

March 8, 2006

Implementation of the Alternative Energy
Portfolio Standards Act of 2004

Docket No. M-00051865

Rulemaking Re Electric Distribution
Companies' Obligation to Serve Retail
Customers at the Conclusion of the
Transition Period Pursuant to
66 Pa. C.S. § 2807(e)(2)

Docket No. L-00040169

Response of DTE Energy Co. to Commission Questions

DTE Energy Co. (**DTE**) is pleased to provide its comments in response to the request of the Public Utility Commission (the **Commission**) dated February 8, 2006 in the above captioned dockets for responses to certain questions.

DTE is a Detroit-based, diversified energy company involved in the development and management of energy-related businesses and services nationwide.

Built on a strong utility base, DTE Energy's largest operating subsidiaries are Detroit Edison, an investor-owned electric utility serving 2.1 million customers in Southeastern Michigan, and Michigan Consolidated Gas Co., a natural gas utility serving 1.2 million customers in Michigan.

DTE Energy has 11,000 employees in utility and non-utility subsidiaries involved in a wide range of energy-related businesses. The company's growing non-utility businesses are built around the strengths, skills and assets of DTE Energy's electric and gas utilities. Non-utility business growth is focused in three areas: power and industrial projects, unconventional natural gas production and fuel transportation and marketing. In particular, DTE subsidiaries are

developing coal mine methane and landfill gas projects in the PJM service territory that would be eligible to sell renewable energy certificates under the Alternative Energy Portfolio Standards Act of 2004 (the **Alternative Energy Act**).

DTE's comments are addressed principally to questions 2, 6, 7 and 8 insofar as they relate to the ability of default service providers to enter into long-term contracts.

1. Long Term Contracts are Necessary to Development of Projects.

Long term contracts are needed to encourage the development of new generating capacity meeting the requirements of the Alternative Energy Act. During the 1990's a substantial number of new generating facilities, mostly fueled by natural gas, were built on a "merchant" basis, without long-term power purchase agreements. Even before the recent run-up in natural gas prices many of these facilities were running at a fraction of their intended capacity and as a result many were financially troubled. Many have been sold or restructured in ways that were costly to the original investors or lenders.

As a result of this experience major banks and investment banks are unwilling to lend to generating projects that do not have long-term power purchase agreements covering a sufficient portion of the project's output to assure payment of debt service. Tax-driven investors, whose return is based in part on investment or production tax credits, although they are tax-owners, view their investments on a credit basis similar to that of lenders. In short, it is not possible to obtain third party financing for projects without a long-term power purchase agreement.

2. Balance Sheet Investors Won't Fill the Gap.

Inability to obtain financing is obviously fatal to projects developed by independent power producers. The absence of such developers would not be fatal to development overall if major companies with the ability to attract capital based on their balance sheets were to invest in projects. DTE is such a company. However, like most such companies DTE Energy has internal standards for investment. To consider a long-term, capital intensive project, DTE Energy has requirements for hedging commodity risk that result in credit standards for internally financed projects similar to those that a third-party lender would apply to an independently owned project. A long-term power purchase agreement is the only effective hedge in the electricity sales context.

3. The Gas Futures Market is Deeper and More Liquid.

It is DTE's experience that the market for futures contracts for natural gas is deeper and more liquid than the market for forward electricity. (And the market for renewable energy certificates is even less developed.) In this context, projects such as DTE's methane projects (or even coal gasification projects) that can choose between delivering btus as gas or as electricity will have an easier time hedging in the gas markets. The inability to obtain long-term power purchase agreements may have the effect of driving btus in the direction of the gas markets, and raising the comparative cost of electricity. (Additional capital and operating costs must be incurred in cleaning and compressing such gas to pipeline quality, and the gas then sells at commodity natural gas prices. Even if such gas is subsequently used to generate electricity, potential cost savings from the direct use of the gas are lost.)

4. Long Term Contracts are Needed for Consumer Price Stability.

Long-term contracts benefit consumers as well as developers. The increasing price and volatility in natural gas prices coupled with predicted eventual declines in both oil and

gas production world-wide make rising prices for energy extremely likely. (Although gas is not a large component of the overall fuel mix, gas is often the fuel at the margin that sets the price.)

New Jersey has arranged for its load serving entities to procure their electricity through wholesale auctions similar in many respects to the provisions of the Commission's proposed Default Service regulations. Those auctions procure power on three year contracts on a rolling basis, one third of peak demand in each year. In the most recently completed auction average prices rose approximately 55 percent over the previous year's auction. Three years is at the long end of a short-term contract. New Jersey consumers are protected from feeling the full impact of increased prices in one year, but they have limited protection.

By contrast, the original California market had no protection for consumers at all. Load serving entities were required to buy all of their power on the daily spot market, with predictable results when prices rose.

Compared to either California or New Jersey utilities before deregulation provided extraordinary price stability because they maintained long-term generation portfolios. The risk, which the retail competition law was intended to address, was that they locked in high prices in a stable price environment.

Since Pennsylvania's implementation of retail competition, there have been no wholesale buyers in Pennsylvania with the legal ability or incentive to enter into long-term contracts. While price stability has been provided by price caps, that is clearly not a long-term solution to consumer protection.

DTE believes that the prudent course both for individual Default Service Providers and for the Commission on behalf of consumers is to both permit and encourage Default Service Providers to have a balanced portfolio of long- and short-term power purchase

arrangements. The weighing of such a portfolio should be capable of adjustment from year to year depending on each load serving entity's forecasts of future prices and its expectation of customer retention.

5. Procurement of Long-Term Contracts can work within the Act and the Commission's Regulatory Framework.

The Commission's proposed regulations for default service issued in these Dockets on December 16, 2004 require default service providers to obtain electric power through a "competitive procurement process" which is defined as:

a fair, transparent, and non-discriminatory process by which a default service provider acquires electric generation supply to serve its default service customers through a bid solicitation process.

Section 54.186 further defines the required process, which must be approved, in each case, by the Commission. In particular, the process must specify "the time period during which the power will need to be supplied for each power supply product" and "bid evaluation criteria."

This language would appear to permit procurement of a portion of a default service provider's electric power supply for long term periods. However, the Commission should recognize that the bid evaluation criteria for long-term contracts will often be different than for short-term contracts. In particular, short-term contracts will typically be with existing generating units, but long-term contracts will often be with units yet to be constructed. Indeed a major purpose of the Advanced Energy Act is to encourage construction of new advanced energy generating units. Such procurements must take into account feasibility criteria in addition to the sort of credit qualifications that might be typical for a short-term contract.

It would be extremely helpful for the Commission to provide guidance to the effect that long-term contracts are permitted and encouraged, and that the Commission will be flexible in approving bid selection criteria adapted to the nature of long-term contracts.

6. Long Term Contracts Should Not Compete Directly with Short-Term Contracts on Price.

The Commission's question No. 6, while couched in terms of coal gasification, raises questions for any long-term contracting process. A long-term contract should not be expected to compete on a current price basis with short-term contracts. Longer-term futures contracts are generally priced higher to reflect both expectations of rising prices and greater uncertainty about future business conditions. However, the long-term hedge is often extremely valuable. For example, if load serving entities in New Jersey had been permitted in 2004 to enter into contracts with a period longer than three years for at least some of their power, even at a ten or fifteen percent premium to then spot prices, it would have served New Jersey customers well.

There are at least two ways to conduct a mixed short-and long-term procurement. One is to specify tranches with different durations and simply take the best bids in each tranche (reserving the right to reject all bids in the longer term tranches). The second is to have an evaluation criteria that includes a forecast of the rate of increase of future spot prices and only accept longer term contracts that have a lower expected cost than a series of shorter-term contracts. The first method runs the risk that all long-term bids are worse than the short-term bids if evaluated on the second basis. However, the first has the benefit of providing long-term price discovery rather than relying on estimation.

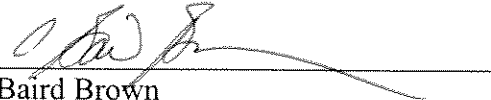
7. The Commission Should Provide Guidance Now.

The Commission's question No. 7 asks about the timing of promulgation of default services regulations. It is important for the Commission to move promptly. The Alternative Energy Act will take effect across the state in different service territories beginning in 2007 through 2011. To enter into contracts that will allow new projects to be constructed and placed in service in that timeframe, procurement would need to begin this year. While

modification to the regulations is not necessary to permit this to happen, the Commission's additional guidance as suggested above would be extremely helpful.

If the Commission has any questions or would like clarification of any of the foregoing, please do not hesitate to contact the undersigned.

Respectfully Submitted

A handwritten signature in black ink, appearing to read 'C. Baird Brown', is written over a horizontal line.

C. Baird Brown
Ballard Spahr Andrews & Ingersoll, LLP
on behalf of DTE Energy Co.