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

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **THE DETROIT EDISON COMPANY** for authority to increase its rates, amend its rate schedules and rules governing the distribution and supply of electric energy, and for miscellaneous accounting authority.	Case No. U-15244

At the January 25, 2010 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. Orjiakor N. Isiogu, Chairman
Hon. Monica Martinez, Commissioner
Hon. Greg R. White, Commissioner

ORDER

Case No. U-15244 involves an application by The Detroit Edison Company (Detroit Edison) for a rate increase. One of the issues presented by the application involved an effort by Detroit Edison to recover in rates a control premium paid by its parent company, DTE Energy Company, for the purchase of MCN Energy Group, Inc.

On December 23, 2008, the Commission issued an order in Case No. U-15244 authorizing Detroit Edison to increase its annual electric revenues by $83,629,000. However, the Commission also determined that the issue of the control premium should be deferred until the Michigan Supreme Court issued a decision in an appeal of a previous Commission case (Case No. U-13808), which was anticipated to establish precedent regarding the control premium issue.

Detroit Edison appealed the Commission's December 23, 2008 order in Case No. U-15244 to the Michigan Court of Appeals, which ordered that appeal held in abeyance pending the Supreme Court's resolution of the appeal of Case No. U-13808.

On May 1, 2009, the Supreme Court issued an opinion in Case No. U-13808 finding that the Commission had properly excluded the control premium costs from Detroit Edison's general rates. *In re Detroit Edison Co*, 483 Mich 993; 764 NW2d 272 (2009). On June 26, 2009, the Supreme Court denied Detroit Edison's motion for reconsideration. *In re Detroit Edison Co*, 483 Mich 1120; 766 NW2d 872 (2009).

A September 16, 2009 letter from the Court of Appeals Clerk to all appellate parties indicated that the court was seeking action by the parties on the issue that caused the appeal to be held in abeyance. A copy of the September 16 letter appears in the Commission's docket file for Case No. U-15244 as entry No. 587.

On October 21, 2009, Attorney General Michael A. Cox (Attorney General) filed a motion to remand with the Court of Appeals. (A copy of the Attorney General's October 21 motion does not appear in the Commission's docket file for Case No. U-15244.)

On November 12, 2009, the Commission issued an order that reviewed the control premium issue in light of the Michigan Supreme Court's May 1, 2009 opinion, and denied Detroit Edison any further relief.

On December 2, 2009, the Michigan Court of Appeals issued an order directing the Commission "to decide the merger control premium issue in light of the Michigan Supreme Court opinion in *In re Application of Detroit Edison Co*, ___ Mich ___; ___NW2d ___ (Docket Nos. 134667, 134668, 134669,134673, 134676, & 134677, decided May 1, 2009)."

Because previously, on November 12, 2009, the Commission issued an order doing exactly what the Court of Appeals' December 2, 2009 order envisions, the Commission finds that it is not necessary to again reconsider the facts and law. Rather, a copy of the Commission's November 12, 2009 order is attached to this order and is formally reaffirmed by the Commission at this time.

The Commission finds that its November 12, 2009 and January 25, 2010 orders fulfill the December 2, 2009 remand directive of the Court of Appeals, and that no further action by the Commission is necessary.

THEREFORE, IT IS ORDERED that:

A. The Commission's November 12, 2009 order in Case No. U-15244, attached to this order as Exhibit A, is formally reaffirmed by the Commission.

B. The Commission's Executive Secretary is directed to immediately send a copy of today's Commission order to the Michigan Court of Appeals and to all parties in the proceeding.

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, under MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

Orjiakor N. Isiogu, Chairman

Monica Martinez, Commissioner

Greg R. White, Commissioner

By its action of January 25, 2010.

Mary Jo Kunkle, Executive Secretary

EXHIBIT A

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

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

* * * * *

In the matter of the application of **THE DETROIT EDISON COMPANY** for authority to increase its rates, amend its rate schedules and rules governing the distribution and supply of electric energy, and for miscellaneous accounting authority.	)	Case No. U-15244

At the November 12, 2009 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. Orjiakor N. Isiogu, Chairman
Hon. Monica Martinez, Commissioner
Hon. Steven A. Transeth, Commissioner

ORDER

On April 13, 2007, The Detroit Edison Company (Detroit Edison) filed an application pursuant to MCL 460.6 and relevant Commission orders requesting authority to increase its rates and to amend its rate schedules and rules governing the distribution and supply of electric energy. As originally filed, Detroit Edison's application sought to increase its rates in the annual amount of $123 million.

As part of its application, Detroit Edison again requested authority to recover in rates its share of a control premium[1] paid by its parent company, DTE Energy Company (DTE), for the purchase

[1] A control premium is the additional premium paid to "take control" of a business and is calculated as the difference in the purchase price of the company to be acquired and its market value immediately before the acquisition was announced.

of MCN Energy Group, Inc. (MCN). DTE paid an aggregate amount of $2.488 billion for MCN, including a total premium of $1.478 billion over the depreciated original cost of MCN of $1.01 billion. Of this total premium, DTE paid an initial acquisition premium[2] of $585 million and an additional control premium of $893 million. DTE allocated $250 million of the $893 million control premium to its subsidiary Michigan Consolidated Gas Company (Mich Con) and assigned the remainder to Detroit Edison. The Commission denied Detroit Edison's request to recover its share of the control premium in its November 23, 2004 order in Case No. U-13808 (November 23 order).[3]

Detroit Edison appealed, and on July 3, 2007, the Court of Appeals issued its opinion. *See, Attorney General v Public Service Comm,* 276 Mich App 216; 740 NW2d 685 (2007). The Court determined that the Commission had erred in disallowing Detroit Edison's recovery of its share of the control premium, finding:

> As the Staff of the PSC opined and the ALJ recommended, we hold that the substantial savings to Edison customers are a direct result of the acquisition of Michigan Consolidated Gas Company (MichCon) and that these synergy savings fully justify the pass through of the acquisition control premium. Edison seeks and is entitled to that portion of the control premium that permits Edison to accomplish these synergy savings. We hold that Edison is clearly entitled to recover its share of the control premium that resulted in these synergy savings. Like the ALJ, we reject the arguments of the AG and MEC/PIRGIM in opposition to Edison's rate request regarding the control premium. *Id.* at 235-236.

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[2]An acquisition premium is "the amount paid above 'book cost' or 'depreciated original cost' to acquire utility property previously devoted to public service." June 29, 1990 order in Case No. U-9323, p. 19. The term "acquisition premium" is used interchangeably to describe the premium paid for plant, stock, or both; however, the term "control premium" refers specifically to a stock purchase premium and an "acquisition adjustment" specifically describes a plant purchase premium.

[3]Mich Con's request to recover its share of the control premium was likewise denied in the April 28, 2005 order in Case No. U-13898 and the Commission reaffirmed the denial in an order issued on September 29, 2009.

Shortly thereafter, the Commission filed an application for leave to appeal to our Supreme Court, and on September 19, 2008, the petition was granted[4] with the issues limited to:

> (1) whether "transmission costs" may be included in the power supply cost recovery factor, MCL 460.6j(1)(a) and (b); and (2) whether the Court of Appeals erred in concluding that the Michigan Public Service Commission's decision to prohibit recovery of the control premium that DTE Energy paid to acquire MCN Energy by including the premium in Detroit Edison's rates was not supported by competent, material, and substantial evidence on the whole record. *Attorney General v Public Service Comm,* 482 Mich 985; 755 NW2d 632 (2008).

On December 23, 2008, the Commission issued an order in this case authorizing Detroit Edison to increase its annual electric revenues by $83,629,000 (December 23 order). The Commission also determined that the issue of the control premium should be deferred until the Supreme Court issued its decision in the appeal of Case No. U-13808.

On May 1, 2009, our Supreme Court issued an opinion in which it reversed the Court of Appeals on the control premium issue holding:

> The Public Service Commission (PSC) excluded the control premium costs from Edison's general rate. On appeal, Edison bore the burden "to show by clear and satisfactory evidence that the order of the commission complained of is unlawful or unreasonable." MCL 462.26(8); see MCL 460.4 (adopting MCL 462.26 standards). Judicial review of administrative agency decisions must "not invade the province of exclusive administrative fact-finding by displacing an agency's choice between two reasonably differing views." *MERC v Detroit Symphony Orchestra*, 393 Mich 116, 124; 223 NW2d 283 (1974); see also *In re Payne*, 444 Mich 679, 692-693; 514 NW2d 121 (1994) ("When reviewing the decision of an administrative agency for substantial evidence, a court should accept the agency's findings of fact if they are supported by that quantum of evidence. A court will not set aside findings merely because alternative findings also could have been supported by substantial evidence on the record."). The Court of Appeals did not give due deference to the PSC's findings of fact and Edison failed to meet its burden. Accordingly, we reinstate the PSC's decision excluding the control premium costs from Edison's general rates.

In re Detroit Edison Co, 483 Mich 993; 764 NW2d 272 (2009).

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[4] *Attorney General v Public Service Comm*, 482 Mich 985; 755 NW2d 632 (2008).

On June 26, 2009, the Supreme Court denied Detroit Edison's motion for reconsideration. *In re Detroit Edison Co*, 483 Mich 1120; 766 NW2d 872 (2009).

Although the Commission held in abeyance its decision on recovery of the control premium in this case, the Commission nevertheless provided an extensive review and analysis of the evidence regarding the issue in the December 23 order:

> Daniel G. Brudzynski, DTE's Vice President of Regulatory Affairs, . . . testified that the basis for the recovery of the cost of the control premium, shown in Exhibit AU-26, is the savings in O&M expense resulting from the merger with MCN. Mr. Brudzynski testified that savings attributable to mergers are largely the result of cost reductions and cost avoidance made possible through economies of scale and the elimination of duplicative operations. 6 Tr 238. Mr. Brudzynski asserted that, '[a]s long as the cost savings enabled by the merger exceed the annual cost of the Control Premium, it is proper for the Commission to allow the inclusion of those costs in the Company's revenue requirement.' 6 Tr 248.
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> Mr. Brudzynski testified that Detroit Edison's share of the total control premium was calculated at $592.5 million and that, based on the company's estimates for pre-tax cost of capital, amortization, and tax adjustment, the control premium cost for the 2009 test year is $63.8 million. 6 Tr 248-249. Mr. Brudzynski further stated that it was appropriate to amortize the cost of the control premium over 40 years to minimize the annual cost to customers and because the 40-year amortization recognizes the 'long-term synergies that will continue to be realized.' 6 Tr 254-255.
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> Mr. Brudzynski testified that based on the company's analysis, the cost savings achieved by Detroit Edison in 2002 as a result of the MCN merger were $80 million and that as additional actions were implemented, the savings increased to $100 million in 2003 and have continued to grow since that time. 6 Tr 261-262. Mr. Brudzynski noted that Detroit Edison's changes in expense levels since the merger are comparable to changes in expense levels by other, similar companies from 2001-2006. 6 Tr 263. Mr. Brudzynski testified that based on Detroit Edison's projected savings of $129 million and control premium cost of $63.8 million, the net benefit to customers is over $60 million in 2009.
>
> Mr. Brudzynski testified that it is not reasonable to expect the company to substantiate the continuing merger-related synergies in every rate case throughout the amortization period. According to Mr. Brudzynski, 'it is more reasonable for the Commission to determine in this case that the actual and projected cost synergies relative to the Control Premium cost on net present value results in a net benefit to customers. . . . While it is clear that substantial cost synergies have been realized since 2002, as time passes and facts and circumstances change it will be

increasingly difficult to substantiate the ongoing merger synergies being realized.' 6 Tr 266-267.

Dr. Nwabueze testified that the Court of Appeals required Detroit Edison to substantiate the savings resulting from the merger in its next rate case. Dr. Nwabueze testified that the company had failed to comply with the Court's order. According to Dr. Nwabueze:

'Staff does not believe that Edison has "substantiated" its 2008 savings because it has not supported with proof or evidence that the savings that the company experienced in 2004 have continued into 2008. The company has not updated the 2004 evidence that it supplied in U-13808 to make sure that those savings are continuing. Edison did not show that employment levels have been permanently reduced or that other reductions were not temporary in nature. Staff believes that merely inflating the 2004 savings for this case, or for rate cases for the next 40 years, would place the "forecasted savings" in the "too speculative" category. . . . Just as Staff would not accept a merely inflated 2004 savings for a 2044 test year, Staff can not accept, per the Court Order, an inflated 2004 savings for the 2008 test year. Therefore, for this case, Staff recommends that the Commission find that Edison did not meet its burden of proof to substantiate its savings and recommends that the Commission not grant Edison recovery of its share of the control premium.' 7 Tr 1858-1859.

In rebuttal, Mr. Brudzynski testified that the Staff's position on substantiating merger savings was based on an unreasonable standard. According to Mr. Brudzynski, the only way to confirm the continued savings was to update the savings estimated in 2002, the year after the merger was completed. Nevertheless, Mr. Brudzynski sponsored an analysis of Detroit Edison's changing employee levels to demonstrate that post-merger expenses would have been higher absent the merger, and therefore, that the merger will continue to provide customer savings. 6 Tr 293-295; Exhibit A-34.

The Attorney General argues that the Commission should find that Detroit Edison has failed to demonstrate that its customers will realize net savings from the MCN merger. According to the Attorney General, such a finding 'will avoid having to litigate the net benefits question again whether the Supreme Court does or does not reverse the Court of Appeals.'

The Attorney General's witness Charles W. King, an economic consultant with Snavely, King, Majoros, O'Connor & Lee, Inc., testified that calculation of the control premium by Detroit Edison ignores the value of the Net Operating Loss (NOL) carry-forwards that the purchase of MCN brought to the company. Mr. King testified that those NOLs sum to $159.7 million and that when these NOLs are recognized, the value of Detroit Edison's share of the control premium drops from $592.5 million to $468.7 million. 6 Tr 1521. Mr. King further testified that if the Commission determined that some portion of the control

premium should be recovered from ratepayers, it was inappropriate to amortize the control premium cost over 40 years when most of the benefits would be exhausted far sooner.

Mr. King testified that he had examined Detroit Edison's accounts in which the claimed merger savings should have occurred, in the categories of customer accounts, customer service, and administrative and general (A&G) costs. Mr. King further testified that, 'there was indeed a discontinuity in the level of the relevant expenses in 2001, but it was not in the form of an expense reduction. Rather, it took the form of a fairly dramatic expense <u>increase</u>.' 6 Tr 1523. Mr. King continued:

The most dramatic increase was in Administrative and General expenses, which jumped by 60 percent, from $333.9 million in 2000 to $534.2 million in 2001. This increase might arguably be explained as reflecting the costs of absorbing a new company into Edison's administrative system. The problem is that this new level of expense never went down again. True, it declined in 2002, but that slightly reduced expense level was still dramatically higher than it had been prior to the merger, and it immediately increased to close to the 2001 level in the following year, 2003. Since then, A&G expenses have remained at levels in the range of 15 to 20 percent higher than their value prior to the merger. Neither the Customer Accounts nor the Customer Service functions showed any immediate impact from the merger, upward or downward. There was what appears to be a delayed effect because in 2003 the costs for both these activities jumped noticeably. That could have been the result of the Company's efforts to implement consolidated information and data systems. If so, the effect was not to reduce costs, but to increase them.' 6 Tr 1524; Exhibit AG-1.

Mr. King concluded that, based on his analysis, there was no evidence of 'synergistic cost savings,' and that Detroit Edison's customers have seen no net benefit from the merger with MCN. According to Mr. King, the MCN merger has actually increased costs to customers.

ABATE offered the testimony of James T. Selecky, a public utility regulation consultant with Brubaker & Associates, Inc. Mr. Selecky testified that he had analyzed certain Detroit Edison expenses that can be considered merger-related from 1996 to the present. Merger-related cost categories include customer accounts, customer services, sales expenses, and A&G costs. According to Mr. Selecky, 'A review of the growth pattern in these merger-impacted expenses since 1996 demonstrates that such costs have not declined as a result of the merger as one would anticipate if the merger were providing ratepayer benefits. Rather, since the merger was completed in 2001 these costs have escalated at a rate approximating the rate of inflation.' 6 Tr 1410. Mr. Selecky continued:

It is important to note that the Company's actual post-2001 expenses should reflect the annual merger savings claimed by DECo for the period 2002 to

> present. Consequently, these claimed merger savings must be added to the Company's post-2001 merger-impacted costs to develop a true picture of the costs that the Company asserts that it would have experienced had the merger never occurred. When one adds these alleged merger savings to DECo's actual post-merger costs, a large gap emerges between the resulting rate of post-merger cost escalation and the general inflation rate. Therefore, it becomes apparent that the Company's claim of merger savings rests on the strained assumption that its merger-impacted expenses would have escalated at a rate far in excess of the general rate of inflation had the merger never occurred. This assumption is simply unreasonable, and the Commission should reject it.' 6 Tr 1410-1411.
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> In rebuttal to Mr. King and Mr. Selecky, Mr. Brudzynski testified that both experts had improperly included costs of merger interest in their calculations and had failed to exclude certain employee benefits and separation costs from their analyses. 6 Tr 298-301.
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> In response to Detroit Edison's rebuttal testimony, the Staff argues that the additional analysis provided by the company was submitted too late in the case to permit the Staff or intervenors an opportunity for review. Because the Staff and intervenors were unable to verify the information, the Staff asserts that the evidence is not credible or reliable. The Staff therefore recommends that the Commission give the evidence no weight in making its determination on the amount, if any, of the control premium that should be recovered from customers.

December 23 order, pp. 38-45.

After reviewing the testimony, exhibits, and arguments of the parties, the Commission remains convinced that the costs that Detroit Edison seeks to recover through the control premium amortization expense outweigh the alleged benefits flowing to Detroit Edison's ratepayers. The Commission agrees with Dr. Nwambuze's assertion that simply inflating the purported savings from 2004 to 2008 levels, as Detroit Edison did in this case, does not substantiate that the claimed net benefit of the merger has continued. The Commission also finds persuasive the analyses provided by the witnesses for ABATE and the Attorney General that demonstrate that costs that would be expected to decrease as the result of a merger actually increased, in some cases at levels in well in excess of inflation. As Mr. Selecky testified, "When one adds these alleged merger savings to DECo's actual post-merger costs, a large gap emerges between the resulting rate of

post-merger cost escalation and the general inflation rate. Therefore, it becomes apparent that the Company's claim of merger savings rests on the strained assumption that its merger-impacted expenses would have escalated at a rate far in excess of the general rate of inflation had the merger never occurred. This assumption is simply unreasonable, and the Commission should reject it." 6 Tr 1410.

The Commission, in its initial consideration of the control premium issue, denied recovery because Detroit Edison had failed to substantiate its claim that the control premium paid by DTE to acquire MCN generated merger synergy savings that provide a net benefit to Detroit Edison ratepayers. *See*, November 23, 2004 order in Case U-13808, pp 52-54. Mich Con's request to recover its share of the control premium was denied because of the same failure to substantiate that the control premium generated synergy savings that provide a net benefit to Mich Con ratepayers. *See*, April 28, 2005 order in Case U-13898, pp. 62-63; and September 29, 2009 order, p. 13. The testimony of Dr. Nwabueze, Mr. Selecky, and Mr. King clearly demonstrate that Detroit Edison again has failed to substantiate its claim that the control premium paid by DTE to acquire MCN generated synergy savings that provide a net benefit to Detroit Edison ratepayers.

Consequently, the Commission finds that Detroit Edison's request for recovery of the MCN control premium should be denied.

THEREFORE, IT IS ORDERED that The Detroit Edison Company's request for control premium recovery is denied.

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, under MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

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Orjiakor N. Isiogu, Chairman

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Monica Martinez, Commissioner

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Steven A. Transeth, Commissioner

By its action of November 12, 2009.

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Mary Jo Kunkle, Executive Secretary