

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
THE DETROIT EDISON COMPANY for)
certain determinations pursuant to Sections 32(c))
and (d) of the Public Utility Holding Company)
Act of 1935 and for accounting approval for)
the transfer of certain assets.)
_____)

Case No. U-12266

At the February 3, 2000 meeting of the Michigan Public Service Commission in Lansing,
Michigan.

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

ORDER

On January 11, 2000, The Detroit Edison Company (Detroit Edison) filed an application requesting determinations pursuant to Sections 32(c) and 32(d)(2) of the Public Utility Holding Company Act of 1935 (PUHCA), 15 USC 79z-5a(c) and 15 USC 79z-5a(d)(2), and approval of related accounting entries necessary for the transfer of Detroit Edison’s River Rouge Unit No. 1 Power Plant (Rouge No. 1) to its affiliate DTE River Rouge No. 1 LLC (DTE River Rouge). On January 14, 2000, Detroit Edison filed an errata with corrected accounting entries.

On January 18, 2000, Energy Michigan, Inc. (Energy Michigan) filed an answer and request for hearing. On January 21, 2000, the Association of Businesses Advocating Tariff Equity (ABATE) filed a petition to intervene and a demand for a hearing. On January 24, 2000, Attorney

General Jennifer M. Granholm (Attorney General) filed a notice of intervention and request for hearings. On January 25, 2000, PG&E Corporation (PG&E) filed a petition to intervene and request for a contested case hearing. On January 28, 2000, Detroit Edison filed a response to the filings of Energy Michigan, ABATE, and the Attorney General.

Detroit Edison, an electric utility located entirely in the state of Michigan, is a wholly owned subsidiary of DTE Energy, Inc. DTE River Rouge is a wholly owned subsidiary of DTE Generation, Inc., which is a wholly owned subsidiary of DTE Energy Resources, Inc., which in turn is a subsidiary of DTE Energy, Inc. Detroit Edison represents that DTE River Rouge, which is a Michigan limited liability company formed to restart, own, and operate Rouge No. 1, is an exempt wholesale generator (EWG) as that term is used in Section 32 of PUHCA.

Rouge No. 1 was built in the 1950s to operate on coal and was removed from active service in 1980.¹ The unit will be transferred to DTE River Rouge, converted to natural gas, restarted, and operated² to produce approximately 225 megawatts (MW) of seasonal peaking generating capacity for competitive sale to electric retailers serving load in the Michigan electric market to supply needed summer peaking capacity for 2000 and 2001. Detroit Edison proposes to transfer Rouge No. 1 at an asset transfer price of approximately \$6.6 million, which is twice the current net book value of the unit.

When regulated utility property with an original cost of \$100,000 or more is sold, conveyed, or transferred to a subsidiary or associated company, the Uniform System of Accounts requires that the utility furnish the Commission with the particular support for its determination of the value of

¹There are two other units on the site that are still in active service.

²Detroit Edison indicates that it may enter into an operation and maintenance agreement by which the utility will operate all or a part of the unit on DTE River Rouge's behalf.

the property and request approval of the proposed journal entries to record the transaction. In accordance with this requirement, Detroit Edison submitted affidavits of Joseph E. Fennell, Jr., its Director of Asset Management Financial Control, and David B. Harwood, its Director of Power Generation, to support the valuation at two times net book value and the proposed accounting entries. Detroit Edison requests approval of specific accounting entries to Accounts 101 (Electric Plant in Service), 102 (Electric Plant Purchased or Sold), 108 (Accumulated Provision for Depreciation of Electric Plant), 131 (Cash), 143 (Accounts Receivable), and 242 (Miscellaneous Current and Accrued Liabilities).

Energy Michigan argues that approval of the transfer would increase Detroit Edison's market power and threaten significant price increases. Further, Energy Michigan asserts that Detroit Edison may not enter into a contract to purchase electricity from an affiliated EWG unless the utility first obtains an exemption from the Commission pursuant to PUHCA. Energy Michigan argues that Detroit Edison intends to engage in self-dealing and that it will be difficult or even impossible for the Commission to protect against abuses. Energy Michigan states that it has reason to believe that Detroit Edison and/or its affiliates have purchased all available firm transmission import capacity into Michigan. Energy Michigan argues that the Commission should refuse to approve the proposed transfer or "should adopt a package of remedies which will increase power supplies while avoiding above market costs and decreasing Detroit Edison's market power." Energy Michigan's answer, p. 4.

ABATE argues that the valuation method proposed by Detroit Edison is fundamentally flawed since the utility did not take all reasonable steps to maximize the value of the asset. Moreover, ABATE contends that Detroit Edison "has made no commitment that the difference between net book value and the sales price would be used to offset [Detroit] Edison's prudently incurred

stranded and implementation costs. Without such a commitment, no sale should be approved.”

ABATE’s petition, p. 3. ABATE argues that the timing is suspect since Detroit Edison is, once again, asking the Commission to act quickly so that electric generation can come on line before the summer.

The Attorney General argues that the exemption should not be granted because it would be more economical to restart Rouge No. 1 as a rate base facility owned by Detroit Edison. The Attorney General contends that the transfer of Rouge No. 1 will reduce Detroit Edison’s reserve margin. The Attorney General indicates that the value of steam plant capacity should range from \$140 to \$820 per kilowatt and that the transfer of Rouge No. 1 could result in excess profits. The Attorney General argues that the transfer will result in an increase in Detroit Edison’s power supply cost recovery costs.

PG&E argues that Detroit Edison should make the capital improvements necessary to return Rouge No. 1 to active service before selling the plant. PG&E contends that the exemption should not be granted without an analysis of the impact of the proposed sale on the market power of the incumbent utility and its affiliates and of the impact on utility stranded costs. PG&E provides a compendium of recently announced divestitures of generating plants.

In its response, Detroit Edison contends that it has demonstrated that an asset transfer price of two times net book value is reasonable. Detroit Edison contends that it would not be opposed to a valuation based on one of the alternative methodologies in recently introduced electric utility restructuring legislation if the valuation was subject to a reasonable cap. Detroit Edison agrees with ABATE’s proposal to credit the gain above net book value to the utility’s stranded costs. Detroit Edison argues that it should not be forced to auction Rouge No. 1 to a third-party because the Commission lacks authority to force divestiture and the sale would be bad public policy.

According to Detroit Edison, restarting the unit as a rate base facility is inconsistent with goals of customer choice. Detroit Edison states that the utility will not be able to purchase power from Rouge No. 1 unless it first obtains an exemption to do so from the Commission pursuant to Section 32(k) of PUHCA. Detroit Edison denies Energy Michigan's claim that the utility and/or its affiliates control transmission import capacity into the state. Detroit Edison states that it has purchased 1430 MW of transmission capacity to serve its native load and that it "is untrue that [Detroit] Edison's affiliates have purchased any transmission capacity into Michigan for the Summer 2000." Detroit Edison's response, p. 9. Finally, Detroit Edison argues that there is no requirement for a contested case hearing to make the findings requested in the company's application.

Discussion

Section 32(c) of PUHCA provides that if a rate or charge in connection with any facility was in effect under the laws of any state on October 24, 1992, in order for the facility to be considered an eligible facility, the state commission having jurisdiction over the rate must make a specific determination that allowing the facility to be an eligible facility (1) will benefit consumers, (2) is in the public interest, and (3) does not violate state law.

Section 32(d)(2) of PUHCA provides that a prohibition in Section 32(d)(1) does not apply to an eligible facility determined as a result of the operation of Section 32(c). Otherwise, an EWG is prohibited from owning or operating a portion of any facility if any other portion of the facility is owned or operated by an electric utility company that is an affiliate or associate company of the EWG.

Although Rouge No. 1 was removed from service in 1980, some costs associated with that unit have continued to be included in determining Detroit Edison's rates, including the rates that were

in effect on October 24, 1992. Thus, a specific Commission determination is required to meet the conditions of Section 32(c). Furthermore, Detroit Edison owns and operates two other units at the same facility as Rouge No. 1, so that a determination under Section 32(c) is also required to meet the conditions of Section 32(d)(2).

Energy Michigan's argument relies on two different sections of PUCHA. Section 32(c) applies to the transfer of utility plant in rate base to an affiliate. Section 32(k), which Energy Michigan also cites, applies to the purchase of electricity by a utility from an affiliate. The two sections deal with different types of transactions between affiliates. Detroit Edison has requested an exemption to transfer the asset pursuant to Section 32(c). It has not asked for an exemption under Section 32(k)(2) to purchase power from an affiliate, nor does this order address that issue. If Detroit Edison seeks to purchase electricity from DTE River Rouge, it must first obtain an exemption to do so pursuant to Section 32(k)(2) of PUCHA because an exemption granted pursuant to Section 32(c) does not exempt the utility from the prohibitions contained in Section 32(k).

In making a determination under Section 32(c), the Commission is required to evaluate whether the proposal (1) will benefit consumers, (2) is in the public interest, and (3) does not violate Michigan law. Regarding the final determination, the Commission is unaware of any requirement of Michigan law that would be violated by Detroit Edison's proposal. Regarding the first two, Energy Michigan, ABATE, the Attorney General, and PG&E have raised a number of issues that need to be addressed. In addition, there are other factors that the Commission should consider in determining whether the proposal benefits consumers and is in the public interest.

First, the restart of Rouge No. 1 will provide additional generating capacity that is needed in the state of Michigan. In recent years, the reserve margin in Michigan has been below 10% and

there have been concerns about the ability to meet summer peak demands.³ The 225 MW of additional generating capacity provided by Rouge No. 1 will help to increase the reliability of electric service in the state.

Second, Detroit Edison indicates that generation from Rouge No. 1 will be used for competitive sale to electric retailers serving load in the Michigan electric market. Both Detroit Edison and Consumers Energy Company are initiating electric customer choice programs and the availability of power from Rouge No. 1 provides an additional source of supply for those programs, albeit from a supplier affiliated with the parent holding company.

Third, Energy Michigan, ABATE and the Attorney General argue that Detroit Edison's proposed asset transfer price of approximately \$6.6 million, or twice current net book value, is not necessarily the fair market value of the asset. Obviously, the best way of determining market value is to offer the asset for sale. However, given existing time constraints, which were created by Detroit Edison, a sale of Rouge No. 1 could not be completed in time to provide service during the summer of 2000.⁴ In addition, as Detroit Edison notes in its affidavits, Rouge No. 1 is a 43 year-old plant that has not operated for 20 years. There apparently have been no sales of similar assets

³In an order issued January 19, 2000, in Case No. U-12292, the Commission directed Detroit Edison, Consumers Energy Company, and American Electric Power to file their plans for meeting electric demand during the summer of 2000.

⁴This is not the first time that Detroit Edison has failed to make a request regarding summer reliability in a timely manner. On March 31, 1998, the company filed a motion in Case No. U-10840 to permit the restart of the Conners Creek generating plant in order to meet its anticipated 1998 summer system peak. The Commission reluctantly granted that request but did not condone the unwarranted delay. Although the timing of the application in this proceeding is better than in Case No. U-10840, it did not allow sufficient time to consider adequately the issues raised. The conditions subsequently identified in this order arise in large part due to the late filing of the application.

to use for comparison purposes.⁵ However, the average market price for non-nuclear sales in the list of divestitures provided by PG&E was 2.1 times net book value.⁶ Finally, legislation has been introduced in the Michigan Senate that contains alternative valuation methodologies that would be applied to this transfer if it were to occur after the effective date of the legislation. Detroit Edison indicates that it would not be opposed to use of one of these methodologies provided there is a reasonable cap that takes into account the company's risk in converting the facility.

Fourth, ABATE argues that, although Detroit Edison proposes an asset transfer price that is in excess of net book value, no method of treating the excess is proposed. Prior Commission orders have provided that the benefits of low cost plants are to be netted against the stranded costs associated with high cost plants. Detroit Edison indicates that it does not object to using the gain above net book value as an offset to stranded cost.

Fifth, Energy Michigan raises concerns about the potential for cross-subsidization since Rouge No. 1 will be obtaining its facilities, fuel, and staffing from a regulated utility. Although Detroit Edison denies that it will supply fuel to Rouge No. 1, it does indicate that it may enter into an agreement to operate the facility for DTE River Rouge. The Commission therefore finds itself forced to consider not only a less than arm's length transfer of the asset, but also a less than arm's length ongoing operating arrangement. Concern over this issue is heightened by the conclusion in

⁵Moreover, there has been no appraisal of the asset even though the "Guidelines for Cost Allocations and Affiliate Transactions" adopted by the National Association of Utility Regulatory Commissioners (NARUC) provide for an appraisal to determine the market value of a capital asset that is transferred from a utility to its non-regulated affiliate. Once again, as in Case No. U-11636, the Commission urges parties affected by dealings between a public utility and an affiliate to give careful consideration to the NARUC guidelines as a benchmark for regulating affiliate transactions.

⁶Nuclear plants should be excluded from this calculation because of their small market value. The nuclear plants on PG&E's list sold for an average of 0.05 times book.

the last compliance audit of Detroit Edison that there is definite cross-subsidization occurring because the utility's regulated activities are subsidizing non-regulated associated companies.

Finally, there have been arguments raised about market power due to allegations that Detroit Edison and its affiliates have purchased all available transmission into Michigan. Detroit Edison denies that its affiliates have purchased any transmission and states that its purchases have been made to serve the utility's retail native load.

In light of the foregoing, the Commission finds that it should approve the application only under the following conditions. First, if legislation is enacted this year which sets forth one or more methods for determining the valuation of generating plants in the future, the asset transfer price will be redetermined based on those methodologies within a range that is not less than the current net book value nor more than four times the current net book value. This will ensure that the asset transfer price will appropriately reflect the market value of the asset. The use of a cap of four times book is a reasonable means of addressing Detroit Edison's concern about the risks involved since it is approximately double the average market to book ratio of 2.1 in the PG&E list. If legislation is not enacted this year, then the asset transfer price will be twice the current net book value, or approximately \$6.6 million.

Second, if the asset transfer price exceeds the current net book value, then the excess will be applied to reduce the utility's stranded costs as ABATE has proposed and Detroit Edison has agreed.

Third, the output from the plant will first be offered to retail marketers participating in retail open access programs in Michigan in 2000 and 2001. Detroit Edison shall file reports by October 1 of each year detailing the prices, terms, and conditions of each offer, the methods used to publicize the offer, the parties receiving the offer, whether or not the offer was accepted, and a

summary of transactions occurring under the offer. The reports should also indicate whether any specific approvals by the Federal Energy Regulatory Commission were required and obtained.⁷

Fourth, the Commission and the Staff must be provided with access to all books and records related to this plant and associated transactions between affiliates in order to assure that cross-subsidization does not occur. This should include DTE River Rouge's response to the request for proposals referenced in Detroit Edison's application.

Fifth, if Detroit Edison and DTE River Rouge enter into an agreement that provides for Detroit Edison to operate the plant, Detroit Edison shall be fully compensated for all direct costs and reasonable overheads. The Commission and the Staff may review all aspects of the arrangement to determine that adequate compensation has been made so as to assure that cross-subsidization and other forms of uncompetitive practices through affiliate favoritism and other means does not occur.

Sixth, within 60 days of this order, Detroit Edison will file a list of its deactivated plants and other similar assets, together with its or its affiliates' plans to restart or reactivate those plants or assets, sufficient to provide the Commission with advance notice of any intended restarts. This filing shall include any other planned or contemplated actions which would impact generating or transmission capacity in this state. The Commission does not wish to be presented with eleventh hour choices in the future. The filing should be updated as circumstances warrant.

With these conditions, pursuant to Sections 32(c) and 32(d)(2) of PUHCA, the Commission finds that allowing Rouge No. 1 to be an eligible facility (1) will benefit consumers, (2) is in the public interest, and (3) does not violate state law. These findings should be viewed in light of the fact that the Commission is essentially presented with a Hobson's choice. The restart of Rouge

⁷Of course, if the power is sold directly to retail customers in Michigan, the provisions of MCL 460.552; MSA 22.152 must be complied with.

No. 1 has been offered as a means to help alleviate concerns about reliability this summer and as a source of supply for retail open access customers -- both laudable objectives. However, the timing of the request has allowed little or no time for measured consideration of the issues raised in the petitions. The situation is remarkably similar to that presented by the Commission's Conners Creek restart order in Case No. U-10840 dated April 14, 1998. Detroit Edison has apparently not heeded the Commission's warning in that case that "the threat of blackouts not be used as a bargaining piece . . . in the ongoing restructuring of the industry." In light of the potentially pressing need for additional capacity this summer, the Commission concludes that it is appropriate to grant the requested exemption at this time. However, the Commission retains the right to revisit the matter if power from Rouge No. 1 is not supplied to customers in Michigan's retail open access program this summer, as promised in Detroit Edison's application.

Ex parte approval is appropriate because no customer's rates or charges will be increased. The argument that Detroit Edison's power supply costs will be increased is misplaced because, as previously discussed, Detroit Edison is not allowed to purchase power from DTE River Rouge unless the utility first obtains an exemption from the Commission pursuant to Section 32(k) of PUHCA, which Detroit Edison has not requested.

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.; 15 USC 79z-5a; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACRS, R 460.17101 et seq.

b. Detroit Edison should notify the Commission within 10 days of this order's issuance if the conditions in this order are unacceptable.

c. With the conditions set forth in this order, allowing Rouge No. 1 to be an eligible facility will benefit consumers, is in the public interest, and does not violate any state law.

d. The proposed accounting entries should be authorized except for any modifications to the asset transfer price that would become necessary if applicable legislation is enacted this year.

e. Ex parte approval is appropriate.

THEREFORE, IT IS ORDERED that:

A. The request of The Detroit Edison Company for determinations regarding Sections 32(c) and 32(d)(2) of the Public Utility Holding Company Act is granted unless The Detroit Edison Company notifies the Commission within 10 days of this order's issuance that the conditions required by this order are unacceptable.

B. The request by The Detroit Edison Company for approval of accounting entries is granted, except for any modifications to the asset transfer price that would become necessary if applicable legislation is enacted this year.

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

/s/ Robert B. Nelson

Commissioner

By its action of February 3, 2000.

/s/ Dorothy Wideman

Its Executive Secretary

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Suggested Minute:

“Adopt and issue order dated February 3, 2000 granting, with conditions, the certification that The Detroit Edison Company requested in connection with the transfer of River Rouge Unit No. 1 to an affiliate, as set forth in the order.”