit Edison would be substantially greater than the control premium costs. For example, Detroit Edison maintained that its 2004 cost savings arising from the merger would be $122.6 million, which is about twice the control premium of $65.7 million

The Staff recommended adjustment of Detroit Edison's calculation of the control premium due to the utility's failure to recognize a tax loss of $456 million realized by DTE from the merger. The Staff asserted that the tax loss would generate a tax savings of $160 million for Detroit Edison. The Staff calculated the cost of the control premium at $46.2 million. See, Attachment I to the Staff's reply brief.

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[24]In its reply brief and its exceptions, Detroit Edison states that its request for recovery of the control premium amounts to $61.6 million.

The Attorney General, ABATE and MEC/PIRGIM opposed recovery of any portion of the cost of the control premium. They insisted that it was mere speculation to suggest that the merger would produce the purported savings for 40 years or more. They urged rejection of any recovery of the control premium on the basis that it would be contrary to sound regulatory policy. They also insisted that the Commission lacks statutory authority to approve such a recovery, which benefits DTE and its shareholders, not Detroit Edison and its ratepayers.

With three exceptions, the ALJ found Detroit Edison's control premium argument persuasive. The ALJ concluded that the savings identified by Detroit Edison's witnesses were a substantial and direct result of the merger. However, he agreed with the Staff regarding the tax loss reduction, he eliminated the control premium amoritization, and he found that 40 years is too long a period of time to project savings.

The ALJ found that the tax losses were essentially the same as a cash asset. The ALJ believed the tax losses should be used as an offset of the control premium for the purpose of calculating the recovery of the savings resulting from the control premium.

The ALJ also noted his concern regarding Detroit Edison's ability to show synergy savings for 40 years or more into the future given such variables as regulatory practices, electric choice industry restructuring, alternative energy sources, and even the needs of DTE, Detroit Edison and MCN as a result of the merger. The ALJ further recognized that the approval in this rate case is limited to those costs and savings actually realized thus far. For that reason, the ALJ stated that Detroit Edison would be required in its next rate case to substantiate the asserted savings for continuing recovery. He also stated that the Staff and other interested parties would be free to present challenges to the asserted cost savings.

Exceptions to the PFD were filed by Detroit Edison, MEC/PIRGIM, the Attorney General, and ABATE with regard to the control premium issue. Detroit Edison maintains that the ALJ erred in agreeing with the Staff's position that the control premium should be reduced to account for MCN's $160 million of tax losses retained by DTE. According to Detroit Edison, the Staff's position should be rejected because there is no basis for the assumption that the benefits of those tax losses are in any way related to the merger control premium. Rather, Detroit Edison maintains that because the book value of MCN reflected the value of these tax losses and because the value of the tax losses were also reflected in MCN's market value, the full value of the tax losses was inherently included in the value of MCN, and was independent of the merger control premium. Detroit Edison insists that the offset of the control premium for the tax losses would only be appropriate if the acquisition of MCN by DTE resulted in DTE realizing value not otherwise available to MCN as an independent company, which was not the case. In an attempt to illustrate its point, Detroit Edison calculated the control premium at page 57 of its exceptions both with and without the tax losses. Detroit Edison argues that the tax losses were "built into the difference between [MCN's] market value and book value," which Detroit Edison has excluded from the derivation of the control premium. Detroit Edison's exceptions, p. 57.

Attorney General argues that DTE, not Detroit Edison, incurred the costs of the merger. For that reason, he asserts that there would be an element of double recovery because MCN stock-holders received a capital gain on the exchange of MCN stock for that of DTE. The Attorney General argues that the double recovery also applies to DTE stockholders, because $1.774 billion in cash was received by DTE when it securitized Detroit Edison's stranded costs in 2000, which provided DTE the financial ability to acquire MCN.

The Attorney General also questions the benefits to consumers because MCN's gas and Detroit Edison's electricity are competing energy sources. According to the Attorney General, without the benefit of independent competition, the efficiencies of competition will be lost. The Attorney General also asserts that it is speculative to assume that Detroit Edison will realize known and measurable cost savings for 40 years because today's apparent efficiencies may become tomorrow inefficiencies.

ABATE argues that the merger has not produced any significant value for Detroit Edison's ratepayers. ABATE notes that Detroit Edison's reported savings are not from historical expense levels, but from projected expense levels. ABATE also posits that because some of the claimed synergy savings may have been reached without the need of merger, the acquisition premium seems excessive. Moreover, ABATE doubts that any meaningful extrapolation over the next 40 years will accurately measure the projected savings. ABATE also stresses that Detroit Edison's exhibits show an increase in expenses as a result of the merger at a level equal to or greater than the rate of inflation.

MEC/PRIGIM urge the rejection of any recovery of the control premium on the basis that it is contrary to sound regulatory policy. MEC/PIRGIM also question the authority of the Commission to award recovery for costs incurred by a parent company to acquire another company. Indeed, MEC/PIRGIM stress that there is no statutory authority for the Commission to approve such a recovery.

MEC/PRIGIM believe that experiences shown in the last decade, subsequent to the proliferation of holding companies, bears witness that a holding company structure is not necessarily in the public interest. According to MEC/PIRGIM, the establishment of holding companies was often pursued for the express purpose of avoiding regulatory oversight by the

Commission so that the parent companies could engage in transactions, mergers, and acquisitions that did not require regulatory approvals. MEC/PIRGIM argue that, if the Commission has no authority to oversee the merger, then how can the Commission authorize expenses associated with the merger. MEC/PIRGIM also insist that there has been no showing or independent verification that the price DTE paid for MCN was reasonable and prudent. Accordingly, MEC/PIRGIM maintain that the control premium is not a proper expense or purpose that should be recognized in regulated rates. Further, because the Internal Revenue Service (IRS) and Generally Accepted Accounting Principles (GAAP) do not provide for the amortization or expensing of good will or acquisition premiums, MEC/PIRGIM insist that the Commission should deny Detroit Edison's request for recovery of a control premium.

The Commission finds that the ALJ's recommendation to include $46.2 million in Detroit Edison's rates for the control premium should be rejected. DTE's decision to pay $893 million over the market price of MCN to acquire MCN's assets was not subject to any form of oversight by the Commission and is curious in light of the acknowledgement by a Detroit Edison witness that MCN was "financially distressed" at the time of the merger. 7 Tr. 924. The Commission is persuaded that Detroit Edison never adequately explained why it would pay such an enormous premium for a company that was in such poor financial condition.[25] The Commission is without any basis to question either the appropriateness of the merger or the reasonableness of the price paid by DTE to acquire MCN. Moreover, if DTE subsequently sells MCN for a profit, the Commission will likely be powerless to recoup any portion of the sale price for Detroit Edison's ratepayers, and could possibly be asked to raise rates again to cover the cost of lost synergies. Any

[25]On September 30, 2003, Mich Con filed a request for rate relief alleging a need for an additional $193 million on an annual basis.

system that requires ratepayers to endure rate increases for both found and lost synergies is truly dubious.

Additionally, the Commission is skeptical of Detroit Edison's contention that the alleged synergy savings associated with the merger could be expected to last for the immediate future let alone the next 40 years.[26] A significant core function of Detroit Edison—its fossil and nuclear generation groups—"were excluded from the merger transition process" because they "were not impacted by the merger." 7 Tr. 925. Detroit Edison even admitted that some of the centralization of activities could have been achieved without the merger. 7 Tr. 926.

According to Detroit Edison, much of the value created from the MCN acquisition was in the form of cost reductions realized through combining overlapping functions and internal services. But a significant portion of the labor savings appears to be attributable to early retirements and voluntary resignations,[27] which are not necessarily permanent. Other aspects of the merger produced confusion and customer consternation. A still pending investigation of Detroit Edison's and Mich Con's efforts to combine their billing systems, which apparently contributed to the incorrect billing of approximately 480,000 Mich Con customers in January 2002, has yet to be resolved. See, the February 6, 2002 order in Case No. U-13287. The costs associated with the billing system problems apparently were not included in the calculation of the merger synergies. 7 Tr. 1002. Still, other savings were derived by considering cost savings on early-terminated contracts without any consideration of the expenses caused by the early termination of such

[26]Arguing that the merger will provide customers with "permanent benefits," Detroit Edison chose a 40 year amortization period because it is the "longest amortization period generally recognized for long-lived assets." 7 Tr. 939.

[27]Through retirement supplements and severance payments, 1,186 employees in merger-affected organizations opted to leave the combined companies, but 375 of these employees have already been replaced. 7 Tr. 929.

contracts.[28] 7 Tr. 932. While Detroit Edison claims that, without the merger, Detroit Edison's O&M expenditures for 2004 would have increased by $84 million, the fact remains that the company's post-merger O&M spending exceeds its pre-merger spending levels by over $100 million.

In any event, the rates established by this order are based on expense levels that are predicated to provide Detroit Edison full recovery of its actual operating expenses during the test year as determined by the Commission.

For these reasons, the Commission finds that none of the control premium requested by Detroit Edison should be included in Detroit Edison's rates. This determination results in a decrease in the revenue requirement of $46.2 million.

b. Increased Generation O&M Expenses

Detroit Edison argues that the ALJ improperly decreased its generation O&M expenses by $45,359,000. Detroit Edison placed its test year O&M expenses (excluding pension, post-retirement health care, and the merger control premium) at $1,274.5 million, but the Staff proposed recovery of only $1,229.2 million. Detroit Edison complains that the Staff's methodology is flawed because it focused on 2002 historical expenditures, which were adjusted for the general effects of inflation at the Consumer Price Index (CPI) rate of 2% for 2003 and 2004.

The company maintains that its approach is more detailed and produces a more accurate estimate of its test year O&M expenditures. According to Detroit Edison, due to the age of its generation fleet and the effect of external forces, such as environmental and market changes, there will be significant upward pressure on its generation O&M expenses that should outstrip inflation

[28] Detroit Edison did not explain whether any of the costs associated with termination of the contract, which occurred prior to the test year, should have been recognized during the test year.

for the foreseeable future. Detroit Edison also maintains that, because this case will not be finally resolved until late 2004, the Commission should add an additional year of inflation increases to account for regulatory lag. Detroit Edison calculated that amount to be $24.6 million.[29]

In response, the Staff points out that Detroit Edison's generation facilities did not begin to age in 2002. According to the Staff, Detroit Edison improperly projected huge increases in O&M related to its generation facilities between 2002 and 2004. The Staff insists that Detroit Edison has failed to explain why these huge increases are necessary or why Detroit Edison should not be expected to remain within a budget based on inflationary adjustments.

The Commission finds that the ALJ did not err in recommending adoption of the Staff's position with regard to Detroit Edison's test year O&M expenditures. As pointed out by the Staff, Detroit Edison's projections of sudden and dramatic O&M expense increases attributable to its aging fleet of generation facilities is not plausible. Power plants must be continually maintained and it is unreasonable to assume that they would all fall into disrepair for no apparent reason. Even more persuasive is the ALJ's observation that "none of the proposed forecasted amounts have been approved by senior management as a budget number." PFD, p. 39. Accordingly, there is no assurance that Detroit Edison will actually spend the additional $45 million.

c. Pension Equalization Mechanism

In its exceptions, ABATE objects to the pension equalization mechanism (PEM) proposed by Detroit Edison. While agreeable with the concept of a mechanism to track pension expenses, ABATE maintains that the mechanism proposed by Detroit Edison is an automatic pension adjustment mechanism that does not allow for review of the expenses for reasonableness and prudency. According to ABATE, it is merely a tracking account that will not afford the parties the

[29]Detroit Edison exceptions, p. 55.

ability to consider the reasonableness and prudence of the expenses, whether the pension plan is correctly funded and invested, or whether the resulting rates are just and reasonable. ABATE also complains that the rate design proposed by the Staff of surcharges and credits, calculated on an equal per kWh basis, will over allocate expense to all high load factor customers. Rather, ABATE urges the Commission to adopt its proposal, which calls for a regulatory asset/liability account to be created and then trued up in the next general rate case. ABATE insists that its proposal will afford all parties the ability to determine whether the expense is just and reasonable.

In response, Detroit Edison argues that ABATE's proposal should be rejected. According to Detroit Edison, its PEM addresses the concern that the Commission expressed in its interim order to ensure that the utility's pension plan is funded in accordance with the level of pension expense recognized in rates. Detroit Edison is concerned that ABATE's proposal would unnecessarily delay the timeliness of the trueup of expense with no meaningful benefit. Moreover, Detroit Edison insists that ABATE's rate design concern is premised on an inaccurate assumption that only surcharges would be implemented under the PEM. Detroit Edison argues that because there is no basis for presuming that credits would be any less likely than surcharges, there is no reason to presume that high load factor customers would be disadvantaged by the uniform kWh methodology.

The Attorney General agrees with ABATE that if pension expense is to be adjusted before Detroit Edison's next general rate case, then the Commission should establish an account for that purpose that should be subject to a trueup proceeding. On the other hand, the Attorney General disagrees with ABATE's argument that pension expense should not be allocated on an equal per kWh basis. According to the Attorney General, pension expense is an overhead cost not directly allocable to specific services; therefore, it is appropriate to allocate the expense across all sales. In

the alternative, the Attorney General states that pension expense should be determined by functional expense categories and allocated the same way direct labor expenses in those categories are allocated.

The Commission finds that these exceptions should be rejected. As explained in Detroit Edison's rebuttal testimony at 13 Tr. 2575-2578 and in Exhibits S-176 and S-177, the PEM is a reasonable methodology for ensuring that the utility's pension plan is funded in accordance with the level of pension expense recognized in rates.

d. Pension Expenditures

The Attorney General contends that Detroit Edison did not have prior authorization to defer $532 million of pension costs as required by instructions in Account No. 182.1, and that approval of the deferral and recovery in this case would constitute unlawful retroactive ratemaking. According to the Attorney General, authorizing recovery beginning in 2004 of $532 million that Detroit Edison deferred in 2002 would shift those costs forward and would violate the rate freeze imposed by MCL 460.10d(1). The Attorney General maintains that when a utility does not have prior authorization to defer a cost, then subsequent recovery of that cost constitutes unlawful retroactive ratemaking. Therefore, he insists that the Commission must exclude Detroit Edison's $44.7 million amortization of projected pension expense for 2004 and reduce Detroit Edison's pension expense in Exhibit A-16, Schedule F5-2 from $112 million to $67 million. Further, assuming only for the sake of argument, that Detroit Edison's deferral, amortization, and recovery of the $44.7 million are lawful, the Attorney General still argues that an appropriate, alternative $46,447,180 cost reduction is justified.

In addition, the Attorney General contends that the Commission should exclude $4.1 million plus $2.35 million of related tax expense from Detroit Edison's expenses for five management retirement plans, which the PFD failed to address.

In response, Detroit Edison states that the Attorney General's arguments are based on an erroneous interpretation of the company's proposal, are inconsistent with the provisions of SFAS 87, and are even a contradiction of the Attorney General's own witness's proposal. Additionally, Detroit Edison maintains that if adopted it would preclude the company from having a reasonable opportunity to earn its authorized rate of return.

With regard to the proposal to exclude $4.1 million plus $2.35 million of related tax expense from Detroit Edison's expenses for five management retirement plans that the PFD failed to address, Detroit Edison states that because the Attorney General did not present any rationale in support of this proposal, there is insufficient basis for its adoption by the Commission.

The Commission finds that the Attorney General's exceptions should be rejected. As pointed out by Detroit Edison, the Attorney General's argument appears to be grounded on the erroneous belief that the amortization of unrecognized losses included in Detroit Edison's projection of pension expense is related to the regulatory asset recognized by the utility on December 31, 2002 to offset the effect of the minimum pension liability. Further, the Commission agrees that the proposal to exclude $4.1 million plus $2.35 million of related tax expense from Detroit Edison's expenses for five management retirement plans was not adequately supported and should be rejected.

e. Other Post-Employment Benefit Expenses

Detroit Edison requested recovery of $105.7 million of other post-employment benefit (OPEB) costs. The Attorney General sought to limit Detroit Edison's recovery of OPEB costs to

$63,754,860. The ALJ recommended rejection of the Attorney General's position. The Attorney General excepts to this recommendation.

The dispute concerns the methodology for projecting the test year OPEB costs. Detroit Edison projection is based on an analysis of the company's OPEB cost, based on the requirements of SFAS 106 and prepared by Hewitt Associates, LLC, its expert on actuarial matters. The Attorney General's proposal is a three year average of OPEB expense for 2002-2004.

The Commission finds that the Attorney General's exception should be rejected. The Commission is persuaded that the ALJ was correct in concluding that Detroit Edison's actuarially-justified projection for its 2004 test year OPEB costs is more reasonable than the Attorney General's use of a simple three-year average.

Detroit Edison shall include in its next general rate case application, a proposal to establish an OPEB equalization mechanism.

f. Choice Sales Prediction

Detroit Edison argues that the ALJ improperly rejected its choice sales volumes, which had the effect of understating its test year NOI by $99,146,000.[30] The ALJ agreed with the Staff's projection of choice sales of 7,565 GWh for the 2004 test year, finding it "highly likely" that choice sales will decline during 2004. PFD, p. 37. The ALJ based his belief on the results of the Staff's headroom analysis, which persuaded him that the likely effect of the interim order would be to cause migration of Detroit Edison's bundled customers to choice sales to slow down.

Detroit Edison maintains that significant headroom still remains for secondary customers and low load-factor primary customers to migrate to choice. Citing the testimony of William J. Newbold, Jr., its Manager of Electric Choice Strategy, Detroit Edison argues that it is critically

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[30]Strict adherence to the Staff's revenue deficiency model combined with data pertaining to Consumers' Rate D-3 demonstrates that the correct value is $91,528,000.

important to analyze the potential for choice savings on a customer-by-customer basis. According to Detroit Edison, use of average data will systematically understate the magnitude of choice savings and the level of choice sales.

Detroit Edison maintains that there is ample proof of its claim that choice sales of 9,250 GWh in 2004 is much more reasonable and realistic than the Staff's projection. In support of its contention, Detroit Edison points to its comprehensive customer-by-customer analysis of choice savings opportunities, which is described in Mr. Newbold's rebuttal at 13 Tr. 2748-55 Exhibits A-95, A-96, and A-97. Detroit Edison asserts that this evidence demonstrates a potential choice market of 10,750 GWh, of which 5,300 GWh are associated with primary customers.

The Commission finds that Detroit Edison's exception has merit and should be recognized. Detroit Edison's projected calendar year 2004 electric choice sales of 9,250 GWh was based on a projection of 8,259 GWh of choice sales as of January 2, 2004, another 632 GWh in process as of that date, and the expected year-end 2004 amount of 9,600 GWh, which prediction included an allowance for the return of some primary customers for whom choice would prove uneconomic. That prediction seems to have been borne out by the record evidence. Indeed, in his rebuttal testimony, Mr. Newbold stated that as of March 15, 2004, there were approximately 9,200 GWh of annual sales in service under the choice program, with another 622 GWh of enrollments in process. 13 Tr. 2745. The difference in revenue associated with adoption of Detroit Edison's choice volumes is $91.5 million. See, Exhibit A-101 and 13 Tr. 2853. In determining stranded costs, the Commission will true up to the actual choice volume.

g. Special Contract Discount Revenue Imputation Issue

Detroit Edison proposed that $40,601,000 ($37.8 million from SMC customers and $2.8 million from LCC customers) of discounts associated with special contracts be recovered

from all of its customers. The Staff proposed an alternative--a transitional primary supply rate (TPSR) tariff, with the associated rate set midway between the SMC contract rate and the full service rate. Under the Staff's approach, 50% of Detroit Edison's recovery of the SMC revenue shortfall would come from former SMC customers who switch to the TPSR tariff. The other 50% would come from all of Detroit Edison's customers.

In the PFD, the ALJ recommended approval of the Staff's proposed TPSR tariff. He also ruled against Detroit Edison on imputation of special contract discounts issue and included $40,601,000 of imputed revenues in determining the test year revenue deficiency.

In conjunction with its rate design-related exceptions, Detroit Edison maintains that if the Commission were to approve the Staff's TPSR proposal, then the Commission must eliminate the $40,601,000 imputation of discounts associated with special contracts.

The Commission finds that Detroit Edison's position on this issue is correct. It is inconsistent to both impute revenues in the test year for SMC discounts and to also provide for recovery of those revenues through use of the TPSR tariff as proposed by the Staff. To correct for the ALJ's conflicting recommendations, it will be necessary to adjust the rate design as discussed later with regard to the rate design issues.

REVENUE DEFICIENCY

The ALJ adopted the Staff's proposed calculation of revenue deficiency. As amended by the findings made in this order, Detroit Edison's revenue deficiency for the 2004 test year is computed as follows:

The Detroit Edison Company
Revenue Deficiency (000)

Description	PFD	Adj.	Order
Rate Base	$7,123,562	-0-	$7,123,562
Rate of Return	7.23%	.01%	7.24%
Income Required	$514,805	$777	$515,581
Adjusted Net Operating Income	293,884	8,198	302,082
Income Deficiency	$220,921	$(7,421)	$213,500
Revenue Multiplier	1.5729	-	1.5729
Revenue Deficiency	$347,485	$(11,673)	$335,812
Adjustments to Revenue Deficiency	-93,113	93,113	0
Adjusted Revenue Deficiency	$254,372	$81,440	$335,812

VI. Regulatory Asset Recovery Surcharge

Section 10d(4) of Act 141 and prior Commission orders authorize Detroit Edison to seek recovery of certain costs accrued and deferred while rate caps are in place. Specifically, Detroit Edison may recover "annual return of and on capital expenditures in excess of depreciation levels incurred… and expenses incurred as a result of changes in taxes, laws, or other state or federal government actions…" MCL 460.10d(4). The Commission shall allow recovery of reasonable and prudent costs over a period determined by the Commission not to exceed five years. Id.

In this case, Detroit Edison has requested recovery of certain Clean Air Act[31] expenses, capital in excess of book depreciation amounts, MISO charges, transmission integration costs, net stranded costs, and customer choice implementation costs through a regulatory asset recovery surcharge (RARS) over a five year period following expiration of rate caps at an amortized pre-tax rate of return of 10.32%.[32] Detroit Edison's brief, p. 119. Detroit Edison has also asked to include financing costs for the deferred amount until fully collected and a $1,513,575 refund to customers

[31] 42 USC 7401 et seq. and 42 USC 7651 et seq.

[32] Detroit Edison applied a 10.66% pre-tax rate of return in its brief, but revised to 10.32% in its reply brief.

required in Case No. U-11588 from the 1997 storm cost amortization in the RARS. Detroit Edison's brief, p. 120.

Initially, Detroit Edison suggested that the RARS apply to all customers, bundled and choice. However, after removal of choice implementation costs from the RARS (discussed further below), Detroit Edison agreed with the Staff, Energy Michigan, and Kroger that the surcharge should be applied only to bundled customers. ABATE added that recovery should not be based on kWh used because it would lead to rate disparity and an undue burden on large customers. ABATE exceptions, p. 11. The Attorney General noted that RARS recovery should not commence until after December 31, 2005, when rate caps expire and precise amounts are known. Attorney General replies to exceptions, p. 24.

Detroit Edison added a request in rebuttal to recover a carrying charge on approved amounts beginning with the implementation date of the interim order in this case and continuing through the date rate caps expire. 13 TR 2869-70; Exhibits A-108 and A-109. The Staff disagreed in its brief and reply brief. See, the Staff's brief, pp. 48-51 and the Staff's reply brief, pp. 10-11.

The ALJ supported Detroit Edison's request and recommended accrual of interest for capped customers. PFD, pp. 57-8.

The correlation between the regulatory assets incurred and utility generation requirements leads the Commission to agree with the parties that the RARS should apply only to bundled customers. Therefore, collection of a monthly surcharge shall begin January 1, 2005 or upon expiration of rate caps,[33] whichever is later, for each bundled customer based on customer class.

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[33]The Commission's interim order in this case issued February 20, 2004 established that the requirements of sections 10f and 10v of PA 141 were met, thereby removing rate caps on customers with peak demand of 15 kW or more. Rate caps for commercial and industrial customers with peak demand of less than 15 kW expire on January 1, 2005 and for residential customers no earlier than January 1, 2006.

The amount to be collected shall be amortized over the subsequent five year period as shown in Attachments I and II in the Staff's replies to exceptions with a 9.74% pre-tax interest rate. As a result, amounts recovered through the RARS will not be included in rate base. Further, the Commission agrees with Detroit Edison and the ALJ that carrying costs should be applied to amounts that are uncollectible while rate caps are in place as reflected in Attachments I and II of the Staff's replies to exceptions.[34]

Clean Air Act Expenses

Clean Air Act expenses are submitted for regulatory asset treatment as a qualifying change in law under 10d(4) of Act 141. Detroit Edison seeks recovery of depreciation on plant and financing costs of plant expenditures. No party disputed that these expenses were recoverable as regulatory assets.

Detroit Edison and the Staff disagreed about the time period over which the stated expenses were incurred. Detroit Edison claimed the costs began accruing May 1, 2000. 9 Tr. 1407, lines 10-13. The Staff contended that Detroit Edison's stated expenses went back to 1998. 14 Tr. 3036, lines 1-3. Therefore, in Staff's testimony, three adjustments were proposed; (1) the Staff included only plant additions that were made subsequent to June 1, 2000 (the approximate date that Act 141 was enacted), (2) the plant additions were jurisdictionalized, and (3) the Staff used a pre-tax rate of return of 9.88% from the effective date of the interim order to the end of 2004 and 9.74%[35] projected for 2005. The ALJ concurred with the Staff's proposed adjustments to Detroit Edison's filing.

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[34]These carrying costs should be calculated using the Commission's authorized pre-tax rate of return.

[35]The percentage was changed from 9.99% to 9.73% in the Staff's reply brief. 14 Tr. 3035-36 and Exhibit S-130. 9.74% is the Commission-approved pre-tax rate of return established pursuant to this order.

The Commission also agrees with the Staff's proposed adjustments to Detroit Edison's Clean Air Act expense recovery. Therefore, Detroit Edison is authorized recovery of expenses as shown with the adjustments in the Staff's replies to exceptions, Attachment I, with a pre-tax rate of return as stated above and amortized as shown in Attachment I.

Capital in Excess of Base Depreciation Levels (Excess Capital)

In accordance with Section 10d(4) of PA 141, yearly depreciation and interest ("return of and on") are calculated using the capital expenditures that exceed a base level of depreciation expense as determined by the Commission. The Staff proposed several adjustments to the amount stated in Detroit Edison's original application as shown in Exhibit S-130 of the Staff's testimony. 14 TR 3036-38. These adjustments include; (1) a different depreciation level from which to calculate the excess capital, (2) proration of the 2000 level of excess capital to coincide with the effective date of Act 141, (3) reduction of projected construction levels, (4) jurisdictionalization of construction and base depreciation, (5) proposal of a different depreciation rate for tangible plant and a different methodology for deriving vintage depreciation layers, (6) proposal of a different methodology for deriving depreciation on intangible plant, and (7) different interest rates for deriving the "return on" component of excess capital (see pre-tax rate of return discussion above). 14 TR 3036-38. The Staff noted that only capital expenses that have accrued subsequent to the effective date of Act 141should be included.[36]

In its exceptions, Detroit Edison continues to advocate use of a pre-tax overall rate of return at 10.32% and does not dispute the Staff's other adjustments to the excess capital calculation. The ALJ adopted the Staff's proposed adjustments. The Commission finds the Staff's adjustments are well taken and should be adopted at the authorized pretax overall rate of return.

[36]Although Act 141 became effective June 5, 2000, for simplicity, the Staff used June 1, 2000.

MISO Charges and Transmission Rate Increases

Section 10d(4) of Act 141 allows qualifying utilities to recover costs that result from changes in the law or from state or federal government actions as regulatory assets. MCL 460.10d(4). Detroit Edison, a qualifying utility, joined the MISO pursuant to section 10w(1) of Act 141, a state law requirement, thereby rendering MISO administrative costs recoverable as regulatory assets. Further, Detroit Edison is seeking recovery of an expected network transmission rate increase (commonly called "Schedule 9") in 2005 ordered by the Federal Energy Regulatory Commission (FERC), a federal government action.

The Staff initially made two adjustments to the figures submitted by Detroit Edison; jurisdictionalization of the costs and removal of the 2005 projected MISO and Schedule 9 transmission cost increase for recovery in the PSCR. 14 TR 3039. The Staff later recognized that jurisdictionalization was not appropriate but maintained that 2005 projected costs be included in the PSCR mechanism instead of the RARS. The Staff's reply brief, Attachment III, p. 13. Further, the Staff proposed that if such costs are not recovered elsewhere, such as the PSCR mechanism, then they should be recoverable through RARS reconciliation. 14 Tr. 3039.

Detroit Edison initially included the 2005 projected Schedule 9 network transmission increases in its proposed RARS calculation but removed it from its rebuttal testimony and initial brief. 13 Tr. 2868. Lines 5 through 7 of the transcript show that Detroit Edison only requests $5.8 million in 2005 MISO costs, which do not include Schedule 9. 13 Tr. 2868. The Staff explicitly acquiesced to removal of the Schedule 9 costs in its reply brief. The Staff's reply brief, p. 12. Detroit Edison objected to removal of the 2005 projected MISO costs in rebuttal and subsequent stages of the case claiming the rate cap prohibited them from recovering these costs from residential customers in any other manner. 13 Tr. 2867-68.

However, Detroit Edison did not reintroduce the Schedule 9 costs again until its exceptions to the PFD. Detroit Edison's exceptions, pp. 88-9. The Staff objected to the late inclusion of this item in its replies to exceptions and maintained that projected MISO costs should be recovered through the PSCR or, in the alternative, recovered through the RARS reconciliation process. The staff's replies to exceptions, p. 23.

Energy Michigan held that these charges should appropriately be recovered through the PSCR because Choice customers do not pay transmission charges to the utility. Energy Michigan's brief, p. 26.

The ALJ adopted the Staff's proposed adjustments, including not jurisdictionalizing MISO administrative costs, removal of Schedule 9 network transmission increases, and limiting RARS recovery from bundled customers only. PFD, p. 54.

The Commission finds that the MISO costs, including 2005 projections and Schedule 9 network transmission cost increases, should be recovered through the PSCR mechanism.[37] In the event that such costs are not recovered through the PSCR, particularly as related to customers who remain under rate caps, then such costs shall be recovered through the reconciliation of the RARS.

<u>Transmission Integration Costs</u>

Detroit Edison requested regulatory asset treatment of $9.4 million in costs incurred during 2000 and 2001 to divest its transmission assets since the action was a step toward compliance with section 10w(1) of PA 141. 13 Tr. 2865-67. The Staff disagreed, claiming that these costs were incurred to transfer the transmission assets to a DTE affiliate in preparation for sale to a third party and therefore appropriately should be treated as an offset to the sale price in determining the premium realized in the sale to International Transmission Company (ITC). 14 TR 3039-40 and

[37]In the future, Detroit Edison should raise such issues in a more timely fashion.

Exhibit S-130, p. 13. In rebuttal, Detroit Edison claimed that there was no relationship between these particular costs and the sale of ITC since they did not decide to sell the transmission business until 2002, the costs were incurred two years prior to the sale and relate primarily to legal, consulting, and auditing to transfer title of the transmission properties, and that the costs would have been incurred whether or not the transmission business was sold. 13 Tr. 2865-67.

The Staff maintained that the costs were appropriately recovered from the proceeds of the ITC sale, which generated a net premium of $26.4 million, and that allowing regulatory asset recovery treatment would result in an overrecovery. The Staff's brief, pp. 56-9. Further, the Staff refers to a joint application to commence the sale of these assets filed in May of 2000 to dispute the timing of the decision to go forward with the sale. Id. at 58.

In response, Detroit Edison pointed out that exclusion of these costs from the RARS will reduce the net premium on the ITC sale, thereby reducing the corresponding offset to implementation costs ordered in Case No. U-13646.

The ALJ agreed with the Staff's position that the transmission integration costs should not be included in RARS and should instead be deducted from gains resulting from the sale of ITC. PFD, p. 58. The Commission agrees that Staff's treatment is appropriate because the sale of the transmission assets to a third party was anticipated at the time the costs were incurred and regulatory asset treatment would result in an over recovery.

Net Stranded Costs

Detroit Edison included net stranded costs of over $11 million as part of the RARS in its application in this case. Exhibit A-22, Schedule A-1. The Staff proposed, and Detroit Edison agreed, to remove this item for separate treatment outside the RARS. Detroit Edison's brief,

p. 119-20. The Commission agrees that net stranded costs should be addressed outside of the RARS.

Electric Restructuring/Implementation Costs

Orders have been issued addressing implementation cost recovery for the years 2000 and 2001 in Case Nos. U-12892 and U-13341 respectively. Detroit Edison has requested regulatory asset treatment of these costs in each case filing. In response, the Commission offered Detroit Edison the option to begin recovery when rate caps expire on January 1, 2006 with a 7% carrying charge or inclusion of those approved costs in the final outcome of this case proceeding. In each instance, Detroit Edison elected to have the matter resolved in this general rate case.

In its initial application, Detroit Edison filed to include the approved amounts from 2000 and 2001 and estimates for 2002[38] and 2003[39] in the RARS calculation with an overall rate of return of 10.01%. Detroit Edison's application, Exhibit A-22. In its testimony, the Staff removed this item from the RARS to be recovered in a separate surcharge. 14 Tr. 3035. Detroit Edison did not object to recovery through a separate surcharge. Detroit Edison's brief, p. 119.

The Commission agrees that it is appropriate to recover implementation costs through a separate surcharge and therefore reserves discussion of the matter for the applicable section later in this order.

1997 Storm Cost Amortization

The Commission ordered Detroit Edison to refund a $1.5 million overrecovery of extra-ordinary storm damage expenses in Case No. U-11588. Though this is not a 10d(4) regulatory asset recovery item, Detroit Edison has included it in the RARS as a credit to provide the refund in

[38]Filed in Case No. U-13738 yet to be decided.

[39]Filed in Case No. U-14079 yet to be decided.

compliance with the order. None of the parties objected. The Commission agrees that the $1.5 million credit for the 1997 storm cost amortization be included in the RARS.

RARS Reconciliation

In its testimony and brief, the Staff advocated for a reconciliation of the RARS surcharge at the end of the recovery period to ensure that projected costs and the revenue collected are accurate. 14 Tr. 3040-41; the Staff's brief, p. 59. The Staff proposed that Detroit Edison return any overcollection to ratepayers with accrued interest at the end of the recovery period for each customer class. However, once the recovery period has ended, Detroit Edison will no longer be able to collect the surcharge in the event of an undercollection.

Detroit Edison raised no objections to this proposal until its reply to exceptions, in which it argued that a reconciliation should take place prior to expiration of the five-year recovery period to replace regulatory asset estimates with actual amounts and to adjust the surcharge for each customer class to ensure recovery of all regulatory asset balances with a pre-tax overall rate of return. Detroit Edison failed to raise this matter prior to the final stage of this case, no other parties were afforded the opportunity to comment.

The Commission finds Detroit Edison's suggestion persuasive. Detroit Edison may file a reconciliation application prior to expiration of the five-year recovery period at Detroit Edison's discretion. At that time, projections will be replaced with actual costs and sales volumes, as well as actual RARS revenue, and the surcharge shall be adjusted accordingly to ensure proper surcharge collection. Upon expiration of the five-year recovery period, Detroit Edison shall file a final reconciliation case for the RARS and, if applicable, provide a refund to customers for any overcollected amounts at the authorized pre-tax rate of return.

Implementation Costs for Choice Program

Detroit Edison seeks to begin recovery of approved choice implementation costs[40] plus those requested for 2003 in Case No. U-14079 beginning January 1, 2006 at a pre-tax rate of return of 10.01% or beginning with the effective date of this final order at a 7% rate of return applicable to all customers. The Staff proposed, and the ALJ agreed, that Detroit Edison should collect a 0.5 mill/kWh surcharge from all customers beginning January 1, 2006, the expiration of all rate caps, with a 7% rate of return, until all approved (including those approved in the future) implementation costs are recovered. The Staff also recommended that a reconciliation case be required when the approved implementation costs plus the 7% carrying charge are collected in full.

The Commission finds that Detroit Edison shall begin collecting a surcharge of 0.5 mill/kWh from all customers on January 1, 2006 to coincide with rate cap expiration at a 7% short term rate of return, consistent with prior Commission orders related to implementation cost recovery. Further, 50% of the proceeds from the sale of ITC shall be used to offset this surcharge in compliance with this order and as directed in Case No. U-13646. Finally, Detroit Edison shall file a reconciliation case when the approved implementation costs and aforementioned 7% carrying charge have been collected in full and shall provide a refund to customers of any overcollected amounts plus interest on that amount at 7%.

[40] Includes amounts incurred before 2003 approved in Case Nos. U-12892 (2000), U-13341 (2001), and U-13738 (2002).

VII. Rate Design

1. Allocation of Revenue Deficiency

The ALJ determined that the Staff's proposal was the most appropriate plan for recovery of the revenue deficiency. That proposal would increase rates across all customers on an equal percentage of revenue basis.

Detroit Edison objects to the ALJ's determination and argues that its proposal to separately identify and recover the costs of serving electric choice customers should be adopted. It argues that the Staff's proposal essentially recovers only a choice customer's funding of the low income energy program and provides no additional rate relief to recover the significant distribution cost increases that have occurred since rates were originally established based on 1995 cost levels. It argues that electric choice customers should not be permitted to contribute less for distribution costs than they would under a full service tariff.

Detroit Edison further argues that the cost-shifting prohibition of Section 10d(2) does not apply to the allocation of a rate increase or decrease. It argues that its proposal does not shift any costs that are already being recovered, it merely applies an increase to recover increased costs. Without the rate increase, Detroit Edison argues, rates would remain unchanged. It argues that the net revenue deficiency (total revenue deficiency less revenue deficiency recovered via transition charges and the revenue deficiency directly assignable to the RAST) should be allocated on an equal percentage basis to all "non-choice" bundled tariffs. Detroit Edison then proposes that the rate increase for electric choice customers be based on the separate analysis of distribution cost increases. It insists that the application of different percentage increases for full and electric choice customers does not conflict with Section 10d(2).

In its replies to exceptions, Detroit Edison reiterates all of its arguments (some verbatim) and concludes that if the Commission adopts the Staff's proposal, it will exacerbate the loss of bundled sales because electric choice customers will not have to pay their fair share of the increased distribution costs.

The Staff responds that the ALJ correctly adopted the Staff's proposal to allocate the revenue deficiency equally to all customer classes. The Staff states that its proposal avoids shifting costs among rate classes, which is prohibited under Section 10d(2). It argues that if the final rates are no longer proportional to the current rates because of the way the increase is allocated to the various rate classes, then a cost shift has occurred. It argues that customers paying bills will not distinguish between the old rates and the new surcharges; they will simply pay the sum of the two rates times their usage. The Staff states that even if cost shifting does not apply to choice customers, the Staff's method ensures that all customers' rates remain in the same proportion after the surcharges as they were before the surcharges, except for the effect of statutory rate caps.

Moreover, the Staff points out that it has recommended that choice customers be responsible for a proportionate share of the Staff's proposed low income and energy efficiency fund and implementation costs. Those charges are in addition to the equal percentage allocation of revenue deficiency to these customers. Therefore, the Staff argues, its proposed rate design does hold the choice customers accountable for a share of the distribution costs. However, Attachment 2 to the Staff's exceptions, which compares the bundled rates without generation costs to the choice rates, indicates that there is a rate differential between the charges to bundled customers and secondary choice customers for distribution costs. Allocation of the revenue deficiency to all classes on an equal percentage basis will increase this differential.

The Commission finds that the ALJ properly recommended adoption of the Staff's proposal to increase all rates on an equal percentage of revenue basis with some modifications. Before the equal percentage increase is applied, the revenue for each class should be restated to reflect the Commission's treatment of SMCs, as discussed later, and the Commission's determination that the rates for secondary choice customers should be increased by 1 mill per kWh to prevent increasing the current rate differential that exists between bundled and choice customers for distribution charges. The Commission rejects Detroit Edison's argument that this method barely permits recovery of the electric choice customers' portion of the LIEEF, which is included separately. The Commission finds that Detroit Edison will have an opportunity to recover its revenue deficiency as found in this order. Moreover, the Commission finds that adoption of Detroit Edison's rate proposal would result in significantly higher rates for certain electric choice customers. For example, as pointed out in the PFD, the Rate D4 meter cost would rise from $5.95 per month to $65 per month.

2. Transitional Power Supply Rate (TPSR) and
Special Manufacturing Contracts (SMC) Discounts

Detroit Edison has entered into special contracts with certain large and manufacturing customers that have been approved by the Commission. In the Commission orders approving those contracts, Detroit Edison agreed that it would have the burden to demonstrate that either the prices of the special contract are justified on a cost of service basis, or that the benefits for other customers are substantial and outweigh the costs that are not recovered from the special contract customer. The Commission consistently affirmed that Detroit Edison's shareholders should expect to bear much if not all of any revenue shortfall that results from the special contracts. The Commission has found that unless Detroit Edison can make a compelling showing for different

treatment, for which it must present at a minimum, clear, convincing, and unequivocal demonstration that the contract prices and terms are justified on the basis of cost of service and that the benefits of other ratepayers are substantial and have a value that outweighs the costs that are not recovered from the contract customers, the shareholders will absorb those revenue shortfalls. In addition, the Commission has found that before any recovery related to these contracts, Detroit Edison would be required to demonstrate that service provided in conjunction with the contracts has not, and will not in the future, impede the development of competition in its service territory.

The ALJ addressed the issue of how to treat discounts made available to special contract customers under SMCs and LCCs (collectively special contracts) at pages 70-76 of the PFD, in which he recommended that the Commission adopt the Staff's proposed TPSR as an alternative to disallowing the recovery of the discounts provided to these customers. He further recommended that the TPSR be calculated according to Exhibit S-128, as modified by the Staff in its brief. However, if the Commission does not adopt the TPSR, the ALJ recommended that it use ABATE's calculation to impute $43,541,000 of revenue for the SMC discounts.

In its exceptions, Detroit Edison points out that the ALJ included a $40,601,000 adjustment to the adjusted net operating income for 2004 related to the revenue shortfall related to these contracts as well as recommending the adoption of the TPSR. PFD, p. 63. Detroit Edison argues that if the Commission adopts the Staff's proposed TPSR, it should remove that adjustment.

Although the Staff initially preferred disallowing all discounts provided pursuant to special contracts, it now takes the position that the TPSR is the preferred resolution. The TPSR imposes a transitional tariff rate set at the midpoint between the special contracts and the amount applicable if special contract customers were required to return to full service tariffs. The TPSR tariff would

be available to only those customers that have previously been special contract customers. The Staff acknowledges that the PFD requires clarification on the issue of whether the Commission adopts the disallowance or the transitional rate, because including both is not appropriate.

The Commission finds that the Staff's proposed TPSR should be adopted, with the modifications agreed to by the Staff and Detroit Edison. As previously discussed, the Commission agrees that it is inappropriate to impute revenues for discounts if the Commission approves a new tariff to serve those customers. Accordingly, the Commission will not impute revenue associated with the SMC customers who will be served under the new TPSR tariff - $37,845,000. This issue is addressed through the rate design for the TPSR tariff by restating Detroit Edison's present revenues to reflect the $37,845,000. Consistent with the Staff's recommendation, 50% of the discount should be allocated to the SMC (TPSR) class and the remaining 50% should be allocated to all other classes on an equal percent of revenue basis. In this manner the special contract customers are provided some cushion against rate shock and Detroit Edison is not deprived of revenue that it needs in order for it to have an opportunity to recover its authorized return on equity.

The Commission rejects the argument that all large customers should be permitted to take service under this tariff. The TPSR shall be limited to those customers that have previously been served pursuant to a special contract approved by the Commission. This does not violate the prohibition against discriminatory rates, as special contract customers differ in circumstance from those customers that have not been served under those contracts. The Commission further rejects the argument that the TPSR will recover far less than the cost of service for special contract customers. The record does not support this argument, and a cost of service study would likely demonstrate that the cost to serve special contract customers is less than to serve primary

customers. The Commission is not persuaded by Energy Michigan's argument that the TPSR will harm other customers. Rather, the Commission finds that the TPSR is a rational method to mitigate the harm that other customers might endure should the special contract customers leave the system entirely. This tariff should be effective until the Commission issues an order in the next rate case.

3. "Backfilling" Rates

The Attorney General excepts to the ALJ's conclusion that MCL 460.10d(2) does not preclude rate increases for residential customers and for small commercial and industrial customers by no more than the reduced PSCR factor. Although he acknowledges that the Commission's order granting interim rate relief to Detroit Edison permitted netting rate reductions against rate increases for customers whose rates are currently capped by statute, the Attorney General argues that the Commission has not yet addressed the arguments in his petition for rehearing of the interim order. The Attorney General insists that the Commission may not increase any element of customers' rates if they are subject to the rate caps required by Act 141.

The Commission rejects the Attorney General's argument and affirms its position in the interim order that the rate caps permit netting of rate reductions against rate increases such that as long as the total rates paid by the customer do not increase, rate adjustments are permissible. In the Commission's view, the use of the plural term "rates" in Section 10d(2) indicates the intention to freeze the sum of rates charged. If the Legislature had wanted to prohibit any increase, notwithstanding an offsetting decrease, it could have explicitly said so. Thus, although Section 10d(2) limits the Commission's ability to permit Detroit Edison to collect additional amounts, that limit does not foreclose netting of increases against decreases. Thus, the Commission rejects the Attorney General's position on this issue.

4. Rate Design Summary

The Commission recognizes that Detroit Edison is experiencing a revenue deficiency in the amount of $335,812,000 and finds that the revenue deficiency should be recovered from all classes of customers on an equal percentage of revenue basis through surcharges. All surcharges shall be calculated in a manner that reflects the rate cap provision of Act 141 just as they were for interim rate relief. The Commission directs Detroit Edison to file tariff sheets with surcharges for all rate classes calculated to recover the approved revenue deficiency in the manner described above. The surcharge tariffs sheets shall indicate the full amount of the surcharge for each rate class and the applicable rate cap credits necessary to insure compliance with the rate cap provisions of Act 141. The Staff will verify that the calculation of the surcharges is consistent with the directions of this order.

Unbundling

MCL 460.10b(2) provides in part:

> No later than 1 year from the effective date of the amendatory act that added this section, each electric utility shall file an application with the Commission to unbundle its existing commercial and industrial rate schedules and separately identify and charge for their discreet services. . . .

Pursuant to that section, Detroit Edison filed an application in Case No. U-13286 on February 4, 2002. However, the Commission has not issued an order in that proceeding approving, rejecting, or modifying Detroit Edison's request, in part because during the statutory rate freeze, true unbundling was thwarted.

Energy Michigan argued that without unbundling, there are discrepancies between the RAST and charges for full service. It argued that without unbundling, there is no way to determine whether full service customers or RAST customers are being charged the full cost to serve them. Lack of unbundling, Energy Michigan argues, prevents making direct comparisons between the

generation service offered by Detroit Edison and that offered by alternate suppliers. Energy Michigan therefore, recommended that the Commission require Detroit Edison to file another unbundling case within 60 days of this order.

The ALJ rejected Energy Michigan's position after finding that Detroit Edison had already complied with its responsibilities under the statute. In his view, the Commission could not require Detroit Edison to file an additional unbundling case.

Energy Michigan excepts and argues that the Commission should require Detroit Edison to file another unbundling case within 60 days of this order. It argues that Detroit Edison plans to file a case concerning rate skewing sometime next year. In Energy Michigan's view, that would be an appropriate case in which to address unbundling issues. It argues that the Commission could delay the effective date of unbundling until January 1, 2006, when the last of the rate caps expires.

Detroit Edison responds that it would be preferable to delay any unbundling until 2006 after all rate caps have expired.

The Commission finds that Detroit Edison should file a new application for approval of a proposal to unbundle its rates as required by Act 141. The costs upon which Detroit Edison based its application in Case No. U-13286 are now stale, and would be an inappropriate basis for determining unbundling issues. In a separate order issued today, the Commission closes Case No. U-13286, recognizing the Commission's determination in this order that a new case will be required. The Commission finds, however, that 60 days may not be sufficient for Detroit Edison to file a new unbundling case that complies with the statute as well as the Commission's directions in Case No. U-13289, and the determinations made in this order. Therefore, the Commission is persuaded that Detroit Edison should be permitted 120 days from the date of this order in which to file its new unbundling case. The new case may be combined with a Detroit Edison request to

adjust rates to remove rate differentials or other inequalities as well as subsidies inherent in its current rates. The Commission anticipates that the case will be concluded before January 1, 2006, so that Detroit Edison's rates may be effectively unbundled at the time that the last of the rate caps expire.

VIII. Tariff Changes

1. Electric Choice Metering

The Staff presented testimony concerning delays experienced by electric choice customers into service and cited the need to install interval meters for all three-phase customers as the cause. In the Staff's view, the problems are "acute, significant, and threaten the ongoing success of [Detroit] Edison's electric Choice program." 14 Tr. p. 3115. The Staff recommended that the Commission require Detroit Edison to propose a method for dealing with the interval meter installation issues and present it to the Commission.

Detroit Edison answered that it was recovering from the overwhelmingly massive volume of enrollments received in Fall 2003. It argued that the recovery has been completed, so at the present time, the problem is neither acute nor significant. Detroit Edison did make a proposal in the present case that calls for energy-based rates for secondary customers and interval meters for primary customers.

CNE proposed a solution that calls for a threshold of 100 to 500 kW, above which interval meters would be required, and to use load profiles to start customers on the choice program without waiting for interval meter installations. In its brief, CNE proposed that the Commission increase the threshold on interval metering to 500 kW or approve Detroit Edison's proposal that interval meters not be required for customers on existing energy rates.

The ALJ recommended that the Commission adopt a portion of CNE's proposal for electric choice metering. That portion would require Detroit Edison to begin serving an electric choice customer within the time required by the RAST, while temporarily using load profiling for customers that are awaiting Detroit Edison's interval demand meter installation, rather than delaying service until that installation is complete. However, the ALJ also found that a collaborative examination of electric choice metering requirements is necessary. He therefore recommended that the Commission require Detroit Edison to prepare a report in collaboration with other interested parties, but, in the meantime, implement CNE's proposal to profile customers for a short period until a meter can be installed when necessary.

Detroit Edison excepts and argues that if a collaborative effort is required before a final proposal is made, the company should not be required to implement on a short term basis CNE's proposal, which the utility says would be expensive. Moreover, Detroit Edison argues, there is no need for further study or collaborative proceeding on this issue. It would be far better, Detroit Edison says, for the Commission to resolve this issue without introducing further, unnecessary delay. Such delay, it argues, only prolongs uncertainty for Detroit Edison, its customers, and the alternative suppliers.

Energy Michigan excepts to the PFD by arguing that Detroit Edison should be required to install new meters within 30 calendar days. It argues that the Commission should reduce and specify the time within which Detroit Edison must attain site-ready status for new choice customers. It argues that customers should be able to begin service under the RAST tariff within 10 days of application if no meter installation is required.

The Staff responds that the ALJ correctly adopted the Staff's position on electric choice metering issues. It agrees with Detroit Edison that implementing the portion of the CNE

recommendation prior to arrival at a long-term solution would result in significant program costs that might later turn out to be unnecessary or unwarranted.

The Staff continues to recommend that the Commission direct Detroit Edison to convene a group of all interested parties in an attempt to work out a mutually satisfactory agreement on the best way to proceed to resolve this issue. It states that three parties in addition to the Staff provided testimony about ways to resolve the ongoing metering issues. Each made similar, but not identical proposals. The Staff states that the differences should be resolved expeditiously, and the Staff believes that the best resolution may incorporate some aspects of each of the parties' proposals.

If, however, the Commission determines that it should select one of the proposals put forth in this case, the Staff recommends adopting Detroit Edison's proposal to adopt energy-based rates and require interval demand meters only for customers served at primary voltage. However, the Staff states that it is reluctant to recommend this solution without simultaneously addressing the appropriate energy-only charges to be assessed to the customers that will be affected by this change. The Staff believes that Detroit Edison's proposal might result in significant rate increases for smaller electric choice customers compared to the current method, which relies on interval demand data.

Energy Michigan urges the Commission to reject Detroit Edison's proposal for electric choice metering. It agrees with the Staff that the proposal may disguise a rate increase for some choice customers, and that Detroit Edison did not propose to reduce its revenue deficiency by the cost of meters that it would no longer need to install. Energy Michigan states that, under those circumstances, Detroit Edison's proposal would essentially provide the utility with a windfall.

The Commission concludes that it should adopt the Staff's proposal to direct Detroit Edison to convene a collaborative process in which interested parties come together to resolve the issues involved in electric choice metering. To that end, the Commission finds that Detroit Edison shall immediately convene such a process and file a report of the agreed resolution with the Commission as soon as a resolution is reached, but no later than March 15, 2005.

2. RAST Sections 2.4 and 2.6.1

Detroit Edison proposed to change Section 2.4 of the RAST to allow only one AES to serve the electric load at a particular location and included in Section 2.6.1 a similar restriction on any account that bills for multiple meters located at different sites. Energy Michigan objected, arguing that the current system works well and that Detroit Edison has not defined "location." Energy Michigan further argued that the revision might impair, for example, the ability of more than one AES to serve separate tenants in a shopping mall.

Detroit Edison argued that its proposed revision was designed to codify its current practice of enrolling all meters at a customer site at once, which the company asserted happens in the majority of cases. The company argued that the reason the current system works is because the majority of sites have only one supplier. Moreover, Detroit Edison argued, the revision would prevent customers from maintaining discounted loads with the utility and moving to an AES only those loads that are not discounted.

The ALJ concluded that this proposed revision should be rejected as Detroit Edison had not demonstrated the need for it, and the likely result would be an unnecessary limitation on electric choice customers' options.

Detroit Edison excepts and argues that its proposed language is intended to match its current practices. It argues that its witness testified that the keys to defining a location are the physical

site itself and ownership of the Detroit Edison electric account(s). 13 Tr. p. 2778-80. If an account is currently billed using multiple meters, Detroit Edison says, all of those meters are moved to RAST as a group. It argues that changing the existing grouping of meters is a complicated, manual process, even without adding the complexities of choice. It states that an enrollment request seeking to enroll one or more, but not all, of the meters in an existing grouping of meters will require that the enrollment be delayed while the customer's account is restructured. This must occur, Detroit Edison says, before the enrollment can enter the automated process. Moreover, Detroit Edison argues, restructuring customer accounts based on AES instructions invites chaos, because the AES probably will not understand the meters and account structure. In cases in which a sub-meter meters a part of the load, separating these meters into two accounts would result in the customer being charged twice for the energy measured by the sub-meter. Detroit Edison argues that the consequences of not approving these changes will complicate and may delay the choice enrollment process.

Energy Michigan responds that there are obvious disadvantages to Detroit Edison's proposal to force all accounts at one site and each account for multiple sites to be either choice or retail bundled service instead of the current practice that each account may be served by the customer's preferred supplier. Energy Michigan argues that there is no evidence on the record that the current system does not work. It argues that many locations have multiple electric accounts because service is provided at multiple voltage levels, unmetered outdoor protective lighting is used, or there are multiple tenants at each site. It may be impractical for one AES to serve all of these accounts on one site.

The Commission is not persuaded that Detroit Edison's proposed changes to its RAST Sections 2.4 and 2.6.1 should be approved. It appears to the Commission that limiting each

account to one AES is sufficient, without the additional restrictions. Notwithstanding Detroit Edison's explanations on the record and in its briefing, the proposed language does not define "location" and would likely lead to confusion.

3. Enrollment Deadlines

Energy Michigan proposed changes to Section 2.5 of the RAST that would create specific time frames for beginning service under the tariff. The ALJ recommended that the Commission adopt Energy Michigan's proposed 10-day time period for beginning RAST service when no metering activity is required at the site. He found that the other proposals by Energy Michigan regarding this tariff should be referred to the collaborative process on metering recommended earlier.

Detroit Edison excepts and argues that Energy Michigan's proposals regarding enrollment deadlines and penalties should not be adopted. It argues that it is unreasonable to adopt limits regarding timing when the collaborative process may well change the number of customers to which metering requirements apply, how many enrollments should be held to the standard, and perhaps even the processes involved in handling enrollments. Detroit Edison states that where meter work is not necessary, proceeding to "site-ready" status is an electronic event that happens almost immediately. Therefore, the 10-day requirement is not needed. It argues that the better response is to change the metering threshold to solve the problem and conduct a collaborative for other issues.

The Commission is persuaded that the ALJ's recommendation concerning the proposed revision to Section 2.5 should be adopted. By Detroit Edison's own admission it will have no trouble meeting the time requirements for sites in which no metering work is required. All other RAST metering issues are referred to the collaborative process established earlier in this order.

4. Telemetry for Interval Meters

Detroit Edison proposed changes to RAST Sections 2.9.1 and 2.9.2 that would require the telecommunications line to the meter be installed before the customer may switch to choice. The current tariff provides a 2-month grace period during which Detroit Edison manually reads the meters. The proposed revision requires successful testing of the telecommunications equipment and imposes a $45 charge whenever any customer installed telecommunications device fails.

Energy Michigan opposed this revision because it would delay a customer switching to choice if an incorrectly installed line caused problems with the remote meter reads. Moreover, it argued that Detroit Edison did not demonstrate on the record that it has a problem of frequent and repetitive site visits due to telecommunications failures.

The Staff recommends that the issue be referred to the collaborative process on electric choice metering.

The ALJ recommended that the Commission reject the proposed revision.

Detroit Edison excepts and argues that its proposed revision should be adopted. It argues that it must reduce manual interval meter reading costs to have a manageable program and to create parity with Consumers Energy Company's programs. Detroit Edison states that this issue should be tied to the metering issue and argues that if a customer is large enough to require interval metering, it should be expected to have telemetry.

The Commission finds that the proposed revision should not be adopted at this time. Although it does not appear unreasonable to the Commission that a customer seeking to be on the RAST should be responsible to provide a telecommunications line, the Commission is persuaded that this issue is related to the other electric choice metering issues and finds that it should be referred to the collaborative process described earlier.

5. RAST Section 4.1

Detroit Edison complains that the ALJ failed to address the company's proposed change to RAST Section 4.1 to clarify that an active account number is needed for a customer location to be enrolled in choice. It states that the Staff proposed language would eliminate the need for an active account number in the hope that it would enable a new customer to immediately take choice service. Detroit Edison argues that the Staff's proposed language would create a tariff requirement that is impossible to meet. It says that without an active account number there is no way to process an enrollment, regardless of tariff language. It argues that its proposed revision is necessary and should be adopted.

The Staff recommends that the Commission not adopt Detroit Edison's proposed language and instead adopt its proposed clarification that would permit a new customer to become a choice customer without the requirement that it first be a bundled customer for a few months.

The Commission is not persuaded that Detroit Edison's proposal should be adopted for the reasons supporting the Staff's position. In the Commission's view, a new customer should not be required to be a Detroit Edison bundled customer before it becomes a choice customer. The Commission finds that the Staff's proposed clarification to this tariff section should be adopted.

6. Resale Tariff

The Staff proposed that Rider No. 4 of Detroit Edison's resale of service tariff be amended to include language permitting those customers taking service under that tariff to choose an AES and participate in choice. Detroit Edison objected to including the added language, arguing that Rider No. 4 works well now. It asserted that the company had not received complaints about the tariff as it stands, nor had the company encountered problems caused by the lack of the Staff's proposed language.

The ALJ recommended that the Commission adopt the Staff's proposed language, consistent with the Commission's action in its December 20, 2001 order in Case No. U-12488.

Detroit Edison excepts and argues that the language proposed by the Staff is nonsensical. It argues that the Staff's proposal purports to dictate the rates imposed upon the ultimate customer, when the resale of service tariff does not contain rates for the ultimate customer, but only for the customer that will resell the service. In Detroit Edison's view, the Staff's proposal would prevent the tenants from sharing in any savings the landlord might obtain by moving to choice. Moreover, Detroit Edison argues, the language would put Detroit Edison in the position of enforcing a change in the contractual arrangement between the landlord and the AES.

Detroit Edison further argues that Rider No. 4 is not currently applicable to the RAST. It states that this does not prevent the landlord from taking RAST service and reselling to tenants, but only that in doing so, the landlord is not subject to the terms of Rider No. 4. Detroit Edison states that it is not certain of the Staff's intention in proposing this amendment. However, it states, if the landlord elects to take RAST service, charges for electric services to tenants should be a landlord/tenant issue only, without reference in the tariff that might require the company to intervene.

The Staff responds that the ALJ correctly adopted the Staff's proposed language modifying Rider No. 4 to make the tariff provision clearer.

The Commission finds that the amending language proposed by the Staff should be adopted. If a landlord takes RAST service to resell to its tenants, the landlord should be held to the Rider No. 4 terms and conditions for service provided by Detroit Edison. The Commission agrees with Detroit Edison that Rider No. 4 should also require that the landlord provide notice to tenants of the decision to obtain electric service pursuant to the RAST, a notice that includes that the rates for

energy are not regulated by the Commission. Detroit Edison should submit proposed tariff language to accomplish such notice.

7. RAST Section 8.2.2

In his direct testimony, Detroit Edison's witness Falletich, proposed changes to the RAST including the deletion of Section 8.2.2 in its entirety. He suggested that the following language be inserted in its place:

> The System Use Charge shall be the product of the applicable rate as shown in section 8.6 and the Customer's maximum demand for each location. The maximum demand shall be the highest demand created during the previous 12 billing months. The maximum demand shall be computed by applying demand conversion tables to electric usage as reflected on the energy only meter, but not less 50% of the Distribution Contract Capacity.

The current language in Section 8.2.2 dates back to the Commission's December 20, 2001 order in Case No. U-12489. In that order, the Commission approved an optional System Use Charge of 2.88¢/kWh for energy metered customers. On April 27, 2002, the Commission issued another order in Case No. U-12489, removing the ¢/kWh System Use Charge and approving a demand based charge. At that time, Section 8.2.2 should have also been changed.

No parties to this proceeding disputed Mr. Falletich's proposal. Therefore, the Commission adopts the changes proposed by the company to RAST Section 8.2.2.

IX. CUSTOMER CHOICE

Recovery of Historical Stranded Costs

The interim order adopted a transition charge of 4 mills per kWh, which was the upper end of the range proposed by the Staff. In so doing, the Commission rejected Detroit Edison's lost margin approach because it clearly resulted in excessive stranded costs. The Commission encouraged parties to suggest ways to mitigate stranded costs and to make recommendations

regarding the relationship between stranded costs calculations and the return to service provisions for retail open access customers.

The Staff recommends that Detroit Edison recover its historical stranded costs for the 2002, 2003, and the first two months of 2004 (prior to the issuance of the interim order) using the Commission's then existing stranded cost methodology. The Staff notes that during this period, rates were still frozen under the provisions of Act 141 and that the existing stranded cost methodology would be appropriate during such a period. The Staff explains that methodology as follows:

> The method relies on calculating the Company's fixed production plant costs and the revenue provided through current rates along with the net revenue from third party sales to cover those fixed costs. Staff witness Mr. Kusiak has provided calculations for the fixed costs of the Company's production plant for 2002 and 2003. Staff witness Mr. Blair has calculated the revenues provided by current rates to recover those fixed costs. Generally, Staff has followed the same method that it used in U-12639, which involves the following steps: (1) calculate the current production plant fixed costs including fixed costs associated with power purchase agreements, (2) use the Company's last cost of service study considered by the Commission in setting rates prior to the rate freeze to estimate the percentage of revenue in the cost of service attributable to production fixed costs, (3) multiply that percentage times current revenue to estimate the amount of revenue in current rates allocable to production fixed costs, (4) calculate net revenue from third party sales, and (5) subtract these last two quantities from the current production fixed costs to determine stranded costs.
>
> This process was followed for 2002 and 2003. The 2003 stranded cost was used as the basis for calculating stranded costs for the first two months of 2004. Generally, Staff has adhered to its original methodology, but has made some modifications.

14 Tr. 3143-3144.

The modifications that the Staff made include: (1) the removal of capital costs of the Fermi II unit, because those costs were replaced by securitization funding, (2) imputation of revenues for special manufacturing contracts and large customer contracts, (3) an adjustment to third party revenues relating to PSCR costs, and (4) an adjustment to recognize revenue generated by the 4

mill per kWh transition charge collected under the interim order. After reviewing rebuttal testimony filed by other parties, the Staff modified its stranded cost calculation of approximately $64 million to include clean air costs in plant balances, removal of customer choice implementation costs, elimination of unamortized investment tax credits recorded as generation related regulatory assets, and an adjustment to options related to third party sales. With these adjustments, Staff recommended a historical stranded cost of $43.616 million.

The ALJ recommended adopting the Staff's proposal as the most reasonable both historically and prospectively. The ALJ concluded that this approach balances the needs of Detroit Edison and those of the other parties with respect to the policies and procedures enunciated by the Commission in prior orders. Exceptions were filed by Detroit Edison, ABATE, and Energy Michigan. Detroit Edison argues for a historical stranded cost of $107.021 million, while ABATE and Energy Michigan argue that the company has stranded benefits rather than stranded costs.

Detroit Edison contends that three modifications should be made to the calculation. First, the company argues for a higher pre-tax rate of return than that adopted by the Commission in the interim order. Second, Detroit Edison argues for use of a different mix of production and distribution revenue requirements from that used in the most recent cost of service study. According to Detroit Edison, the use of the revenue allocation factor supported by ABATE and Energy Michigan would be inappropriate because that methodology does not use fully allocated production plant, ignores production working capital, and allocates revenues on a cost-of-service study that does not properly reflect the current revenue requirements split between production and distribution. Detroit Edison contends that these adjustments will increase net stranded costs to $14.8 million in 2002 and $74.5 million in 2003. Finally, Detroit Edison argues that stranded costs should exclude $13 million of stranded benefits. In its replies to exceptions, Detroit Edison

reiterates its position that the calculation in the PFD has methodological flaws. In addition, Detroit Edison contends that any derivation of stranded benefits from the production fixed cost framework is a fictional result because the choice sales losses do not create an incremental source of cash flow from which the utility can provide securitization offset credits to choice customers.

In its exceptions, ABATE argues for numerous adjustments to the stranded cost calculation, including: (1) a modification of the pre-tax rate of return, (2) an adjustment to the cost of service for the accelerated amortization of Fermi 2 and the adjustment of rates to reflect the Fermi 2 phase-in, (3) inclusion of rate base additions related to the deferred depreciation return associated with Fermi 2, Fermi 2 FAS 90 costs, Greenwood 1 FAS 90 costs, and a deduction from rate base associated with the Fermi 10-year recovery, and (4) inclusion of Fermi 2 phase-in costs relating to amortization of deferred return, deferred depreciation and $300 million of Fermi 2 costs excluded from rate base. According to ABATE, these adjustments result in $16.642 million of stranded benefits (i.e. negative stranded cost) rather than the $43.616 million found by the ALJ.

Energy Michigan also argues that Detroit Edison has negative stranded costs. According to Energy Michigan, the stranded cost calculation includes the sale of unneeded hedges, options, and imbalance power, which would result in stranded benefits of $20 million. Energy Michigan argues that the Commission should provide a credit for PSCR customers for the revenue contained in the frozen PSCR and should use the entire balance including revenue from the sale of hedges and resale and sales of imbalance power as revenue to Detroit Edison which is available to offset production fixed costs. According to Energy Michigan, this would result in Detroit Edison possessing enough revenues from hedges to offset all production fixed costs. Moreover, Energy Michigan argues that the allocation of customer revenue to pay production fixed costs is under-stated. Energy Michigan argues that the stranded cost calculation should include adjustments

related to deferred depreciation, FAS 90 costs, a different pre-tax rate of return, cost of service revenues utilized to develop total production revenues available to pay fixed costs, and removal of any nuclear revenue from the total production revenue denominator. Finally, Energy Michigan argues that the Commission should recognize the transition charge revenues collected as a result of the interim order and the effect of more stringent return to service provisions.

In its reply to exceptions, Energy Michigan argues that Detroit Edison, in its exceptions, is attempting to create a new stranded cost calculation that is unsupported by the record. According to Energy Michigan, Detroit Edison discussed the theoretical concept that production fixed costs should be revised to reflect more current mixes of production and distribution requirements, but the utility produced no specific allocation or implementation of that concept.

In its replies to exceptions, the Staff contends that ABATE is using different rates of return at different points in the stranded cost calculation, which is inappropriate. According to Staff, arguments raised by the parties regarding the specific rate of return are irrelevant, because as long as the same rate of return is used through the cost of service study, it should not materially impact the final calculation. With respect to the other changes proposed by ABATE, the Staff contends that it has applied a consistent methodology compared with ABATE's, which has serious inconsistencies. With regard to Energy Michigan's rely to exceptions, the Staff contends that hedge costs should not be included in the stranded cost calculation because hedge revenues were also not included. Finally, the Staff argues that Energy Michigan's methodology has the same inconsistency problems as ABATE.

It is clear from the discussion that the parties propose vastly different levels of historical stranded cost, with Detroit Edison proposing to more than double the ALJ's recommendation from $43.616 million to $107.021 million, while ABATE and Energy Michigan each argue for a

negative level of stranded cost. Both sides pick and choose various adjustments to the calculation designed to raise or lower the stranded cost level. However, the relevant question is not whether a particular calculation can be devised to result in a higher or lower stranded cost. Rather, as recognized by the ALJ, the appropriate consideration is whether the calculation properly balances the needs of the utility and its customers. As previously noted, the Staff had originally calculated stranded costs of approximately $64 million, but, after reviewing the rebuttal testimony of other parties, made four specific adjustments resulting in a stranded cost of $43.616 million. After reviewing these adjustments, the ALJ concluded that they fairly recognize the need for both bundled and choice customer to pay a fair share of their costs.

The exceptions in this case do not provide any convincing reason to believe that the historical stranded cost recommended by the ALJ does not fairly balance the competing interests involved. At most, the arguments merely demonstrate that by mixing and matching the various components of the calculation, it is possible to generate different (indeed markedly different) numbers. The ALJ appropriately considered the various additional modifications proposed by the parties and concluded that those modifications are neither necessary nor appropriate. The Commission confirms that conclusion.

The interim order set the transition charge for recovery of historical stranded cost at 4 mills per kWh for both primary and secondary customers. Although the ALJ addressed the total dollar amount of stranded cost, he did not address the specific level of recovery for each customer class or the time period over which recovery should occur.

In its exceptions, Kroger argues that the transition charge should be set at 4 mills per kWh for secondary customers and zero for primary customers until the remaining balance of the $43.616 million is collected. Kroger argues that primary customers have little or no headroom (i.e. the

amount by which full service customer rates exceed the cost of third party supplied power), while secondary customers have headroom that ranges from 1.22 to 3.40 cents per kWh. Kroger contends that the higher headroom justifies a different transition charge for the two customer classes. In addition, Kroger argues that when avoided purchase power costs are factored into account, Detroit Edison has no stranded costs for customers taking service at primary voltage and above. Kroger argues that the generation margin loss for secondary customers is 3.5 to 4 times larger than for primary customers. Accordingly, Kroger contends that the 4 mill per kWh transition charge should remain only on secondary customers until the remaining balance of the $43.616 million is collected.

In its replies to exceptions, Detroit Edison agrees with Kroger that class specific transition charges are both supported by the record and warranted. However, the utility argues that, contrary to Kroger's assertion, it has positive head room for customers on Rate D6 with use between 400 and 500 hours per month. Detroit Edison claims that the existing rate for high load factor customers may already be competitive with the market.

In its exceptions, Energy Michigan argues that the ALJ failed to specify the timeframe to recover the historical stranded costs and that the Commission must do so. Energy Michigan contends that the stranded costs should be reduced by the amount actually collected pursuant to the interim order. Energy Michigan claims that these charges should be recovered prospectively over a three-year time frame to avoid burdening customers and that an adjustment should be made to recognize changes in the return to service provisions.

In its replies to exceptions, Energy Michigan argues that Kroger's proposal shifts cost responsibility to secondary customers who make up less than 30% of the choice customers. Energy Michigan claims that Detroit Edison's witness supported the same transition charge for all

customers between 2 to 4 mills per kWh. In addition, Energy Michigan argues that it would be inequitable to charge secondary customers more than primary customers because there is a larger need for headroom for secondary customers.

It its reply to exceptions, the Attorney General argues that the level of headroom should not be a factor in determining a just and reasonable transition charge.

In addition to determining the amount of historical stranded cost, it is necessary for the Commission to determine the level of the transition charge and the time period for collection. The interim order set a transition charge of 4 mills per kWh for all choice customers. Although some parties argue that a fixed transition charge applicable to all choice customers is fair, that argument would be valid only if all customers were similarly situated. However, the record in this proceeding demonstrates that there is a significant difference between the headroom available to different classes of customers. As shown on Exhibit S-144, the headroom varies between 0.81 and negative 0.44 cents per kWh for primary customers on Rate D6 and between 0.82 and negative 0.36 cents per kWh for transmission customers on Rate D6. For secondary customers, Exhibit S-144 shows that the headroom varies between 1.99 and 1.22 cents per kWh on Rate D4 and between 2.37 and 2.07 cents per kWh on Rate D3. This data demonstrates that secondary customers have significantly more headroom than other customers. In fact, the difference between the highest headroom for primary or transmission customers and the lowest headroom for secondary customers is 4 mills per kWh. In light of this significantly larger headroom, the Commission determines that the transition charge in the future should be set at 3 mills per kWh for customers served at secondary voltage and at 1 mill per kWh for other customers.

Detroit Edison will collect the 3 mills per kWh charge from secondary customers and 1 mill per kWh from its primary customers until the amount collected plus interim transition charges

previously collected equals the historical stranded cost of $43.616 million, or until any additional stranded costs incurred during the remainder of 2004 are determined. A comprehensive true-up of 2004 stranded costs is provided for later in this order. The transition charges may be adjusted to reflect the outcome of these cases. The amortized balance will accrue a seven percent carrying charge until it is fully amortized. During the final month of the collection period, Detroit Edison shall reduce the transition charge from 3 mills per kWh for secondary customers and 1 mill per kWh for its primary customers down to the level needed to fully amortize the account by the end of the month.

Return to Service

In the interim order in this proceeding, the Commission requested parties to make recommendations regarding the relationship between stranded cost determinations and return to service provisions for retail open access customers. Proposals were made by Detroit Edison, ABATE, Energy Michigan, CNE, and the Staff. The ALJ indicated that the most appropriate return to service provisions must provide Detroit Edison the ability to economically purchase needed future power supplies, provide reasonable forecasting of electric supply requirements, and eliminate the need to obtain reserve production capacity, while providing the least restrictive requirements on the ability of customers to move from regulated to unregulated service. The ALJ concluded that the proposal by CNE most closely met these requirements. Exceptions on this issue were filed by Detroit Edison, ABATE, Energy Michigan, Kroger, CNE, and the Staff.

Detroit Edison argues that the ALJ has "proposed significant and radical changes in the definition of stranded costs and the manner in which [Detroit] Edison's revenue deficiency due to Choice sales loss is recovered." Detroit Edison's exceptions, p. 74. To remedy this matter, Detroit Edison proposes a regulatory cost adjustment based on non-cost margins. Detroit Edison

contends that the utility's current tariffs do not accurately reflect cost of service, which results in false economic signals. Detroit Edison contends that its regulatory cost adjustment would be calculated on the subsidy level currently contained in the company's bundled rates. In addition, Detroit Edison argues that MCL 460.10a(16) requires an annual contested case proceeding to reconcile recovery of stranded cost amounts, so that stranded cost determinations cannot be terminated. Finally, Detroit Edison indicates that conceptually it supports the New Energy proposal, but that it does not solve the serious issues surrounding long-term capacity planning.

ABATE argues that the recommendation of the ALJ would eliminate restrictions on the timing of switching, provided that the pricing was at the higher of market or tariff. ABATE contends that this approach would magnify risk because customers would not know what prices they would pay if they returned to bundled service. In addition, ABATE argues that it is unclear what the market price would be for a returning customer or what obligations Detroit Edison would have to buy power. ABATE supports its proposal, which would obligate customers to commit to a supplier for two years. Customers would be required to notify the utility by the end of the year, which would provide six months to shop for power needed to meet summer peak requirements.

Energy Michigan argues that the return to service provisions recommended by the ALJ do not provide certainty to choice customers or to the utility. Instead, it recommends that the notice requirement for return to service be set at 12 months, that market rates apply during the 12-month notice period or thereafter unless the customer commits to taking retail service for 12 full months at the utility's retail rates, and that transition charges be reduced to reflect the more stringent return to service provisions. Energy Michigan argues that the New Energy proposal allows customers to move back and forth between regulated and unregulated rates with no notice and no mandated minimum term of service.

In addition, Energy Michigan argues that stranded costs should be mitigated with stranded benefits from the Fermi 2 nuclear plant, which is expected to be competitive with market prices on various occasions. Energy Michigan proposes a RAST Value Credit, which would entitle choice customers to a portion of the margin on sales of Fermi power equal to the portion that choice customers pay for Fermi costs. As an alternative, Energy Michigan proposes that choice customers be allowed to buy 20% of their power requirements from Detroit Edison at variable cost of production.

Kroger argues that the return to service plan proposed by the ALJ requires customers to effectively give up the ability to receive cost-based rates in the future as a condition of shopping. According to Kroger, once a customer chooses to take service from an alternative supplier, it would only be able to return if the cost-based service is higher than the market. Kroger argues that few customers will take such a risk. Kroger indicates that it supports the return to service plan proposed by ABATE. If the PFD is adopted, Kroger argues that customers who are currently receiving service from an alternative supplier receive a one-time right to return to bundled rates. Kroger argues that a grace period is required to avoid penalizing customers who have signed long-term contracts with a supplier.

CNE argues that the Commission should use the Illinois model for stranded cost recovery, which it indicates was the product of input from all concerned parties and which has worked well according to CNE. CNE claims that the Illinois model will work well in Michigan because it was designed to accommodate similar conditions.

The Staff points out that the ALJ's recommendation means that once off bundled rates, a customer could never return, which in the Staff's view is unreasonably long. The Staff argues that its three-year limitation on return to bundled service is reasonable.

In its reply to exceptions, Detroit Edison argues that returning customers should pay the higher of market rates or bundled rates on a monthly basis so as to provide the utility with the opportunity to recover its allocated production fixed costs in the wholesale energy markets via longer-term sales at market prices. Detroit Edison argues that if the Commission adopts the Staff's proposed return to service provision, it should modify the timeframe to properly capture the full market cycle of supply and demand in the region. In addition, Detroit Edison contends that the CNE proposal does not require customers to stay off of bundled rates.

Detroit Edison contends that the ABATE, Energy Michigan, and Kroger return to service proposals improperly assume that the paying of a securitization or historical stranded cost charge entitles a choice customer to a claim on the utility assets. Detroit Edison argues that it would not be able to use available capacity to obtain higher prices for longer terms under either the ABATE or the Energy Michigan proposals. In addition, Detroit Edison denies any suggestion by Energy Michigan that the interim order requires a linkage between return to service provisions and reduction in transition charges. Moreover, Detroit Edison denies that it provided a numerical evaluation of this reduction and contends that, on the contrary, choice customers should be charged for the right to return to the utility's cost-based tariff. In addition, Detroit Edison contends that Energy Michigan's proposed RAST Value Credit is based only on the variable cost of Fermi 2 production and ignores other charges, such as property taxes, insurance, operations and maintenance expense, administrative overhead, and post-securitization capital additions. Finally, Detroit Edison indicates that it is willing to provide customers with a reasonable grace period that does not extend beyond the length of the customer's current contract.

ABATE supports Energy Michigan's proposed RAST Value Credit in its reply to exceptions. ABATE argues that CNE's proposal for the Illinois model amounts to a lost revenue approach and

that the whole idea of competition is to put pressure on the utilities to bring their costs down. Finally, ABATE argues that there are substantial opportunities to mitigate stranded costs so that Detroit Edison would be protected if stranded costs were terminated.

In its replies to exceptions, Kroger argues that there is substantial opposition to any proposal prohibiting choice customers from returning to bundled service. In addition Kroger argues that the three-year period proposed by the Staff is unreasonable and should be shortened.

In its replies to exceptions, CNE continues to support its return to service proposal, arguing that the lack of detail cited by Detroit Edison and ABATE can be alleviated by a collaborative among the parties to determine an appropriate market based calculation, including addressing long-term capacity issues. CNE notes that the Illinois approach is generally supported by Detroit Edison and contends that none of the other parties have specifically rejected the approach.

In his reply to exceptions, the Attorney General contends that the Commission should offset nonsecuritized stranded costs with stranded benefits, but argues that the Commission cannot authorize a bypass or reduction of previously approved securitization charges. The Attorney General agrees with the parties who argue that charging permanently higher prices for a customer who returns to bundled service is inappropriate and suggests that a 12 to 24 month period would represent a reasonable balance. Finally, the Attorney General argues that Kroger's proposal for a grace period is unnecessary because prior Commission orders have effectively created notice that changes may occur.

In its replies to exceptions, the Staff opposes Energy Michigan's RAST Value Credit and the alternative proposal to allow choice customers to purchase up to 20% of their power from Detroit Edison at the utility's variable cost. In addition, the Staff opposes Energy Michigan's assertion

that some offset should be made for more stringent return to service provisions, because the Staff believes that its return to service proposal is balanced.

In its replies to exceptions, Energy Michigan contends, contrary to Detroit Edison's argument, that the Staff is not proposing to terminate or eliminate stranded cost recovery, but rather to substitute, on a going forward basis, a requirement that choice customers pay Fermi-related securitization charges without offset as their share of stranded costs, although Energy Michigan does not support this approach without additional modification to allow choice customers to sell Fermi power into the market. In addition, Energy Michigan argues that CNE's proposal is a lost revenue methodology and contends that competition will not exist under such a methodology unless savings are at least equal to 10% for primary customers and 15% for secondary customers. Energy Michigan contends that the CNE return to service provision should not be adopted and instead supports return to service with one-year notice.

Currently, choice customers are required to give 30- or 60-days notice prior to returning to bundled sales service. The ALJ concluded that any artificially restricted time period would not be consistent with the intent of Act 141 and, therefore, recommended the proposal set forth by CNE, which had no such restrictions. Although a program without restrictions may have some theoretical merit, it is clear that the proposal offered by CNE does not embody a comprehensive program which can be implemented. It its reply to exceptions, CNE appears to recognize that lack of detail in its proposal and recommends that a collaborative be held "among parties to determine an appropriate 'market based' calculation, including addressing long term capacity issues versus short term issues." CNE reply to exceptions, p. 4. Although the Commission has utilized collaboratives from time to time to address issues and is doing so for some issues in this case, in the Commission's view, the time for such an approach on this issue is past.

The fundamental issue is how to provide a predictable program that allows customers to make reasonable economic decisions about the stranded costs they will be expected to pay and allows the utility to plan for the number of customers it will need to prepare to serve. Increased certainty about stranded cost should assist customers in making appropriate decisions regarding the economic value of choice. Moreover, the utility needs some reasonable horizon to allow it to plan for the needs of its customers. The critical timeframe relates to the summer peak demand season. Currently, customers have to give the utility only 30- or 60-days notice, which is insufficient to allow the utility to plan for its peak demands.

The Commission's authority to require return to service requirements is well within the scope of Act 141. See, MCL 460.10d. After reviewing various proposed time frames, the Commission concludes that new choice customers should be prohibited from returning to bundled service for two years. Additionally, the Commission finds that customers returning to bundled service shall be required to provide the utility with notice no later than December 1 that the customer will be taking bundled service during the coming summer[41] and obligating the customer to take such service. The obligation of a returning customer to remain on bundled service shall be for one year. Detroit Edison shall explicitly inform a returning customer of this obligation and of the consequences of a failure to abide with this requirement. Any customer who fails to give the appropriate notice as provided by this order or who does not stay on ROA service for two years shall be required to pay the higher of the applicable tariff energy prices plus 10% or the market priced power charge plus 10% for any power taken from the utility. In the Commission's opinion, these changes fairly balance the competing interests between utility and customers. However,

[41]The Commission finds that the summer season should be defined as beginning June 1, which means that ROA customers need to provide Detroit Edison with 6 months notice to return to service.

given the proximity of the release of this order to December 1, the Commission finds that existing choice customers shall have until December 31, 2004 to provide notice of their intent to return to bundled service by June 1, 2005. Moreover, the Commission finds that existing choice customers should be "grandfathered" so that they may return to bundled service for the summer of 2005 at bundled rates even though they have not been ROA customers for two years, so long as they comply with all of the other requirements.

X. Mitigation

The ALJ agreed with the Staff's proposal that Detroit Edison be required to mitigate production fixed costs associated with choice customers who chose an alternative supplier. This proposal would terminate choice customers continued obligation for Detroit Edison's investment in production plant in return for a $93.113 million reduction in revenue deficiency. The ALJ found that this proposal addresses many of the concerns voiced by intervenors in this case. The ALJ concluded that it grants historical stranded cost recovery while providing a definitive framework for going forward for bundled and choice customers. Exceptions were filed by Detroit Edison. Replies to exceptions were filed by the Attorney General and RRC.

Detroit Edison argues that adoption of the mitigation proposal would require modifications to the company's 45-day report required by MCL 460.6j(11). Detroit Edison argues that such changes should be made retroactive to February 20, 2004, the date of the interim order. In addition, Detroit Edison argues that the PSCR reconciliation should not be used as a means to second guess the company's mitigation efforts and that the mitigation process must be clear.

In his reply to exceptions, the Attorney General argues that the mitigation proposal starts with the wrong base and that mitigation credits should be calculated in an annual stranded cost true-up case. The Attorney General indicates that this was the intended point of his exception No. VI, that

the Commission should not remove interconnection revenues from the utility's adjusted operating income.

In its reply to exceptions, the RRC argues that adjustments for mitigation are not allowed under Act 304 or under the PSCR clause approved by the Commission. The RRC contends that any PSCR exclusions such as the mitigation adjustment proposed by the ALJ do not comport with the requirements of Detroit Edison's Rule B-4.6.

The Commission finds that the Staff's proposal should be rejected. While the proposal is innovative and addresses the Commission's request for mitigation of production fixed costs, the Commission is not prepared to effectively require Detroit Edison to sell off a slice of its generation on the open market at the same time that the utility's bundled customers find themselves dependent on additional resources during peak summer hours. This is especially true in light of the Commission's June 3, 2004 order in Case No. U-14138, in which the Commission granted Detroit Edison's request for authority to engage in certain transactions for the purchase of electric power, capacity and ancillary services from affiliated exempt wholesale generators, and the Commission's October 14, 2004 order in Case No. U-14231, in which the Commission commenced an investigation into the potential need for the construction of new generation capacity within this state. The Commission is also aware of the proposed implementation of MISO's "Day 2" market on March 1, 2005, which will provide additional opportunities to mitigate production fixed costs.

This ruling increases Detroit Edison's revenue deficiency. The $93,113,000 reduction to revenue associated with adoption of the Staff's position must be reversed. The same is true of the $57,768,000 NOI adjustment associated with the treatment of interconnection revenues. The net effect of the changes results in a $35,345,000 increase in Detroit Edison's revenue deficiency.

Given the Commission's decision not to adopt the "slice of generation" proposal, and because the rate caps will remain in effect until January 1, 2006, it is clear that there will be a need for a comprehensive true-up of the 2004 PSCR and production fixed cost stranded cost calculations. Detroit Edison shall file its 2004 stranded cost case in conjunction with its PSCR reconciliation case to ensure a comprehensive evaluation of its stranded costs including equitable treatment of interconnection/third party revenues.

At this time, the Commission finds that there are likely to be no stranded costs beyond those addressed in today's order. Consequently, the Commission also finds there will likely no longer be any need to have annual proceedings to true-up stranded costs pursuant to Section 10a(16) of Act 141. Detroit Edison shall be free to file a true-up proceeding in the event it deems it appropriate to do so. If Detroit Edison experiences a significant increase in choice load subsequent to issuance of this order that results in the determination of further stranded costs, then the company may file a rate case to address any further rate relief needed.

Finally, in light of the ruling rejecting the Staff's mitigation approach, the Commission finds that it should waive the 10-day requirement on PSCR notification for December 2004 in the event that Detroit Edison desires to reduce its December 2004 PSCR factor.

XI. Power Supply Cost Recovery (PSCR)

The ALJ noted that Detroit Edison indicates that it "will abide by the Commission's decision, and therefore anticipates a separate 2004 reconciliation, and the filing of a separate 2005 plan case by September 30, 2004." Detroit Edison's reply brief, p. 14. Accordingly, the ALJ concluded that Detroit Edison had effectively withdrawn its request for approval of a PSCR plan. The ALJ determined that, based on Detroit Edison withdrawing its PSCR proposal, the issue is not properly

before the Commission at this time. Exceptions were filed by Detroit Edison, RRC, Attorney General, and Staff.

In its exceptions, Detroit Edison indicates that it has not withdrawn its PSCR plan, but rather has conjoined its PSCR plan and its general rate case. Detroit Edison contends that there are four issues that were left undecided or insufficiently addressed in the PFD: (1) approval of the 2004 PSCR plan, (2) a new PSCR base and factor, (3) a determination of how to address SO_2, NO_x, and transmission costs in the PSCR process, and (4) the treatment of wholesale power sales mitigation issues. Detroit Edison contends that it has developed a cogent and reasonable PSCR plan and 5-year forecast. The company argues that network transmission expenses should be included as PSCR costs, in accordance with prior Commission decisions. Furthermore, Detroit Edison contends that SO_2 emission allowances should be recovered through the PSCR mechanism because the utility's practice of purchasing emission allowances and higher sulfur coal results in the lowest compliance costs. Detroit Edison contends that the PSCR base should be adjusted to $0.01858 per kWh to be consistent with other adjustments made in the PFD. As a result of the ALJ's adoption of the Staff's choice mitigation proposal, Detroit Edison contends that the Commission should: (1) make an adjustment to net over- or under-recovery equivalent to 90% of the proceeds from interconnection sales which are less than or equal to 110% of annual choice sales; (2) determine the expense allocation factor to be applied to total power supply costs; (3) report and account for interconnection sales that exceed 110% of choice sales, such that the 90%/10% split applies given that annual interconnection sales do not exceed 110% of choice sales; and (4) treat electric choice customers similar to interruptible customers. In addition, Detroit Edison argues that the PSCR process should not become a means to second guess the utility's mitigation and that such mitiga-

tion is based upon a slice of the system concept, which represents a major change from the current PSCR practice.

The RRC indicates that it is not assured that Detroit Edison's statement in its reply brief indicates that it has in essence withdrawn its PSCR proposals. RRC argues that it is unclear how PSCR costs are to be reconciled under such an approach. According to the RRC: "Parties are left rather up in the air on the answers to these questions." RRC exceptions, p. 2. The RRC indicates that if Detroit Edison has not withdrawn its PSCR request, then the RRC supports its position on transmission charges and other related issues.

In his exceptions, the Attorney General is opposed to resetting the PSCR base factor to zero because there has been no identification of the allowance for PSCR costs in base rates to match the recommended zero PSCR factor. In addition, the Attorney General argues that Detroit Edison's proposal to file a separate PSCR reconciliation for 2004 and a separate 2005 plan violates the provisions of MCL 460.6j(18), which provides for a 48-month PSCR filing with annual reconciliation. The Attorney General agrees that the Commission should treat Detroit Edison's statements as withdrawing the company's PSCR request, but argues that the Commission should not adopt that proposal. The Attorney General contends that it is now too late to conduct a new PSCR plan case and the Commission should rule that the reasonableness of 2004 PSCR costs have not been decided nor have issues relating to inclusion of transmission costs.

In its exceptions, the Staff indicates that the ALJ misunderstood Detroit Edison's PSCR request, which was that it be allowed to modify the operation of the PSCR to include the company's mitigation proposals or, in the alternative, accept continuation of the PSCR suspension until its proposals could be considered in this case. Staff contends that the determination of the

PSCR base, including the expenses to be included in PSCR costs and the resulting PSCR factor, are properly before the Commission.

In its reply to exceptions, Detroit Edison denies that it withdrew its PSCR request but contends that its PSCR plan and factor continue to be conjoined in the rate case. Detroit Edison indicates that it filed a separate PSCR plan case for 2005 on September 30, 2004, in Case No. U-14275, and plans to file a separate PSCR reconciliation in March. Detroit Edison reiterates the same need for clarifications that it raised in its exceptions. In addition, Detroit Edison argues that its filing of a PSCR plan pursuant to MCL 460.6j(18) was proper, but claims that the Commission implicitly rejected that application and, instead, established a 2004 PSCR plan pursuant to MCL 460.6j(3)-(7).

In its reply to exceptions, ABATE supports the Attorney General's suggestion that issues regarding the reasonableness and prudence of 2004 PSCR costs should be deferred until the reconciliation, but argues that the inclusion of the cost of transmission should not be deferred. In addition, ABATE contends that Detroit Edison's forecast overstated the volume of choice sales because it failed to take into account the impact of the price increases the company is seeking.

In its replies to exceptions, the RRC argues that, consistent with longstanding rate making practices, transmission and MISO expenses that Detroit Edison proposes to recover through its PSCR should instead be recovered through its base rate transmission services. Furthermore, the RRC argues that neither Act 304 nor the rules governing the PSCR clause allow for the recovery of mitigation adjustments through the PSCR process and such adjustments should therefore be rejected. Finally, the RRC argues that, in light of Detroit Edison's failure to comply with the requirements of MCL 460.6j(18), it supports the Attorney General's recommendation that the Commission issue a final order that continues and fixes 15.49 mills per kWh as the base allowance

for PSCR costs, fixes a negative 1.05 mills per kWh as the PSCR factor for 2004, and defers other issues to the reconciliation.

In its reply to exceptions, the Attorney General argues that Detroit Edison's PSCR filing fails to comply with either MCL 460.6j(18) or MCL 460.6j(3)-(7) because: (1) MCL 460.6j(18) requires that PSCR factors in a general rate case must cover a future period of 48 months, (2) MCL 460.6j(18)(b) restricts PSCR reconciliations and Detroit Edison's proposed process does not comply with the statute, and (3) MCL 460.6j(18)(c) prohibits revisions to PSCR factors. According to the Attorney General, the Commission has established an allowance for PSCR costs in Case No. U-10102 and established a PSCR factor for 2004 in the interim order, and the only lawful action would be to continue these rates, subject to rehearing of the PSCR factor established in the interim order and subject to reconciliation under MCL 460.6j(12).

Act 304 offers a utility two different mechanisms for recovery of its power supply costs: (1) a filing pursuant to MCL 460.6j(3)-(7), with an annual PSCR plan setting PSCR factors for a 12-month period, a 5-year forecast, and an annual reconciliation, or (2) a PSCR filing in a general rate case, pursuant to MCL 460.6j(18), setting PSCR factors for a 48-month period, with annual reconciliations. Normally, utilities file under the first option, but in this case Detroit Edison filed under the second:

> Applicant is requesting, pursuant to Act 304, MCL 460.6j(18), that the Commission reinstates the Company's PSCR mechanism for 2004 in this case, coincident with approval of the Company's request for a mitigation adjustment to operate in tandem with the PSCR mechanism.

Application, p. 4.

> Pursuant to the provisions of Act 304, each PSCR factor and plan established in this case will be subject to the annual reconciliation procedures, as referenced in MCL 460.6j(18), to be conducted in this docket.

Application, p. 5.

However, this state of affairs became unclear when, in its reply brief, Detroit Edison included the following rather Delphic statement:

> The Attorney General reasserts his argument that [Detroit] Edison did not file a proper PSCR plan case (brief, pp 16-19). [Detroit] Edison maintains that its filing was proper, as explained at pages 2-6 of its October 31, 2003 Reply Brief Concerning Implementation of the PSCR Process, and at pages 30-33 of its February 19, 2004 Interim Reply Brief. The Commission, however, disapproved [Detroit] Edison's PSCR procedure in its December 18, 2003 Opinion and Order, and February 20, 2004 Interim Order. Kroger agrees (brief, p. 2). As the Attorney General essentially asserts, [Detroit] Edison's filing has been considered as a conjoined PSCR plan case and general rate case, which have been combined under the same docket for hearing and administrative efficiency. R 460.17301(5). The Attorney General states (brief, p 19): 'At this date, this will mean that the Commission should conduct a 2004 PSCR reconciliation under MCL 460.6j(12)-(15) without applying MCL 460.6j(18) and should require [Detroit Edison] to file a 2005 PSCR plan case under MCL 460.6j(3)-(7).' [Detroit] Edison will abide by the Commission's decision, and therefore anticipates a separate 2004 reconciliation, and the filing of a separate 2005 plan case by September 30, 2004.

Detroit Edison Reply Brief, p. 13-4.

Whatever Detroit Edison may have meant by this obscure statement, the ALJ concluded that the company had withdrawn its PSCR request.

> Concerning Detroit Edison's proposal to conduct a Power Supply Cost Recovery Plan (PSCR) in the context of its general rate case pursuant to MCL 460.6j(18), Detroit Edison states: 'Detroit Edison will abide by the Commission's decision, and therefore anticipates a separate 2004 reconciliation, and the filing of a separate 2005 plan case by September 30, 2004.' The ALJ finds that this is effectively a withdrawal of the request.
>
> There is considerable discussion and argument presented concerning whether transmission costs are properly included in the PSCR base and whether their approved recovery would constitute double recovery. The ALJ concludes that based on Detroit Edison withdrawing its PSCR proposal the issue is not properly before the Commission at this time.

PFD, p. 121.

In its exceptions, Detroit Edison argues vociferously that it has not withdrawn its PSCR proposal and contends that a number of important issues have been either left undecided or insufficiently addressed by the PFD. However, in its reply to exceptions, Detroit Edison argues

that the Commission has "in essence" rejected the company's application to establish a PSCR factor under MCL 460.6j(18) and instead established a PSCR factor under MCL 460.6j(3)-(7). No explanation is provided as to how Detroit Edison believes that this was accomplished.

The Commission wishes there to be no doubt that it has not "in essence" rejected Detroit Edison's request under MCL 460.6j(18). If the Commission had rejected Detroit Edison's request, it would have done so with clear and unmistakable language that leaves no doubt as to the Commission's intent.

Because of the ALJ's failure to address the PSCR issues, the Commission is left with the problem of how to fashion an appropriate remedy to deal with the PSCR issues given the current state of affairs. Toward that end, the Commission finds that the Staff's positions on the PSCR issues should be adopted for the purpose of complying with Act 304. The Staff's case accepted Detroit Edison's request to include NOx allowance expenses and network transmission expenses as PSCR costs. The resulting PSCR base was presented on Exhibit S-123. Because the Staff's mitigation proposal has not been accepted, the PSCR base on Exhibit S-123 needs to be recalculated to reflect third party sales revenue. The result is a PSCR base of $0.01732 at the generation level and a PSCR factor of zero. The Staff also supported changing Detroit Edison's loss factor to 7.2%.

The Attorney General had suggested that the Commission rule that all questions regarding the lawfulness, reasonableness, and prudence of Detroit Edison's PSCR revenues and expenses during 2004 remain open for review and decision in the company's 2004 reconciliation case under MCL 460.6j(12). In the Commission's judgment this is a reasonable and judicious alternative for issues not specifically addressed by this order. Accordingly, the Commission finds that all PSCR

issues not otherwise explicitly addressed in this order, may be addressed in Detroit Edison's 2004 reconciliation to be filed no later than March 31, 2005.

Finally, the Commission notes that Detroit Edison has filed an application for a 2005 PSCR plan in Case No. U-14275. However, MCL 460.6j(18) requires that PSCR factors filed pursuant to a rate case cover a future 48-month period. The prehearing conference in Case No. U-14275 is scheduled for November 23, 2004. The ALJ in Case No. U-14275 is directed to conduct a proceeding to address whether Detroit Edison's application is permitted in light of the statutory requirement that the factors cover a 48-month period.

XII. Low-Income Energy Efficiency Fund (LIEEF)

In the interim order, the Commission rejected arguments made by the Staff and MEC/PIRGIM that the Commission should defer resolution of the LIEEF program issues until the final order in this case. The Commission found that, upon issuance of interim relief, there would no longer be excess securitization savings to fund the LIEEF program. Therefore, the Commission concluded that if the LIEEF were to continue, the costs must be added to the utility's cost of service.

Further, the Commission accepted Detroit Edison's conditions on its voluntary continued funding of the LIEEF (1) that the cost should be included in its distribution O&M expense and in turn recovered from all bundled and choice customers, and (2) that Detroit Edison's funding obligation would be limited in light of Act 141's rate caps. The Commission approved the inclusion of $39,858,000 (which is approximately equivalent to 2% of commercial and industrial revenues from both choice and tariff customers) in O&M costs to fund the LIEEF during 2004 and beyond.

In the PFD, the ALJ found persuasive Detroit Edison's argument that it is not appropriate to use LIEEF for a statewide program when the proceeds are derived solely from Detroit Edison's

customers. He concluded that Detroit Edison's customers paying for LIEEF should not have to bear the burden for the entire state. In his view, Detroit Edison customers will benefit by limiting the scope of the LIEEF to Detroit Edison's service territory.

Further, the ALJ rejected ABATE's proposal to eliminate the LIEEF, for lack of demonstrated need. The ALJ noted the record evidence that the current need is outstripping the available funds. He further rejected the Staff's proposal that Detroit Edison explore the possibility of using a PAYS® tariff. The proposed tariff would provide loans to customers for the purchase of energy efficiency products, for which the customer would receive a charge on the monthly bill for repayment. Finally, the ALJ concurred with Detroit Edison's proposal that the LIEEF program funding continue only until the company files its next rate case.

ABATE excepts and argues that the ALJ's recommendation would effectively create a tax on customers to pay for subsidies to certain residential customers. It insists that any funds to support this program should be tax dollars, which are raised on the basis of income and not energy usage. It argues that there is no statutory authority for the Commission to approve this program funding. ABATE recognizes that the fund will directly benefit Detroit Edison through a reduction in payments, delinquencies, late payment collections, uncollectible accounts, and termination of service. ABATE argues that to the extent that this program is even considered, there must be a review of the link between the program and the uncollectible expense included in rates.

The Staff excepts and argues that the ALJ erred when he determined that the statutory mandates regarding LIEEF programming are no longer applicable merely because the savings resulting from securitization were incorporated into base rates by the interim order. The Staff argues that Section 10d(7) mandates funding for a period of at least six years from any savings created by securitization over and above the amount needed to provide all ratepayers with a 5%

reduction in rates. It argues that although the Commission rolled securitization savings into base rates, the ratepayer cost savings generated from securitization continue. In fact, customers benefit today, next year, and beyond from securitization even if total rates rise because without securitization, rates would simply be higher. It argues that the language in Section 10d(7) does not reflect a legislative intent to discontinue LIEEF programming for the six-year period because securitization savings "have been recalibrated through a utility-initiated rate case." Staff's exceptions, p. 6. It argues that the rates have now captured those benefits and provisions of Section 10d(7) still apply. In his reply brief, the Attorney General agreed with this legal assessment.

The Staff further excepts to the ALJ's discussion concerning application of the funds placed into the LIEEF to other than just Detroit Edison customers. The Staff states that rather than restrict the use of the LIEEF dollars, the Commission should seek to include all utilities in contributing to the LIEEF.

The Staff reiterates its position that the emphasis for use of these funds should be on a market transformation to increase energy efficiency, rather than merely paying energy bills for those who can least afford them. The Staff takes the position that such an emphasis would permit long-term advances in making energy bills affordable for low-income customers.

The Staff further excepts to the ALJ's rejection of the Staff's proposed PAYS® tariff. It states that the benefit of the proposed tariff is inherent in its design. It is a market-based approach to financing only highly cost-effective energy efficiency improvements. It argues that the tariff could take advantage of some of the greatly expanded utility billing system capabilities already developed for electric customer choice. The Staff indicates that this approach has been highly successful in other jurisdictions. The Staff emphasizes that its recommendation is only that Detroit Edison explore such options

The Commission finds that the LIEEF funding and program adopted in the interim order should be reaffirmed in this final order. Contrary to the arguments advanced by the Staff, the Commission has already determined that there are no longer any excess securitization savings to fund the LIEEF pursuant to MCL 460.10d(7). For that reason, the Commission found that any funding of the LIEEF must be incorporated into the utility's cost of service.

The Commission accepted Detroit Edison's proposed conditions under which it would continue to fund the LIEEF in the interim order. However, in this order, the Commission rejects Detroit Edison's further assertion that the funds should only be used for low-income customers located in Detroit Edison's service territory. Under the LIEEF program established by the Legislature, funds were available for use throughout the state. The Commission finds that this policy should be continued.

Further, the Commission finds that the funds should be administered by the Commission, as has been the practice with the statutory LIEEF. The Commission further concludes that the existence and funding of the LIEEF should continue at the present level unless the issue is revisited in an appropriate case.

The Commission rejects arguments that the LIEEF as described above constitutes a tax upon Detroit Edison's customers. Rather, the Commission finds that the benefits to all Detroit Edison customers will likely outweigh the burden of including LIEEF as a part of the cost of distribution service. Moreover, the design of this program should remain competitively neutral, as all low-income customers located within Detroit Edison's service area will be possible recipients of assistance, despite whether their energy needs are served by Detroit Edison or an AES.

Finally, the Commission will not direct Detroit Edison to conduct any particular program beyond that already discussed above. However, the Commission stands willing to approve such a

tariff, should Detroit Edison follow up on the Staff's suggestion. The Commission finds that implementation of a PAYS® tariff could bring a competitive advantage to those energy suppliers willing to undertake such a program. Accordingly, the Commission directs Detroit Edison to meet with interested parties within 120 days from the date of this order to discuss the implementation of a program containing the essential elements of the PAYS® concept. Detroit Edison should include any tariff proposal for which there is substantial agreement in its next general rate case application.

XIII. Rate Balancing and Deskewing

In an earlier section of this order, the Commission directed Detroit Edison to address the unbundling issue in a new proceeding to be filed on or before March 23, 2005. This proceeding shall include consideration of imbalances between distribution and ROA customers.

XIV. Petitions for Rehearing

On March 12, 2004, Energy Michigan filed a petition for rehearing of the February 20 interim order. According to Energy Michigan, the Commission committed legal error by granting interim relief in an amount that would exceed the level of relief justified for final relief. Energy Michigan also maintained that the interim order will result in unintended consequences, such as (a) the destruction of the economic incentive for competition in Detroit Edison's service territory, (b) higher 2004 summer electric rates due to migration of customers to bundled service, and (c) higher 2005 summer electric rates due to a second migration of customers to bundled service.

On March 17, 2004, ABATE filed a petition for rehearing. ABATE argued that the combination of the January 15, 2004 order in Case No. U-12933 and the February 20 interim order will have catastrophic consequences for high load factor primary customers that currently

participate in Detroit Edison's open access program. According to ABATE, because there is a good chance that the final rate relief will treat stranded costs and the elimination of the securitization offsets much differently than they were handled in the interim order, it would be inequitable not to rescind the interim order at this time. Moreover, ABATE argued that if a contract between a large primary customer and an alternative electric supplier expires pending a decision by the Commission on its petition for rehearing and the customer returns to bundled sales, then the Commission should grant a waiver of the requirement that the returning customer must remain a customer of Detroit Edison for 12 months after returning to bundled service.

On March 22, 2004, additional petitions for rehearing were filed by the Attorney General and CNE. The Attorney General argued that the interim order was unlawful because it imposed interim rate surcharges upon residential and small business customers whose rates are capped by MCL 460.10d(2). According to the Attorney General, the PSCR factor reduction the Commission approved in its February 20 order does not justify imposition of the interim rate surcharge surcharges on capped customers even though the surcharge does not total more than the PSCR factor reduction. The Attorney General also argued that the securitization offset credit approved in Case No. U-12478 is a rate within the meaning of subsections (1), (2), and (5) of MCL 460.10d. The Attorney General insisted that elimination of the securitization credit constitutes a rate increase, which is prohibited for small business customers before 2005 and for residential customers before 2006. The Attorney General also contended that the request for interim rate relief filed by Detroit Edison should be rejected because the company realized $2.6 billion in benefits from the rate freeze required by MCL 460.10d. Finally, the Attorney General asked the Commission to clarify that Detroit Edison should not make payments to its pension fund from interim rate revenues until after a final order is issued in this case.

In its petition for rehearing, CNE contended that the interim order broke from precedent in allocating rate increases on a basis other than the traditional equal percentage method. CNE argued that the interim order levied the heaviest burden upon choice customers, thereby threatening the viability of the choice program during the pendency of this case.

On April 2 and 12, 2004, Detroit Edison and the Staff filed their responses to the petitions for rehearing. In so doing, they maintained that the petitions for rehearing were nothing more that repetitions of arguments previously considered and rejected by the Commission.

Rule 403 of the Commission's Rules of Practice and Procedure, 1999 AC, R 460.17403, provides that a petition for rehearing may be based on claims of error, newly discovered evidence, facts or circumstances arising after the hearing, or unintended consequences resulting from compliance with the order. A petition for rehearing is not merely another opportunity for a party to argue a position or to express disagreement with the Commission's decision. Unless a party can show the decision to be incorrect or improper because of errors, newly discovered evidence, or unintended consequences of the decision, the Commission will not grant rehearing.

The Commission finds that the petitions for rehearing should be rejected. Interim relief is discretionary and the Commission has broad leeway in determining when it is appropriate. Attorney General v Public Service Comm, 63 Mich 69; 234 NW2d 437 (1975). The primary purpose of interim relief is to provide additional revenues on an expedited basis when a utility is experiencing a significant revenue deficiency and the revenue deficiency is likely to be experienced for a prolonged period of time. See, the December 21, 2001 order in Case No. U-13000. The Commission was persuaded that Detroit Edison had proven an immediate need for a revenue increase and that the failure to consider interim relief could cause a hardship to the utility due to the loss of revenues that would never be recouped.

The Commission was not persuaded by any of the arguments raised by Energy Michigan, ABATE, the Attorney General, or CNE to the effect that the interim order should be changed prior to issuance of a final order. Detroit Edison was ordered to collect the interim rates under bond and subject to refund. These protections and the right of the parties seeking rehearing to present their positions with regard to final rate relief ensures them of fairness and the opportunity to be heard on the merits of their contentions.

XV. Spent Nuclear Fuel Surcharge

MEC/PIRGIM maintains that the ALJ erroneously endorsed the position taken by Detroit Edison regarding the issue of spent nuclear fuel (SNF) fees by finding that the matter should not be considered in this proceeding.

The Commission finds that the ALJ cannot be faulted for his recommendation. On several prior occasions, the Commission has addressed related issues. See, the November 20, 2001 order in Case No. U-12613. Moreover, the issues raised by MEC/PIRGIM are currently under consideration in a complaint proceeding docketed as Case No. U-13771.

Renewable Energy Program (REP)

In the PFD, the ALJ concluded that the Commission has authority to establish an REP for Michigan utilities, and that the Staff's position regarding the long-term economic rationale for the adoption of an REP is correct. In the ALJ's view, a reasonable route for utilities to mitigate costs for compliance with current and future pollution regulations is through an REP. The ALJ advises that Detroit Edison should prepare a survey outlining all available renewable energy opportunities within its service territory. The ALJ recommends that Detroit Edison commence implementation of an REP that will accommodate at least 1% of its residential sales by the end of calendar year 2005 and continue growth to accommodate at least 2%-3% of its total residential sales by the end

of calendar year 2008. He also recommends that the Commission authorize Detroit Edison to implement an REP funding mechanism, which will allow the company to recover any REP costs not recovered from customers participating in the REP.

Detroit Edison, ABATE, the Attorney General, and RRC except to the ALJ's recommendations.

Detroit Edison would not follow the ALJ's recommendations. In the company's view, evaluation of renewable energy resources should be conducted on a statewide, not a service-territory-wide, basis. The company states that the proposed survey of available renewable energy opportunities within Detroit Edison's service territory will need to be completed before the company can determine what level of renewable energy is available for an REP—to establish a set level of megawatt hours to be made available is, therefore, premature. Moreover, the company states, a specific target amount or percentage of renewable energy should not be established for Detroit Edison given the rapid decline in the overall electric market share the company has experienced. Nor should the company be required to purchase renewable energy generation at a set price or under pre-established commercial conditions, as this would leave Detroit Edison vulnerable to low-priced competition by other retail energy suppliers that may have access to "green power" generation from other states and geographic areas with larger and more economic supplies. Detroit Edison disagrees with the ALJ's assessment of the use of an REP to assist in its air quality compliance. While acknowledging the usefulness of renewable energy in air emissions reductions, the company stresses that compliance measures are determined under federal law and regulation; the federal agencies that are charged with establishing policies and practices for an air compliance program have not completed the extensive evaluations necessary to determine whether a specific renewable energy approach is acceptable.

ABATE argues that the Commission lacks authority to establish an REP for Michigan utilities. In ABATE's view, 2000 PA 141, MCL 460.10 et seq. (Act 141), does not provide clear statutory authority for such a program and the ALJ was incorrect in following the Commission's decisions that have found such statutory authority.

The Attorney General, while also not agreeing that statutory authority exists to establish an REP, argues that the REP recommended by the ALJ is not just and reasonable. The Attorney General notes that under MCL 460.6j(6), when the Commission reviews an electric utility's power supply cost recovery plan, the Commission must consider whether that utility has taken all appropriate actions to minimize its fuel costs. Because the cost of REP power may exceed costs for other available types of generation, the Attorney General argues that the utility's fuel costs will not be minimized and, thus, an REP cannot result in just and reasonable rates. Moreover, he argues that because a capacity value for renewable resource generation has not been shown, the present record does not support a conclusion that pollution compliance costs may be lowered by an REP. However, the Attorney General does support study and exploration of renewable resource generation options, and he notes that an REP could be implemented to the extent that a utility's customers would voluntarily opt for the purchase of REP power at its actual cost. ABATE supports the Attorney General's position.

The RRC states that encouragement of research, development, and use of renewable energy resources could be beneficial to the environment. However, the RRC argues, the Commission should not implement an REP for Detroit Edison. Moreover, the RRC argues, the Commission does not have the statutory authority to require Detroit Edison to implement a non-voluntary REP. In the RRC's view, any REP must be "self-sustaining," that is all costs of an REP may only be recovered through voluntary participation in the program and expenses associated with the REP

may not be recovered in any other manner. While encouragement of renewable energy resources may be politically desirable, the RRC continues, the Commission should not force Detroit Edison's customers to become unwilling sponsors for the use of renewable, or "green," energy generation sources.

The Attorney General, ABATE, and the RRC re-present arguments regarding the Commission's authority over REPs that the Commission has considered in past proceedings. The Commission remains convinced that it has the necessary statutory authority to direct Detroit Edison to offer an REP. As stated in past orders, the Legislature adopted the following two provisions when passing Act 141:

> The commission shall establish rates, terms, and conditions of electric service that promote and enhance the development of new generation, transmission, and distribution technologies.

MCL 460.10b(1).

> The commission shall establish the Michigan renewables energy program. The program shall be designed to inform customers in this state of the availability and value of using renewable energy generation and the potential for reduced pollution. The program shall also be designed to promote the use of existing renewable energy sources and encourage the development of new facilities.

MCL 460.10r(6).

Contrary to the parties' continued insistence and re-argument, the existence of these statutory provisions constitutes a marked difference from the posture of Union Carbide Corp v Public Service Commission, 431 Mich 135; 428 NW2d 322 (1988). In Union Carbide, the Court found that the Commission did not have any specific statutory authority to order Consumers Power Company to dispatch its generation units in a manner deemed reasonable by the Commission; the Court concluded that the Legislature had failed to convey that authority. As regards an REP for Detroit Edison, MCL 460.10b(1) is a clear grant of authority to the Commission to establish rates,

terms, and conditions of electric service "that promote and enhance the development of new generation." The Commission is also specifically charged in MCL 460.10r(6) with the duty to "establish the Michigan renewables energy program." Indeed, the Legislature specifically directed the Commission "to promote the use of existing renewable energy sources and encourage the development of new facilities," and the Commission previously has found that MCL 460.10b requires it to establish rates, terms, and conditions of service that promote new generation, transmission, and distribution technologies.[42] Nothing in Sections 10b(1) or 10r(6) of Act 141 suggests that the Legislature envisioned that a utility could effectively thwart development of the Michigan renewables energy program and the promotion of new generation technologies by simply declining to participate. Sections 10b(1) and 10r(6) of Act 141 do not indicate that the mandate for the Commission to take action is conditioned on obtaining the permission of the utility, or any other party. Indeed, the words "only if a utility wants to do so" are conspicuously absent from Sections 10b(1) and 10r(6).[43]

The ALJ recommended that Detroit Edison undertake a survey outlining all available renewable energy opportunities within its service territories, that the company implement an REP, and that it establish long-term relationships with renewable energy suppliers. The ALJ further recommended that the Commission establish a funding mechanism for the company's REP, similar to that established for Consumers Energy Company in Case No. U-13843. The Commission has reviewed the parties' exceptions to the ALJ's recommendations, but is unpersuaded that an REP is inappropriate for Detroit Edison. Diversity of fuel and generation sources is a proper regulatory goal, and the ALJ's proposals are a necessary and appropriate initial course of action for the company.

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[42]Order dated May 18, 2004 in Case No. U-12915, pages 4 and 5.

[43]See, Order dated May 18, 2004 in Case No. U-13843.

For these reasons, the Commission finds that Detroit Edison should implement an REP, which should be available to all customers throughout Detroit Edison's service territory on a voluntary basis. That program should be able to accommodate approximately 1% of the company's residential sales prior to the end of calendar year 2006—this accommodates the time lag since much of the testimony was filed in this record. The company should target expansion of the program to be able to accommodate approximately 2%-3% of the company's residential sales prior to the end of calendar year 2008. Such is not an unreasonable goal for this program, and with the company's promotional assistance, it may prove to be at the low end of actual customer involvement. The REP must be open to all of Detroit Edison's customers.

As pointed out by Detroit Edison, in order to implement the REP the company will need a good comprehension of the available renewable resource energy options and facilities available within its service territories. Thus, the ALJ's recommendation that the company conduct such a survey is appropriate and the Commission directs Detroit Edison to undertake that study, with July 1, 2005 as the target date for its conclusion. At a minimum, the survey should include at least a preliminary inventory of all available renewable resources and those that might be developed within the Detroit Edison service territory, the estimated costs to produce that energy, and the format that Detroit Edison's REP should take.[44] And, the company shall file an application on or before July 1, 2005 to implement a renewable energy program, including proposed tariffs.

While the record shows that generation from renewable resources may be more costly than that from existing fossil-fueled sources, it is also true that renewable-fueled technologies provide portfolio diversity and other significant benefits. From that course of action, costs may decrease

[44]The Commission notes Detroit Edison's August 18, 2004 filing in Case No. U-12915. That request for proposals already may have provided the company with significant background information upon which to craft its REP for presentation to this Commission. Additionally, that information should hasten the completion of the initial survey recommended by the ALJ.

or stabilize. However, it is inappropriate to implement an REP for Detroit Edison and then leave the prospect of funding to be determined later. Thus, the ALJ's suggestion of a funding mechanism similar to that already authorized for Consumers Energy Company is proper, and the Commission finds appropriate the implementation of that funding mechanism for Detroit Edison. Accordingly, with the rates approved in this case, Detroit Edison shall begin implementing a five-cent per-meter, per-billing-cycle charge on all meters within the Detroit Edison system for all customers whose rates are no longer capped pursuant to MCL 460.10d(2), and then so forth as the caps expire for the remaining customers.[45]

The revenue collected from this five-cent-per-meter charge must be segregated on the company's books and records into a separate renewable resource fund account, to accrue interest at Detroit Edison's average short-term interest rate. Monies from this fund account shall be used by Detroit Edison to cover any short-fall in the amounts actually received by the company for its sale of renewable resource energy under its to-be-filed REP. Should the fund balance become significant, and unnecessary for this initial purpose, the Commission may direct other appropriate uses for the fund, such as (but not limited to) advertising to promote renewable energy or educational programs that will promote the use of renewable energy resources. The company's July 1, 2005 REP filing should propose accounting and cost recovery mechanisms for the REP power, and that proposal may utilize this funding mechanism. While Consumers Energy Company has initiated a method to price and to recover the costs related to its REP, that approach may not be the most appropriate for Detroit Edison.

In the Commission's view, access to dependable renewable energy is an appropriate goal for Detroit Edison and other Commission-jurisdictional electric utilities. To foster that goal, the

[45]The company is not required to list a separate line item on each bill, although the company must account for the funds received from the charge separately on its books and records.

Commission believes that the company should enter into longer-term agreements for the supply of renewable energy—such longer-term contracts may well make the financing of necessary projects easier and more acceptable to financing entities. In this regard, 20-year agreements containing commercially reasonable terms negotiated between the parties are appropriate and the Commission encourages Detroit Edison to establish such agreements. The Commission notes Detroit Edison's August 18, 2004 filing in Case No. U-12915, in which the company proposes to contract with a third-party to operate a Detroit Edison REP. Given Detroit Edison's apparent interest in working through a third-party to administer its REP, the company should work with that third-party to ensure that the agreements entered into for the provision of renewable energy power for the REP contain commercially reasonable terms that permit financing of the facilities that are necessary to provide that renewable energy.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCL 462.2 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1999 AC, R 460.17101 et seq.

b. Detroit Edison is experiencing a revenue deficiency in the annual amount of $335,812,000 and, according to the terms of this order, an increase in its annual revenues is warranted.

c. Detroit Edison should be directed to file an application to resolve other remaining stranded cost issues addressed in this order in conjunction with its PSCR reconciliation cases.

d. Detroit Edison should be directed to meet with interested parties to discuss the implementation of a program containing the essential elements of the PAYS® concept and the unresolved electric choice metering issues. Detroit Edison should include any tariff proposal for which there

is substantial agreement in its next general rate case application. The company should also be directed to file a report with the Commission no later than March 15, 2005.

e. The petitions for rehearing of the February 20, 2004 interim order should be dismissed.

f. The bond requirement established by the February 20, 2004 interim order should be rescinded.

g. Detroit Edison should be directed to file an application to unbundled its rates and to resolve certain other rate subsidiaries and imbalances between distribution rates of bundled and unbundled customers on or before March 23, 2005.

h. Detroit Edison should be ordered to implement an REP as set forth in the order.

THEREFORE, IT IS ORDERED that:

A. The Detroit Edison Company is authorized to increase its annual electric revenues by $335,812,000 consistent with rate cap provisions of 2000 PA 141 for service rendered on and after November 24, 2004 and as provided in this order, which is $87,382,000 above interim relief.

B. Within 30 days, The Detroit Edison Company shall file revised rate schedules reflecting the rates approved in this order and set forth on Exhibit A.

C. The Detroit Edison Company shall file a proceeding to address other remaining stranded cost issues addressed in this order.

D. The Detroit Edison Company shall immediately convene collaborative meetings with interested parties and the Commission Staff to discuss the implementation of a program containing the essential elements of the PAYS® concept and the unresolved electric choice metering issues. The company shall file reports of the agreed resolutions on these issues with the Commission as soon as any resolutions are reached, but no later than March 15, 2005.

E. The petitions for rehearing of the February 20, 2004 interim order are rejected.

F. The bond requirement established by the February 20, 2004 interim order is rescinded.

G. The Detroit Edison Company shall file an application to unbundled its rates and to resolve certain other rate subsidies and imbalances between distribution of bundled and unbundled customers on or before March 23, 2005.

H. The Detroit Edison Company shall continue the Low Income and Energy Efficiency Fund program authorized in the February 20, 2004 order in this proceeding.

I. Due to their length, the revised tariff sheets approved this order are included in the Commission's docket file for this proceeding, but they have not been attached to copies of this order. However, an electronic version of the revised tariff sheets does appear on the Commission's website.

J. The Detroit Edison Company is directed to implement a renewable energy program as set forth in the order.

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

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

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ J. Peter Lark
Chair

(S E A L)

/s/ Robert B. Nelson
Commissioner

/s/ Laura Chappelle
Commissioner

By its action of November 23, 2004.

/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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Chair

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Commissioner

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Commissioner

By its action of November 23, 2004.

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Its Executive Secretary