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Detroit Edison

May 13, 1997

The Honorable John D. Dingell
U.S. House of Representatives
Washington, D.C. 20515-2216

Dear ~~John:~~ John

Thank you for your inquiry of April 10, 1997. Detroit Edison welcomes the opportunity to share our thoughts with you about the impact of federal legislation on the issue of electric utility restructuring.

Detroit Edison believes that the primary responsibility for developing and implementing retail competition in the electric utility industry rests with the states. Therefore, we have been working closely with the Governor's office, the Michigan Jobs Commission, the Michigan Public Service Commission, and the Michigan Legislature to help fashion a restructuring plan that is fair and equitable. We have made considerable progress in this regard and are hopeful that a negotiated agreement satisfying the needs of all the stakeholders can be worked out. The process underway in Michigan is discussed in our response to your second question.

I believe that retail competition in the electric industry is inevitable. Therefore, it is critical to Detroit Edison, its customers, employees and shareholders that it be done right. Detroit Edison plays an important role in Michigan. We employ over 8,000 people, in addition to the thousands more who work for our suppliers. We pay over $172 million annually in property taxes, making Detroit Edison Michigan's second largest property taxpayer. In addition, we pay over $58 million annually of other state and local taxes. Of the approximately 130,000 Detroit Edison shareholders, 65,000 live in Michigan. Many of them are senior citizens, and many (44%) of them are small investors who own between 100 and 500 shares. Over 50% have held the stock for over 20 years and they look to the dividend to protect them during their retirement years. Additionally, Detroit Edison has been a respected corporate citizen for many years. For instance, The Detroit Edison Foundation has contributed about $35 million over the last 10 years to worthwhile educational, health and human services, civic, community, and cultural institutions throughout Southeastern Michigan. Through very difficult times, Detroit Edison has been a constant in helping to revitalize the City of Detroit.

We believe that Michigan should take the lead in restructuring the state's utilities, but the federal government also has a role in this process. There is a need for federal legislation to clarify jurisdictional responsibilities between Lansing and Washington regarding the management of specific aspects of a restructured electric industry. The issues proposed by the various pieces of legislation under consideration are complex and technical.

I know you also understand that utility restructuring puts much at stake! As always, I applaud your careful and sincere efforts to learn as much about an issue as you can before drawing conclusions. The care with which you approach public policy issues has served Michigan extremely well. I look forward to working with you to ensure that federal restructuring initiatives properly recognize the important role of individualized state-level solutions.

Sincerely,

John

John E. Lobbia
Chairman and Chief Executive Officer

Question No. 1 From your company's point of view, is it necessary for Congress to enact legislation bearing on retail competition, and why? If you favor legislation, please outline which issues should be addressed and how you think they should be resolved.

Answer: Detroit Edison believes strongly that the primary responsibility for developing and implementing retail competition in the electric utility industry rests with the states and not with the federal government. An orderly transition to retail competition can only occur when all of the risks, benefits and practical difficulties associated with the move to competition are thoroughly analyzed. To do this in the detail required, and to be certain that the rights and concerns of both individual consumers and business are addressed, necessarily means that each state should be allowed to determine how, and to what degree and at what pace it should embrace competition in the supply of retail electricity. Any attempt at a "one size fits all" approach to enact industry reform at the retail level at this early date will likely cause much more harm than good. However, the company understands that there are issues related to retail competition that will require the passage of federal legislation. Detroit Edison believes that Congress will have to address the following issues in order to allow retail competition to develop nationally:

- Newly enacted state retail access laws should be substantially "grandfathered" in any federal legislation in order to respect the policy choices made by the states with regard to implementing retail competition.

- State and federal regulatory jurisdictions need to be clearly defined. In particular, federal legislation should codify the authority of the FERC over unbundled[1] transmission service. Furthermore, federal legislation should delegate recognition over the transmission component of a bundled retail sale to the states, even if the transmission and other components are identified separately. The legislation should specifically identify that the states have jurisdiction over the distribution component of a retail sale and the authority to delineate the interface between transmission and distribution.

- Reciprocal opportunities to market power to retail customers in jurisdictions where sellers are located must be established as a precondition before any seller is permitted to offer electricity for sale on the retail market in a state that has opened itself up for retail competition. This reciprocity must be established whether the transaction originates in interstate or international commerce.

- A reasonable opportunity for the full recovery of transition costs, including stranded costs, must be ensured. Federal legislation should ensure that bypass of the local utility in an attempt to evade responsibility is not permitted.

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[1] Unbundling is considered the separation of the various components of electricity production, transportation and delivery, and service for the purpose of individually pricing and selling these items.

- PURPA should be repealed. PURPA makes absolutely no sense in a competitive environment serving only to unfairly disadvantage existing utilities by creating forced uneconomic purchase obligations.

- PUHCA may also have to be examined if it proves to be an undue hindrance to the development of a robust competitive market.

- Regulatory requirements including FERC accounting rules and filing requirements must be reviewed to remove the burden placed upon electric utilities that are not placed upon new participants and other entities participating in the restructured electric energy market.

- All new electric generation should be deregulated, whether it is owned by investor-owned utilities, independents or public power entities. States should be encouraged to act expeditiously to deregulate existing generation.

- Public power utilities now exempt from FERC's Order 888 and 889 should be subjected by legislation to FERC's open wholesale access rules and subject to the same regulation of transmission facilities and services when interconnected to the grid.

- In order to create efficient regional and national electric markets without jeopardizing reliability, FERC should be given the jurisdiction to act as the backstop to NERC[2] and regional entities in enforcing interconnection rules and operating standards for electric generators, transmission operators, and anyone connecting to the transmission grid.

Federal legislation should not affect previous prudence decisions rendered by FERC and the states or existing wholesale and retail contracts for the sale of electricity approved by either FERC and/or the states, whichever had the appropriate regulatory jurisdiction.

Question No. 2 If the state(s) you serve has adopted or is considering adopting retail competition, what are your biggest concerns? Please be specific. Indicate how you are dealing with them and any recommendations you may have.

Answer: Detroit Edison believes that states should have the autonomy to develop their programs with minimal federal oversight, hence the following discussion is presented for informational purposes and should not be taken as a pattern for developing federal legislation.

In January 1996, Governor Engler sent a report, prepared by the Michigan Jobs Commission (MJC), to the Michigan Public Service Commission (MPSC) urging broad changes in the structure of the electric utility business in Michigan over the next five years.

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2 North American Electric Reliability Council

According to the governor, these changes are being sought "to promote competition in our electric utility industry within reasonably established time-frames." Detroit Edison, together with Consumers Energy, the other large electric utility in Michigan, supported the MJC guidelines because they provide a framework for an orderly transition to a more competitive electric utility industry.

On December 19, 1996, the Michigan Public Service Commission Staff filed a conceptual framework for restructuring the electric utility industry in Michigan. The Staff report recommended a phased-in program of direct access based on two fundamental principles: (1) all customers should be eligible to participate in the emerging competitive market; and (2) rates should not be increased for any customers and should be reduced where possible.

Detroit Edison believes that the MPSC Staff Report provides a fair and balanced approach to restructuring. It recognizes that it is important to Michigan residents and utility shareholders to maintain a financially healthy Michigan-based electric utility industry while reducing rates and providing customer choice. Under the staff proposal, retail customer choice would begin as early as July 1, 1997, and Detroit Edison's customers would save nearly $300 million annually.

The Staff Report addresses a number of issues that are important to Detroit Edison, of which reliability is one of the most important. Reliability of electric service is one of the best features of the current regulated electric system or model. Detroit Edison was required under that system to invest in electric generation, transmission, and distribution facilities to ensure that electricity would be available to customers when they needed it. This investment supports Michigan's industrial base and quality of life. The Staff Report allows recovery for utility investments that previously have been reviewed and found prudent by the MPSC.

It provides for Detroit Edison to recover those prudent generation investments and other obligations that it undertook in order to meet the obligation it had to serve all of its customers. These obligations were incurred on the expectation that Detroit Edison would continue to serve those customers over a time long enough to allow it to recover the cost of its investment along with a reasonable (MPSC-approved) rate of return.

If the system changes before these assets are paid off, the Staff Report provides a mechanism that allows Michigan utilities to recover these stranded investments while electric utility restructuring is occurring. Stranded investments or stranded costs are prudent investments made under the current regulatory framework that may not be recoverable in a competitive environment because of customers leaving the system and ceasing to pay for them.

Stranded cost recovery must be a fundamental component of any restructuring program if government is to maintain any credibility and if companies, like Detroit Edison, are to survive. For example, FERC states in Order 888:

"We will not ignore the effects of recent significant statutory and regulatory changes on the past investment decisions of utilities. While, as some commenters point out, there has always been some risk that a utility would lose a particular customer, in the past that risk was smaller. It was not unreasonable for the utility to plan to continue serving the needs of its wholesale requirements customers and retail customers, and for those customers to expect the utility to plan to meet future customer needs. With the new open access, the risk of losing a customer is radically increased. If a former wholesale requirements customer or a former retail customer uses the new open access to reach a new supplier, we believe that the utility is entitled to recover legitimate, prudent and verifiable costs that it incurred under the prior regulatory regime to serve that customer." (Federal Register, Vol. 61 No. 92, pp. 21629-21630)

The MPSC Staff Report agreed with this conclusion. They said:

"The opportunity to recover transition costs is necessary to assure a fair, smooth, and realizable restructuring of the electric industry. Without reasonable recovery of transition costs, significant adverse and unacceptable impacts on various interested parties will occur. In short, reasonable recovery of transition costs helps to assure financially healthy utilities and reliable electric service within the State."

Where feasible, the Staff Report identified securitization of the utility assets as the preferred method of allowing the utility to recover its stranded assets and to provide a rate reduction for all customers. Stranded costs that are not recovered through rate reduction bonds will, under the staff proposal, be recovered through a transition charge billed to direct-access customers. The transition charge begins when the customer takes direct access and continues through 2007.

Under the securitization option, stranded-cost items, such as regulatory assets and the capital costs of nuclear plants, are refinanced through the issuance of regulatory rate-reduction bonds that are authorized by the state. These include provisions for debt service through non-bypassable charges on all delivered energy. The result is financing charges lower than those associated with traditional utility financing. When the designated financing entity issues the bonds, and the funds are delivered to the utility, electric rates are reduced to reflect the resulting lower financing charge. The utility collects securitization charges from all customers and forwards them to the designated financing entity for debt servicing.

Detroit Edison endorses the MPSC Staff's approach to the process of deregulation and believes that without the recognition of stranded costs and the employment of a mitigating remedy like securitization, an orderly transition to retail competition cannot be achieved. However, there are other issues related to state action that need to be understood as well. These include:

- **Unbundling of Services --** How will Detroit Edison price the use of critical Michigan transmission, distribution, and the different generation components of service used to provide for retail wheeling? Currently, customers automatically receive these services including ancillary services such as load following, standby, frequency and voltage regulation as an integrated part of their bill for electric services. In a retail wheeling scenario, customers will no longer automatically receive the bundled "product quality" services without paying for them separately.

- **Obligation to serve --** What will be Detroit Edison's obligation to serve a customer if at any time that customer opts for retail wheeling? May that customer elect to return to Detroit Edison's system at any time? If so, is Detroit Edison required to provide full service to this customer?

- **Deskewing of Rates (Rate Balancing) --** Social policies of the past have resulted in the subsidization of residential customers' rates by industrial and commercial customers. In a competitive market, there should be no subsidization of one class of customer at the expense of another. Unnecessary subsidies in rates penalize the local utility when its customers have a choice of suppliers.

- **Contract Flexibility --** Both customers and utilities would like the ability to negotiate contracts without contested rate case proceedings. Regulatory bodies should allow utilities and customers more flexibility in this area. Detroit Edison pioneered these initiatives through special contracts with its large industrial and commercial customers.

- **Social Policy --** Social programs benefiting low-income persons, senior citizens, and those providing energy management and conservation are currently supported by Detroit Edison's electricity rates. In a competitive environment, who will pay for these stranded (societal) benefits?

- **Employee Protection --** Any restructuring program must include funding for employee retraining to assure that utility employees are not unduly impacted by retail competition. Promoting employee retraining is good public policy, improves the Michigan economy by retaining a well-trained work force, and is consistent with the approach taken in other states.

Question No. 3 Whether or not you favor federal legislation, please indicate your position on the following specific issues (to the extent not addressed in your prior responses):

(a) A Federal mandate requiring states to adopt competition by a date certain. **If retail competition is under consideration in the state(s) you serve, do you believe Congress should provide additional direction and authority?**

Answer: As stated in the answer to Question No. 1, Detroit Edison believes strongly that the primary responsibility for developing and implementing retail competition in the electric utility industry rests with the states. Therefore, the decision on whether to include a "date certain" is premature. Nonetheless, any federal bill that contains a date certain must allow enough time for an orderly transition to proceed, and should incorporate **Detroit Edison's Principles For Fair Competition**, including:

1. Fairness

- Ensuring that competition benefits all.
- Providing a level playing field.

2. Reliability

- Maintaining the convenience and reliability of the electric system.

3. Economic Security

- Retaining jobs, tax base and Michigan's energy supply.
- Recovering investment costs.

Detroit Edison would oppose any Federal legislation that inadequately addresses or fails to address these issues. This would be true whether or not such legislation contains a "date certain."

(b) Recovery of stranded investment. **If the state(s) you serve already has adopted retail competition, how was this issue addressed and are you satisfied with the outcome? If your state(s) is considering adopting retail competition, how would you recommend that this issue be treated? Do you think that Congress should enact legislation relating to stranded cost issues and if so what would you recommend? Is securitization a useful mechanism for dealing with stranded costs, and whom does it benefit?**

Answer: As previously stated, Detroit Edison supports the findings of both FERC and the MPSC Staff Report, when they agreed that the recovery of stranded costs that utilities incurred under the present regulatory scheme is necessary to ensure a fair and smooth transition to retail competition. Agreeing again with the MPSC Staff Report, Detroit Edison believes that securitization is the preferred way to deal with the issue of stranded costs. Notably, in two states where full recovery of stranded costs was not allowed - Arizona and New Hampshire - resulting disputes and litigation have delayed the prospects for open retail access.

If federal legislation is adopted, it should deal with the issue of stranded costs in the following manner:

- Tie the utility's duty to grant open access to all its distribution and transmission facilities to a corresponding commitment by FERC and state regulators to provide for the full recovery of all legitimate and verifiable wholesale and retail stranded costs over a time period and in a manner that does not adversely affect the utility's financial viability.

- Permit the use of non-bypassable distribution and transmission charges, service or access charges, or exit fees in order to expedite the fair recovery of transition costs. These fees or charges should not unduly discriminate among different customers, nor shift cost recovery responsibility among different classes of customers.

- Prevent redefining stranded costs and their allocation among electric customers in a manner that is different, or changes the way regulators have previously determined that such investments were just and reasonable, so that such costs would become non-recoverable.

- FERC should be authorized to impose properly-calculated retail transition cost surcharges in those rare instances where states fail to or inadequately address the issue of stranded cost recovery.

- Divestiture of generation should not be required as a condition of stranded cost recovery.

(c) *Reciprocity.* Can states condition access to their retail markets on the adoption of retail competition by other states? Should Congress enact such a requirement? Could such a requirement create an incentive for states with low electric rates not to adopt retail competition, in order to keep cheap power at home?

Answer: Arguably, a state can condition access to its open retail markets, under state law, to suppliers who are "open" in their "home" territory in that state or in other states. See, for example, the recent Supreme Court ruling in General Motors Corporation v. Tracy, February 18, 1997, which upholds broad state powers to impose different taxes on different kinds of "gas marketers" in Ohio -- even though the more heavily taxed type of marketers were often interstate companies, while the exempted type were generally in-state companies.

Congress can act here in two different ways: first, it can by federal law impose such a reciprocity requirement on closed and open utilities, pursuant to its Commerce Clause powers. Second, Congress can instead authorize "open" states to discriminate against "closed state utilities," just as Congress did in the case of low-level nuclear waste. For example, Congress could forbid any supplier of electricity from providing electricity to retail consumers in another state, unless (1) all transmission and local distribution facilities owned, controlled, or operated by such supplier or its affiliates are themselves "open," (2) any person generating the electricity to be supplied, and that person's affiliates, provide open access to any transmission or local distribution facilities they own, control or operate.

A key point is that a state is not engaging in "economic protectionism" when it repeals an old law permitting retail sales only by in-state monopolists with exclusive franchises, and moves to legalize competition in its markets by any "open" supplier, whether in-state or out-of-state. Current constitutional restrictions against state regulation of interstate commerce are in large part aimed at "economic protectionism" by the states. An example of such protectionism in energy markets is Louisiana's "first use" tax, which in the early 1980's taxed in-state and out-of-state buyers of Louisiana's gas, but then gave full rebates to in-state buyers. A more recent example, in the New England milk market, was held unconstitutional by the Supreme Court in its West Lynn Creamery decision, 512 U.S. 186 (1994). In this case, Massachusetts milk regulators charged fees to all in-state milk dealers -- based on their sales of milk produced in-state and out-of-state -- but then distributed the resulting fund only to in-state dairy farmers. The Court held that this was effectively a tax imposed only on out-of-state products, that would cause local goods to constitute a larger share and out-of-state goods to constitute a smaller share of total sales in the market. This is impermissible. However, as noted, states that adopt open access for all "open" suppliers -- whether in-state or out-of-state -- are going in the opposite direction. They are allowing a closed, locally-dominated market to be increasingly served by in- or out-of-state suppliers. This furthers interstate commerce instead of restricting it.

Arguably, such reciprocity requirements -- whether under state or federal law -- may deter some closed states from adopting open retail access, in order to keep their cheap power "at home." However, if power is universally cheap in these hypothetical states, very few suppliers will prove to be cheaper, and little new power likely will be wheeled in, even if the state opens up.

Moreover, state regulators have no control over wholesale sales, and power suppliers in these hypothetically cheap states accordingly can be wheeled out of the state now under Order 888 to wholesale markets around the country. Thus, cheap power, in fact, cannot be protected and kept securely at home by the states.

Finally, FERC's experience with gas pipelines suggests that reciprocity rules may encourage more "openings" than "closings" at the state level. Interstate pipelines were given a variety of competitive benefits in the early days of "voluntary" open access under Order 436. If they accepted the burden of opening up and carrying gas for all producers, consumers, and marketers, they were also granted competitive benefits, such as the right to add new delivery points and lines to serve new customers without advance FERC proceedings, and the right to limit their stranded costs via take-or-pay credits. Proposed "carrot-and-stick" electric reciprocity rules are similar: they pose an obvious burden to utilities that must then face a tougher, competitive market; but they also offer utilities the benefit of expanding into new in-state or regional markets. In sum, a practical balancing of these burdens and benefits thus helped to restructure the gas pipeline industry. The same result is likely in the electric utility industry.

Question No. 4 If Congress enacts comprehensive restructuring legislation, should it mandate "unbundling" of local distribution company services? What impact would this have, and would the effects differ for various customer classes? Would this entail substantial expense and who would incur any such costs?

Answer: The unbundling of retail rates should occur and will occur eventually as part of the change from regulation to competition. This unbundling will involve local distribution company services including ancillary services such as backup energy and voltage support. The costs will vary for different customer classes depending on the actual costs required to serve that customer class.

To the extent current retail rates were based entirely and accurately on cost-of -service principles, there should be no major effect because the sum of the component costs should within reason equal the total bundled tariff that one started with. To the extent today's rates deviate from the cost to serve, and provide cross-subsidies such as discounts to senior citizens or to charitable institutions such as homeless shelters, unbundling rates would increase rates to those previously receiving discounts. There can also be other reasons for bundled rates to be skewed away from true costs besides discounts. An example might be where residential rates are subsidized by other customer classes as a means to temper rate increases.

Unbundled rates should not contain special discounts. In order to reinstate such discounts the unbundled rates to all other customer classes should have to specifically include a societal benefit surcharge to make up for the revenue loss. As stated in the answer to Question No. 1, Detroit Edison believes some restructuring legislation is necessary, but it should not include the unbundling of local distribution company services.

Question No. 5 Recently Chair Moler of the Federal Energy Regulatory Commission recommended that, as part of comprehensive legislation, Congress authorize the Commission to enforce compliance with the North American Electric Reliability Council standards to help maintain the reliability of service. Do you believe this is necessary, and why or why not?

Answer: Detroit Edison agrees with and supports Chair Moler's proposal.

Detroit Edison supports the expansion of the North American Electric Reliability Council (NERC) to include other legitimate energy interests that have not been members in the past. Detroit Edison recognizes that maintenance of current levels of reliability is a critical industry issue.

Historically, NERC standards have been voluntary and without penalty for non-compliance. Recently, NERC made compliance with its standards mandatory for all members. Currently, however, not all industry participants are members of NERC or one of its regional councils. The Company believes all industry participants should be required to join NERC through a regional council or, at a minimum, agree to abide by NERC standards as a condition of use of the electric system. In addition, FERC may need to play an enforcement role when NERC finds that entities are not in compliance with NERC standards.

The industry has previously done a very good job in maintaining bulk power reliability. The basic NERC reliability process must be retained with only minor changes to reflect the expanding number of industry participants. The key challenge now is to determine how much to change a system that has worked very well in the past in light of the expected structural changes in the industry.

Question No. 6 What concerns does your company have with respect to the role of public power and federal power marketing in an increasingly competitive wholesale electric market? In markets in which retail competition has been adopted? Are there concerns you would like to have addressed if Congress enacts comprehensive restructuring legislation? Should Congress consider changes to federal law as it applies to regulation of public or federal power's transmission obligations?

Answer: As competition in the electric power industry progresses, provisions must be established for regulatory parity and financial parity between private and public power suppliers. If emerging competition is to work effectively, preferential governmental entitlements and exemptions must be minimized or eliminated.

Formation of many of the public power entities that exist today was reasonable in the circumstances that existed at the time of such creation. However, the advent of increased electrical interconnection and open access to transmission services significantly changes those circumstances and permits opportunities for existing exemptions and entitlements to be unjustifiably exploited, to the detriment of retail consumers and the competitive process itself.

Extension of the methods developed by the FERC in Order 888, whereby access to private systems is granted to public entities who provide like access to their systems, is an excellent method to help move public systems to a level playing field. For example, public suppliers with retail consumers should not be entitled to access the retail customers of private suppliers, unless they permit private suppliers reciprocal access to their retail customers. Imposition of such a requirement could easily be justified on the basis of the public system's "election" to connect its facilities to those of private systems. Existing state and federal restrictions on private utilities that are not similarly applicable to public systems should also be eliminated or prohibited.

There must also be financial parity between private and public power whenever public power seeks to expand beyond traditional service areas and customer markets. Federal policies adopted over half a century ago provide significant subsidies to government-owned electric utilities and rural electric cooperatives. A recent report by Putnam, Hayes & Bartlett, a nationally recognized economic and management consulting firm, examined the types of subsidies available to government-owned electric utilities and rural electric cooperatives. The report identified the primary subsidies available to government-owned utilities, such as municipal electric systems, as:

- exemption from federal and state income taxes;
- exemption from other taxes, such as property and excise taxes;
- the ability to issue tax-exempt securities to finance investments; and
- preferential access to low-price federal power, primarily hydropower generated at federal dams and sold through the Power Marketing Administrations.

The primary subsidies generally available to rural electric cooperatives were:

- exemption from federal taxes, except social security;
- exemption from state and local income taxes;
- preferential access to low price federal power;
- direct loans from the federal government at interest rates below market rates; and
- federal loan guarantees that allow them to borrow money at lower interest rates than they otherwise would have to pay.

Public power entities seeking to expand beyond their traditional service areas and customer markets should not be subsidized and should have to compete upon a level playing field under the same rules as all other suppliers.

Question No. 7 If Congress enacts comprehensive restructuring legislation, should changes be made to federal, state and local tax codes, and if so, why? Please be specific.

Answer: When the utility industry was being regulated by state and federal governments, inclusions in utility bills were used by regulators to achieve social purposes. It was easier to create add-ons to a utility bill than to raise taxes. This policy is evidenced by government imposition of fees in lieu of taxes on federal programs like the Low Income Home Energy Assistance Program, the Nuclear Waste Fund, the Clean Air Act implementation and regulations, and a myriad of additional programs. States, too, have used their utilities to collect revenues on their behalf. Detroit Edison is the second largest property tax payer in Michigan. These taxes support Michigan schools and numerous community services.

When only one utility was the designated provider assigned to a service area, higher taxes on real and personal property, gross revenues, or fees for licenses entailed no competitive disadvantage because there were no other competitors. With the advent of competition, however, circumstances will change. Any tax advantage bestowed on a competitor will make a significant difference in the cost-per-unit of electricity charged a retail customer. Down-sizing the utility's capital investment will also have an impact on state and federal tax revenues. The expansion of user fees will probably be utilized by taxing authorities to try to offset the decrease in tax revenues. In most other deregulated industries, similarly-situated competitors have similar tax liabilities. The differences in tax liabilities among potential competitors need to be addressed before retail competition is permitted to proceed.

At this time, Detroit Edison can identify two areas where the Internal Revenue Code (IRC) will require modification.

IRC Section 468A Currently, a utility which owns a nuclear power plant is required to externally fund (usually by way of a trust) the amount which will be necessary to decommission the plant. Under Internal Revenue Code Section 468A, the utility is permitted to currently deduct contributions to a "qualified nuclear decommissioning trust", assuming that the amounts contributed are recovered in the utility's cost-of-service and are contributed to the trust on a levelized basis, generally over the period of time that the utility is allowed to recover its capital investment and operating costs of the plant from its customers. Absent Section 468A, decommissioning amounts collected from customers would be income in the year of receipt and offsetting deductions would not be available until decommissioning expenses were actually incurred.

Section 468A was designed to operate within the structure of a regulated electric utility industry, and its mechanics are dependent upon traditional cost-of-service ratemaking. Under the restructuring packages currently being considered by many states, amounts collected to cover a utility's nuclear decommissioning costs could no longer be contributed to a qualified trust and would therefore be ineligible for the favorable tax treatment afforded by Section 468A.

Congress should amend Section 468A to sever its dependence on traditional cost-of-service ratemaking. The amendment should provide that a taxpayer can deduct contributions to a qualified fund when decommissioning amounts are collected under any restructuring approach, including traditional cost-of-service ratemaking, market based or competitive rates or a deregulation transition surcharge.

IRC Section 451 Internal Revenue Code Section 451 should be amended to specifically provide that proceeds from rate reduction bonds which are issued to facilitate a competitive electric industry by reducing customer rates and recovering stranded costs are not taxable. This would encourage electric utilities to consider "securitization," the issuance of Rate Reduction Bonds that would permit the utilities to reduce customer rates and recover their stranded costs.

Question No. 8 What, if any, concerns do you have about the reliability of the electric system? If the industry moved to retail competition, will adequate reserves be available? Is the transmission system capable of handling full retail competition?

Answer: A major concern is that today's electric infrastructure was not designed for and will not handle the increased demands placed upon it by full retail competition. It is unclear whether the significant expenditures for monitoring and billing that are necessary for full retail competition will be made by the traditional industry, or if the industry will need to adopt other solutions.

The move to full retail competition cannot occur instantaneously because it will take time to work out details such as metering, billing, verification, and accounting, on the scale necessary for full retail competition.

We believe that market mechanisms will be capable of providing for adequate reserves when full retail competition arrives. If regulatory mandates are necessary during a transition to competition, there has to be full compensation for the obligations whether they are primary obligations or default obligations as a supplier of last resort.

The Company believes that physical transmission limitations that now exist will be mitigated by market mechanisms and additional facilities. Detroit Edison anticipates that a competitive interstate electricity environment will provide innovative, competition driven solutions to expanding transfer capability into and out of Michigan. Certainly, the present interconnections between Michigan and the rest of the interconnected grid are physically limited in the amount of power that can be imported or exported, and the limits are sensitive to changes in load and operating conditions. However, physical limitations should diminish in importance as market mechanisms create transactions with offsetting power flows and real time monitoring of conditions enable independent system operators to maximize utilization of the system.

Detroit Edison believes that markets will work to remove physical constraints and will provide the transmission and generation capacity needed for reliability. For this to occur, however, the industry must get to a market where each supplier is held accountable for its commitments and no supplier is saddled with reliability or other obligations that other suppliers do not have.