

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suedeem G. Kelly.

Detroit Edison Company

Docket No. ER04-14-002

ORDER DENYING REHEARING

(Issued March 9, 2004)

1. In this order, we deny Detroit Edison Company's (Detroit Edison) request for rehearing of the Commission's December 1, 2003 Order in this proceeding.¹ This order benefits customers by ensuring that the Commission has up-to-date cost of service data in order to establish just and reasonable cost-based rates for ancillary services.

Background

2. On October 2, 2003, Detroit Edison filed, pursuant to Section 205 of the Federal Power Act (FPA),² a stand-alone ancillary services tariff, which includes updated and revised ancillary service rates and supersedes its existing tariff and rates schedules applicable to these ancillary services. The ancillary services tariff sets forth the rates, terms and conditions pursuant to which Detroit Edison will offer ancillary services to customers taking open access transmission service from Midwest Independent Transmission System Operator, Inc. (Midwest ISO) into or within the service territory of the International Transmission Company (International Transmission).

3. In the December 1 Order, the Commission accepted, subject to refund, and set for hearing, Detroit Edison's proposed ancillary services tariff. The Commission also rejected Detroit Edison's proposal to adopt, for the purpose of establishing its ancillary service rates, the 12.88 percent return on equity (ROE) that was approved by the Commission for use in the transmission rate formula in Attachment O to the Midwest ISO open access transmission tariff (OATT).³ The Commission found that Detroit

¹ Detroit Edison Co., 105 FERC ¶ 61,264 (2003) (December 1 Order).

² 16 U.S.C. §824d (2000).

³ Midwest Independent Transmission System Operator, Inc., 100 FERC ¶ 61,292 (2002), reh'g denied, 102 FERC ¶ 61,143 (2003) (Midwest ISO Order).

Edison had not supported using the same ROE approved for use in transmission rates in Midwest ISO for Detroit Edison's ancillary service rates. It explained that the ROE accepted in the Midwest ISO Order included a 50 basis point adder for turning over operational control of transmission facilities to Midwest ISO, and the upward adjustment of 50 basis points only applied to transmission facilities, not generation facilities used to provide ancillary services. It explained that this ensures that the adder is targeted to those responsible for achieving operational independence, *i.e.*, those who have turned over operational control of their transmission facilities to Midwest ISO, and, as a result, the Commission did not believe it was appropriate to apply the same 50 basis point adder for use in determining the rate for ancillary services.

4. In addition, the Commission found that even without the 50 basis point adder, it is not appropriate simply to apply the ROE from the Midwest ISO Order for use in Detroit Edison's ancillary service rates without further investigation. The Commission stated that it did not approve a generic ROE for all Midwest ISO members to use in formulating ancillary service rates by approving an ROE for use in the Midwest ISO OATT. Therefore, ROE determination was also included as part of the hearing ordered by the Commission.

5. On December 30, 2003, Detroit Edison filed, pursuant to Section 313(a) of the FPA,⁴ a request for rehearing of the December 1 Order. Specifically, Detroit Edison requests that the Commission reverse its determinations in the December 1 Order concerning Detroit Edison's proposed ROE and approve Detroit Edison's proposed 12.88 percent ROE.

Discussion

Rate of Return on Equity

6. Detroit Edison believes that its proposed 12.88 percent ROE was rejected without reason. More specifically, Detroit Edison contends that the Commission's rejection of the use of the 50 basis point adder approved in the Midwest ISO Order ignores the independence benefits yielded by its parent company, Detroit Edison Energy Company (DTE Energy). Detroit Edison argues that by completely divesting its transmission facilities to International Transmission, DTE Energy has done more than merely turn over operational control of its transmission facilities to Midwest ISO. According to Detroit Edison, the Commission provided no reason why it chose not to provide the same incentives and rewards to a company that has completely divested its transmission, thus ensuring that transmission is operated independent from generation interests, as those

⁴ 16 U.S.C. § 8251 (a) (2000).

given to transmission owners who have merely turned over operational control of their transmission facilities to Midwest ISO. Detroit Edison argues that it should be treated in the same manner as other Midwest ISO transmission owners and allowed the 50 basis point ROE adder.

7. The Commission does not agree. As noted in the December 1 Order, the additional 50 basis points allowed in the Midwest ISO Order applied only to investment in transmission facilities in the transmission rate formula in Attachment O to the Midwest ISO OATT, not generation facilities used to provide ancillary services under Schedules 1-6 of the Midwest ISO OATT. In this manner, the adder is targeted precisely to the behavior that it is designed to encourage: turning over operational control of transmission facilities to Midwest ISO. Applying the adder to ancillary services would not be consistent with the purpose of the adder since it is control of transmission facilities, not generation facilities providing ancillary services, that is transferred to Midwest ISO that enables the Midwest ISO to operate the transmission system, and provide non-discriminatory access to that system, on a regional basis. Moreover, as we noted in the December 1 Order, no Midwest ISO members, including vertically integrated utilities, have received the 50 basis point adder for ancillary service rates. Therefore, we disagree with Detroit Edison that it is being treated any differently than other members of Midwest ISO.

8. In addition, while we applaud DTE Energy's divestiture of its transmission assets to create an independent transmission company, we will not permit Detroit Edison to collect in connection with its stand-alone ancillary services tariff an incentive adder designed to encourage transfer of control of transmission facilities to Midwest ISO. As part of the divestiture transaction, DTE Energy, Detroit Edison and the purchasers proposed, and the Commission accepted, additional rate incentives (*i.e.*, in addition to the 50 basis points allowed all Midwest ISO transmission owners), including an additional 100 basis points to allow an overall ROE of 13.88 percent,⁵ for International Transmission to take effect upon the close of the divestiture. Commission approval of these incentives was a predicate to the divestiture transaction. Thus, we believe that, through its voluntary transfer of transmission facilities, DTE Energy has already been adequately compensated for its creation of an independent transmission company⁶.

9. Detroit Edison also argues that the 12.88 percent ROE request is consistent with precedent established in an order in which the Commission accepted the use of a rate of

⁵ See *ITC Holdings Corp., et al.*, 102 FERC ¶ 61,182 at P 68, *reh'g denied*, 104 FERC ¶ 61,033 (2003).

⁶ *Id.* at P 103 and n.77. (DTE Energy received a premium of \$268 million over a pre-divestiture net book value of \$341.855 million).

return for generators providing black start service under the New England Power Pool (NEPOOL) OATT that was based on a proxy ROE equal to the average of the FERC-accepted ROEs for NEPOOL transmission owners.⁷ However, we find that the facts present in NEPOOL are distinguishable from the instant case. In that case, the proposal involved a regional formula rate that applied to all generators providing black start service, and addressed concerns about difficulties associated with measuring capital costs for numerous merchant generators in the region. By accepting the use of a proxy ROE, the Commission averted the need for numerous generators in the region to make filings to support rates of return, thus “avert[ing] litigation over capital costs in the future.”⁸ It also avoided the need for merchant generators “to disclose actual capital cost data,”⁹ thus addressing a concern raised that merchant generators would elect to no longer supply such service rather than disclose data of a competitively sensitive nature.

10. Similar facts are not present in this case, which does not involve a generic regional rate formula that must accommodate both traditional utilities and merchant generators. Rather, this case involves a stand-alone ancillary services tariff for an individual traditional utility. Moreover, because Detroit Edison is subject to cost-of-service regulation for other services that it provides, requiring it to support its cost of capital for the purpose of establishing ancillary service rates does not require it to disclose information that it is not otherwise already required to provide.

11. Furthermore, the proposal before the Commission in NEPOOL involved a formula rate for black start service, whereby generators providing black start service would update their rates annually to reflect updated cost data and the current ROE used by the transmission owners in the transmission service formula rate under the NEPOOL OATT. In contrast, in the instant proceeding, Detroit Edison proposes stated rates for ancillary services that will not be updated automatically to reflect updated cost data or changes in the transmission owners’ approved ROE and proposes to base such rates on a ROE established in a proceeding two years prior to Detroit Edison’s filing. In order to ensure that such stated rates are just and reasonable, it is important that they be established based on complete and up-to-date cost-of-service data, including Detroit Edison’s cost of capital. Accordingly, the Commission does not agree that NEPOOL establishes precedent for Detroit Edison’s proposal.¹⁰

⁷ New England Power Pool, 92 FERC ¶ 61,020 at 61,041 (2000) (NEPOOL).

⁸ Id.

⁹ Id.

¹⁰ Detroit Edison also cites two delegated letter orders accepting proposed rates for reactive power service where the applicant proposed to adopt a proxy rate of return based on the transmission owner’s approved rate of return. However, Detroit Edison’s reliance on those orders is misplaced, as such actions taken by Commission staff do not constitute

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12. Detroit Edison also contends that while transmission plant resources provide transmission services and generation resources provide ancillary services, both are transmission-related services that utilities are required to offer pursuant to Order No. 888¹¹ and the Midwest ISO OATT. While Detroit Edison is correct that ancillary services are a necessary adjunct to the provision of transmission service, as discussed above, the 50 basis point adder allowed in the Midwest ISO Order was intended to encourage transfer of operational control of transmission facilities to the Midwest ISO; thus, it is appropriately targeted only to the transmission rate formula in Attachment O to the Midwest ISO OATT. As we discuss above, here, Detroit Edison is proposing to establish new stated rates for ancillary services in a stand-alone ancillary service tariff and, in order to ensure that such rates are just and reasonable, they must be established based upon complete and up-to-date cost-of-service data, including Detroit Edison's cost of capital.¹²

precedent binding the Commission in future cases. See, e.g., Idaho Power Co., 95 FERC ¶ 61,482 at 62,718 and n. 12 (2001). Moreover, in other cases where applicants have proposed to use a proxy rate of return to establish stated ancillary service rates and the rate of return has not been shown to be just and reasonable, the Commission has included the rate of return among the issues set for hearing. See, e.g., Troy Energy LLC, 105 FERC ¶ 61,250 (2003).

¹¹ Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Order No. 888, FERC Stats. & Regs., Regulations Preambles January 1991-June 1996 ¶ 31,036 (1996), order on reh'g, Order No. 888-A, FERC Stats. & Regs., Regulations Preambles July 1996-December 2000 ¶ 31,048 (1997), order on reh'g, Order No. 888-B, 81 FERC ¶ 61,248 (1997), order on reh'g, Order No. 888-C, 82 FERC ¶ 61,046 (1998), aff'd in relevant part sub nom., Transmission Access Policy Study Group v. FERC, 225 F.3d 667 (D.C. Cir. 2000), aff'd sub nom. New York v. FERC, 535 U.S. 1 (2002).

¹² Detroit Edison also argues that the Commission has previously approved filings that apply the same ROE when calculating rates for both transmission service and ancillary services. However, in both cases cited by Detroit Edison in this regard, the Commission set for hearing the proposed ancillary service rates, including the ROE reflected in those proposed rates. Wisconsin Energy Corp. Operating Companies, 90 FERC ¶ 61,298 (2000); Central Illinois Light Co., 98 FERC ¶ 61,242, reh'g denied, 99 FERC ¶ 61,255 (2002). Moreover, while the Commission does not determine a separate cost of capital for each electric utility function (*i.e.*, generation, transmission, etc.), here, where Detroit Edison proposes new stated rates in a stand-alone ancillary services tariff, it is important that the rates be established based on up-to-date cost of capital analysis rather than on a cost of capital established in a proceeding two years before Detroit Edison's filing.

The Commission orders:

Detroit Edison's request for rehearing is hereby denied, as discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.