STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of **THE DETROIT EDISON COMPANY** for authority to amend its rate schedules governing the supply of electric energy and to amend other miscellaneous rates.	))))))	Case No. U-8789

At the December 28, 1998 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. John G. Strand, Chairman
Hon. David A. Svanda, Commissioner

OPINION AND ORDER

On December 27, 1988, the Commission issued an order in this proceeding approving a settlement agreement entered into by the parties. Subsequently, it became apparent that a dispute had arisen among the parties with respect to Paragraph I-E of the settlement, which relates to the phase-in revenues for The Detroit Edison Company's (Detroit Edison) Fermi 2 Nuclear Generating Plant (Fermi 2) under Statement of Financial Accounting Standards 92 (SFAS 92). On June 5, 1997, the Commission issued an order inviting the parties to submit briefs regarding the meaning and intent of the settlement and whether a contested case would be required to implement the provisions of the settlement. Briefs and reply briefs were filed by Detroit Edison, the Association of Businesses Advocating Tariff Equity (ABATE), Attorney General Frank J. Kelley (Attorney

General), Energy Michigan, and the Commission Staff (Staff), all of whom were parties to the settlement.

I.

THE SETTLEMENT AGREEMENT

The settlement agreement resolved numerous issues relating to Detroit Edison's request to increase its rates for the retail sale of electricity by approximately $198 million, which was later amended to $298 million. Paragraph I-E of the settlement agreement provides as follows:

> E. FERMI 2 PHASE-IN REVENUES
>
> In accordance with [SFAS 92], the revenue changes recorded pursuant to the final Fermi 2 phase-in plan are:
>
> | | |
> |---|---|
> | 1988 Actual | $ 68,379,000 |
> | 1989 | 104,695,000 |
> | 1990 | 70,800,000 |
> | 1991 | 70,800,000 |
> | 1992 | 70,800,000 |
> | 1993 | 70,800,000 |
> | 1994 | 70,800,000 |
> | 1995-1997 | No change |
> | 1998 | ($ 53,357,000) |
> | 1999 | ($128,049,000) |
> | 2000 | Revert to non-phase-in ratemaking |
>
> The parties agree that the amounts and accounting entries shown on Attachment C[1] will be included in cost of service for ratemaking purposes and that the Company shall file a timely general rate case with the MPSC on or before June 1, 1993 (including calendar 1992 actual financial data) to determine the electric rates to be charged retail customers, taking into account the Fermi 2 phase-in revenues required for the year 1994 and beyond.[2]

Settlement agreement, p. 6, footnotes added.

---

[1]Attachment C provides accounting entries for the years 1988 through 1998 for items labeled: (1) AFDO, (2) Deferred Depreciation, (3) Amortization of Deferred Depreciation, (4) Amortization of AFDO, (5) Accumulated Unamortized Deferrals, (6) Deferred Taxes, and (7) Accumulated Deferred Taxes.

[2]Detroit Edison filed a general rate case on July 1, 1992 in Case No. U-10102.

In addition to the above-quoted portion of the settlement agreement, the parties have argued that Paragraphs I-F and II-C are relevant to this matter. Paragraph I-F provides as follows:

> F. <u>ADDITIONAL FERMI 2 INVESTMENT FOR RATEMAKING PURPOSES</u>
>
> In this proceeding, the Company requested, on a total Company basis, that $1,700,000,000 in Fermi 2 investment be included in rate base, over and above the Fermi 2 investment included in rate base in MPSC Case No. U-7660 and the Company anticipated requesting inclusion in rate base of approximately $513,000,000 more related to the Company purchase of Wolverine's remaining ownership interest in Fermi 2.
>
> This Fermi 2 investment of $2,213,000,000 will be treated by the Commission and the parties for ratemaking purposes in this case as follows:
>
> - $700,000,000 will be included in rate base effective January 1, 1989;
>
> - $300,000,000 will be amortized, without return, ratably over 10 years commencing January 1, 1989. For the first five years, the Company shall reduce annual operating costs by the amount of the annual amortization during each of the five years of the period;
>
> - $700,000,000 will be written off no later than March 31, 1989 ($200,000,000 for Wolverine principal and interest and $500,000,000 for Fermi 2 project costs); and
>
> - $513,000,000 purchase by the Company of the remaining Wolverine capacity on January 1, 1990, will be accounted for as a "regulatory asset" with a nineteen year principal amortization and associated interest computed at the rate of 8%. The resulting $53,000,000 annual amortization including interest will commence January 1, 1990. The debt and the interest costs associated with the Wolverine purchase by the Company will be excluded from the calculation of the Company's return on investment for its other rate based properties in subsequent ratemaking proceedings.
>
> The parties agree for ratemaking purposes that the retail rates established in this Stipulation and Agreement reflect the jurisdictional portion of the above total Company amounts.

Settlement agreement, pp. 7-8.

Paragraph II-C provides as follows:

> C. In any future applicable base retail rate proceeding before the Commission, each party agrees not to oppose, and should any party intervene, each such party agrees to include as a cost of service item for ratemaking purposes the jurisdictional portion of the following:
>
> (1) The Fermi 2 phase-in amounts as provided in Section I-E. FERMI 2 PHASE-IN REVENUES, and Section III-A;
>
> (2) Years 6 through 10 of the $300,000,000, ten year Fermi 2 amortization and the treatment for years 5 through 19 of the $513,000,000 purchase as set forth in Section I-F. ADDITIONAL FERMI 2 INVESTMENT FOR RATEMAKING PURPOSES; and
>
> (3) Amortization of Fermi 2 investment as provided in Section I-P. COMPANY AMORTIZATION OF FERMI 2.
>
> The amortizations in sub-paragraphs (2) and (3) do not include income tax effects. The parties agree that applicable income tax effects should be included in future rate proceedings for these amortizations.
>
> However, no party is bound by this Stipulation and Agreement to support inclusion in the Company's cost of service of any other amount or item.

Settlement Agreement, pp. 28-29.

II.

POSITIONS OF THE PARTIES

Detroit Edison

Detroit Edison's position is that the company has complied with the provisions of the settlement agreement and that the only requirement in the settlement agreement is that its cost of service be reduced in 1998 and 1999 by approximately $183 million. According to Detroit Edison, a "reduction of the Company's cost of service, of course, is not the same as a reduction in electric

rates." Detroit Edison's brief, p. 4. Detroit Edison proposes to implement the settlement by securitizing approximately $2.8 billion in assets under a proposal it made in Case No. U-11290.

In its reply brief, Detroit Edison indicates that it would be willing to attempt to negotiate a resolution of this dispute, provided that discussions are limited to Paragraphs I-E and I-F of the settlement agreement.

ABATE

ABATE's position is that the Commission should order Detroit Edison to file a full general rate case. According to ABATE, Paragraph II-C of the settlement agreement necessarily anticipated the filing of a base retail rate proceeding before the Commission to reduce the cost of service in 1998 and 1999. In the alternative, ABATE claims that Detroit Edison is required to submit "a request to reduce its rates across the board to reflect the decrease in phase-in revenues and termination of the amortization provided for in the Settlement Agreement." ABATE's brief, p. 8.

In its reply brief, ABATE argues that Detroit Edison's securitization proposal is inconsistent with the settlement agreement since the concepts involved were foreign to the issues being negotiated at the time.

Attorney General

The Attorney General contends that the settlement agreement requires rate cuts of $53 million in 1998 and $128 million in 1999. According to the Attorney General, Detroit Edison's customers paid higher rates in 1988 through 1992 than they would have without the Fermi 2 phase-in and the Commission's order in Case No. U-10102 supports the conclusion that Detroit Edison has received ratemaking to reflect all Fermi 2 phase-in elements. The Attorney General recommends that the

Commission order Detroit Edison to file a rate case reflecting the revenue requirement reductions in Paragraph I-E.

The Attorney General's reply brief argues that a hearing should be conducted because other proposals for rate reductions would shift the allocation of Fermi 2 costs among different rate classes.

Energy Michigan

Energy Michigan contends that the intent of the settlement agreement was that the reduction in revenue requirements in Paragraphs I-E and I-F would result in rate reductions for Detroit Edison's customers in 1998 and 1999. According to Energy Michigan, the Commission could order Detroit Edison to file a rate case to implement the settlement, but that is not necessary. Energy Michigan argues that the parties were given the opportunity to address these issues in Case No. U-10102, as required by the settlement agreement, and that rates can now be reduced pursuant to the settlement agreement.

In its reply brief, Energy Michigan argues that all parties to the settlement agreement, other than Detroit Edison, agree that the revenue changes were to translate directly into rate reductions and that the Commission should reduce rates pursuant to the settlement agreement. In the alternative, Energy Michigan indicates that it would be willing to accept a freeze on rates through the end of the year 2000 in exchange for the accelerated introduction of retail direct access.

Staff

The Staff argues that the settlement agreement provides for a reduction in the cost of service by reducing revenue requirements associated with the Fermi 2 plant for the years 1998 and 1999. The Staff indicates that the settlement agreement does not provide for automatic rate reductions.

According to the Staff, it would be expected that Detroit Edison would initiate a rate case to accomplish the reduction in its cost of service, but that the other parties to the settlement could initiate a proceeding on their own to compel Detroit Edison to comply with the settlement agreement. Alternatively, the Commission could initiate a proceeding on its own motion.

III.

DISCUSSION

This case presents an instance where the parties have voluntarily entered into a settlement agreement, have implemented most of the provisions of that settlement agreement, but now, ten years later, are unable to agree on the meaning of remaining provisions. Paragraph I-E of the settlement agreement provides that, in accordance with SFAS 92, revenue reductions of approximately $53 million in 1998 and $128 million in 1999 are to be "recorded pursuant to the final Fermi 2 phase-in plan."[3] In addition, Paragraph I-F provides for a 10-year amortization of $300 million that ends on January 1, 1999. This equates to $30 million annually on an income basis or approximately $42 million on a revenue basis. The parties disagree as to whether these represent only cost of service adjustments, whether a corresponding rate reduction is necessarily required, and whether further rate proceedings are required.

Automatic Rate Reductions

One contention is that the amounts specified above must necessarily be automatically translated into rate reductions (with or without further hearings). The Commission rejects this contention for several reasons.

---

[3]In addition, the situation is to "revert to non-phase-in ratemaking" in the year 2000.

First, it is not well supported by the language of the settlement agreement taken as a whole. Elsewhere, when specific rate changes are to be implemented, the settlement agreement is explicit. For example, Paragraph I-A specifically identifies the rate increases that are to occur in 1989, 1990, 1991, and 1992, explains how those rate increases are to be allocated among the various rate classes, and provides full details about the process by which the rate changes will be implemented. Given the full and explicit details regarding required rate changes in Paragraph I-A, it is difficult to conclude that the sparse outline in Paragraph I-E is intended to accomplish a similar purpose.

Second, the settlement agreement appears to set up a process for reviewing the potential rate effects in question. Paragraph I-E requires that Detroit Edison "shall file a timely general rate case with the MPSC on or before June 1, 1993 (including calendar 1992 actual financial data) to determine the electric rates to be charged retail customers, taking into account the Fermi 2 phase-in revenues required for the year 1994 and beyond." Settlement agreement, p. 6. On July 1, 1992, Detroit Edison filed an application in Case No. U-10102, seeking a rate increase of approximately $82 million. On January 21, 1994, the Commission issued an order reducing rates by approximately $78 million. The settlement agreement requires that this rate case take into account the Fermi 2 phase-in revenues required for the year 1994 and beyond, which would appear to include 1998 and 1999. Despite this requirement of the settlement agreement, no party recommended any adjustments for the Fermi 2 phase-in revenues for these years. It is unclear why the parties ignored this issue, although the Attorney General argues that since "there were no Fermi 2 revenue requirements changes for 1995 through 1997, it is not surprising that the Fermi 2 phase-in and amortization were not discussed or disputed in [Case No.] U-10102."[4] Attorney General's reply brief, p. 8. In any

---

[4]A similar argument is made by Energy Michigan.

event, the fact that the settlement agreement set up a process for taking into account the Fermi 2 phase-in revenues required for the year 1994 and beyond indicates that something other than an automatic rate reduction was intended.

Third, Paragraph II-C of the settlement agreement provides that "each party agrees not to oppose, and should any party intervene, each such party agrees to include as a cost of service item for ratemaking purposes" the Fermi 2 phase-in revenues under Paragraph I-E and the ten-year Fermi amortization under Paragraph I-F. This provision indicates that the parties committed to including the Fermi 2 revenues and amortization as a cost of service but stopped short of requiring a rate reduction.

Fourth, the contention that Paragraph I-E requires rate reductions in 1998 and 1999 is inconsistent with the interpretation being given to the remainder of that paragraph. Paragraph I-E provides a list of "revenue changes recorded pursuant to the final Fermi 2 phase-in plan" for the years 1988 through 1999. Positive revenue changes are to be recorded for the years 1988 through 1994 and negative revenue changes for the years 1998 and 1999. However, the "revenue changes recorded" under Paragraph I-E have not corresponded to actual rate changes for each year. For example, Paragraph I-E indicates a revenue <u>increase</u> of $70,800,000 for 1994, but, as previously indicated, rates were actually <u>reduced</u> in 1994 by approximately $78 million.

Finally, if the settlement agreement were actually intended to require rate reductions in 1998 and 1999, it would have been very easy to include an unambiguous provision such as: "Rates shall be reduced by $53 million on January 1, 1998 and by an additional $128 million on January 1, 1999." No such unambiguous provision was included.

Required Rate Case Filing

ABATE argues that the settlement agreement necessarily anticipates a rate case filing to reduce the cost of service in 1998 and 1999. ABATE reaches this conclusion from the language of Paragraph II-C that obligates the parties to include as a cost of service item for ratemaking purposes the Fermi 2 phase-in revenues and amortization. According to ABATE, the "fact that the parties did not specifically require a rate case in 1998 and 1999 is not determinative." ABATE's brief, p. 7.

ABATE's argument that the settlement agreement necessarily anticipates a rate case for 1998 and 1999 is not well-taken. Paragraph II-C only requires that the parties commit to taking certain positions in future rate proceedings, if any. It does not require that there necessarily be a future proceeding. Even if it did, as previously noted, the settlement agreement expressly required that a rate proceeding be filed to incorporate the Fermi 2 phase-in revenues for the year 1994 and beyond, which was Case No. U-10102. ABATE has offered no reason to conclude that the language in Paragraph II-C requires anything more than the proceeding conducted as Case No. U-10102.

Securitization

Detroit Edison proposes that the settlement agreement be implemented by adopting the proposal it made in Case No. U-11290 to securitize $2.8 billion in assets. According to Detroit Edison, this approach would take into account the end of the Fermi 2 phase-in and the adjustments in the cost of service for 1998 and 1999. This proposal was opposed by ABATE, the Attorney General, and Energy Michigan.

The Commission rejects the securitization proposal for two reasons. First, securitization is a relatively new financial concept that has been developed only in the last few years. It could hardly have been the intent of the parties ten years ago to require securitization, a concept that would have

been unknown at the time. Second, as the Commission noted in Case No. U-11290, legislation is required before securitization can be implemented. No such legislation has been forthcoming.

Cost of Service and Revenue Requirement Adjustment

The Staff argues that the settlement agreement "provides for a reduction in the cost of service by reducing the revenue requirements associated with Fermi 2 plant for the years 1998 and 1999." Staff's brief, p. 1. The Staff notes that Paragraph I-E provides that the amounts will be included in the cost of service for ratemaking purposes and that Paragraph II-C obligates the parties to include the Fermi 2 phase-in revenues and amortization as a cost of service item for ratemaking purposes. Although it differs in the details, the Staff's position is broadly consistent with those of other parties. ABATE agrees that the settlement agreement was intended to reduce the cost of service in 1998 and 1999. ABATE's brief, p. 7. The Attorney General argues that Paragraph I-E was intended to adjust Detroit Edison's annual revenue requirements for each year. Attorney General's brief, p. 7. Energy Michigan argues that Paragraphs I-E and I-F provide for reductions in revenue requirements in the later years in exchange for rate increases in the earlier years. Energy Michigan's brief, p. 3. Detroit Edison agrees that the settlement agreement requires that its "annual revenue requirement, e.g., its cost of service, be reduced in 1998 and 1999 by some $182 million." Detroit Edison's brief, p. 4.

Although there is broad agreement that the settlement agreement calls for reductions in Detroit Edison's cost of service and corresponding reductions in its revenue requirements, there is no agreement regarding the mechanism for implementing changes in the cost of service.

On its face, the settlement agreement appears to provide such a mechanism by requiring a rate case to take "into account the Fermi 2 phase-in revenues required for the year 1994 and beyond."

Settlement agreement, p. 6. This required rate case (Case No. U-10102) has been completed, and on January 21, 1994, the Commission issued an order reducing rates by approximately $78 million. However, no party to that proceeding raised any issues regarding the Fermi 2 phase-in revenues for 1998 and 1999. Some parties argue that this was because the settlement agreement provides for "no change" from 1995 through 1997, although that interpretation effectively renders the words "and beyond" a nullity. Nonetheless, the parties did not raise the 1998/1999 Fermi 2 cost of service issues in Case No. U-10102, and the Commission accepts their apparent interpretation that that case was not intended to be the mechanism for doing so.

As previously discussed, as a mechanism for implementing the Fermi 2 cost of service reductions, the settlement agreement does not require automatic rate reductions, or a rate case filing (other than possibly Case No. U-10102), or securitization. Neither does it prohibit any of these actions. In summary, the settlement agreement sets forth specific cost of service adjustments, but is silent on the means for implementing those adjustments. Under the circumstances, the Commission finds that it should adopt reasonable means of implementing the cost of service reductions that are consistent with the intent of the settlement agreement. The Commission has done so in several cases.

In the June 19, 1995 order in Cases Nos. U-10143 and U-10176, which involved a retail wheeling experiment, the Commission determined that rate reductions for the experiment should occur coincident with the cost of service reductions, as follows:

> The Fermi 2 and Midland surcharges recover cost items that are being amortized over a fixed period of years. In the case of Fermi 2, the phase-in revenues decrease by $53 million in 1998 and another $128 million in 1999, and the annual $30 million amortization ends in 1998. (December 27, 1988 order in Case No. U-8789, Exhibit A, pp. 6 and 7.) The Midland amortization ends in 2001. (May 7, 1991 order in Case No. U-7830 Step 3B, p. 302.) Because the rates set in this order are for purposes of a limited experiment, the Commission will require that these cost

> decreases be reflected in retail delivery rates as soon as they occur, whether that is prior to or during the experiment.

June 19, 1995 order in Cases Nos. U-10143 and U-10176, p. 53.

Similarly, on November 25, 1997, the Commission issued an order in Case No. U-11588 that reduced Detroit Edison's rates by approximately $38 million. This rate reduction reflected the net effect of the $53 million reduction associated with the Fermi 2 phase-in for 1998 and a two-year amortization of incremental storm damage expenses.

Finally, the Commission is today issuing an order in Case No. U-11726 that reduces rates by $93.8 million and provides for accelerated amortization of the Fermi 2 plant (and related regulatory assets) by approximately $164 million annually.

These orders are consistent with the findings of this order: (1) that the settlement agreement provides for reductions in Detroit Edison's cost of service during 1998 and 1999, (2) that the settlement agreement does not specify a mechanism for implementing those reductions, and (3) that the Commission should adopt reasonable means to implement the cost of service reductions consistent with the settlement agreement. The only remaining issue is whether the Commission's orders have fully accounted for the cost of service reductions provided by the settlement agreement and, if not, what additional actions should be taken to implement the settlement. Accordingly, the Commission is directing that briefs should be filed on these issues by January 15, 1999. In addition, the parties should address the meaning of the phrase "revert to non-phase-in ratemaking" in the year 2000 and what actions, if any, are necessary to implement this provision.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 106, as amended, MCL 460.551 et seq.; MSA 22.151 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; MSA 22.1 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; MSA 22.13(1) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACS, R 460.17101 et seq.

b. The settlement agreement approved by the December 27, 1988 order in this docket provides for reductions in Detroit Edison's Fermi 2 cost of service in 1998 and 1999, but does not specify a mechanism for implementing those reductions.

c. The Commission should adopt reasonable mechanisms to assure that the Fermi 2 cost of service reductions are implemented consistent with the intent of the settlement agreement.

d. Briefs should be filed by January 15, 1999 regarding the issues of whether the Commission's orders have fully accounted for the reductions in the Fermi 2 cost of service and, if not, what additional actions should be taken, as well as what actions are needed to revert to non-phase-in ratemaking in 2000.

THEREFORE, IT IS ORDERED that briefs shall be filed by January 15, 1999 consistent with this 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; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ John G. Strand
Chairman

(S E A L)

/s/ David A. Svanda
Commissioner

By its action of December 28, 1998.

/s/ Dorothy Wideman
Its Executive Secretary