DTE ENERGY CO
Form 10-Q
May 09, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarterly Period ended March 31, 2007
Commission file number 1-11607
DTE ENERGY COMPANY
(Exact name of registrant as specified in its charter)

Michigan	**38-3217752**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2000 2nd Avenue, Detroit, Michigan	**48226-1279**
(Address of principal executive offices)	(Zip Code)

313-235-4000
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

At March 31, 2007, 176,064,812 shares of DTE Energy s common stock, substantially all held by non-affiliates, were outstanding.

DTE Energy Company
Quarterly Report on Form 10-Q
Quarter Ended March 31, 2007
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Chief Financial Officer Section 906 Form 10-Q Certification

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DEFINITIONS

Coke and Coke Battery	Raw coal is heated to high temperatures in ovens to separate impurities, leaving a carbon residue called coke. Coke is combined with iron ore to create a high metallic iron that is used to produce steel. A series of coke ovens configured in a module is referred to as a battery.
Company	DTE Energy Company and any subsidiary companies
CTA	Costs to achieve, consisting of project management, consultant support and employee severance, related to the Performance Excellence Process
Customer Choice	Statewide initiatives giving customers in Michigan the option to choose alternative suppliers for electricity and gas.
Detroit Edison	The Detroit Edison Company (a direct wholly owned subsidiary of DTE Energy) and any subsidiary companies
DTE Energy	DTE Energy Company, directly or indirectly, the parent of Detroit Edison, MichCon and numerous non-utility subsidiaries
EPA	United States Environmental Protection Agency
FERC	Federal Energy Regulatory Commission
GCR	A gas cost recovery mechanism authorized by the MPSC, permitting MichCon to pass the cost of natural gas to its customers.
ITC	International Transmission Company (until February 28, 2003, a wholly owned subsidiary of DTE Energy)
MDEQ	Michigan Department of Environmental Quality
MichCon	Michigan Consolidated Gas Company (an indirect wholly owned subsidiary of DTE Energy) and subsidiary companies
MISO	Midwest Independent System Operator, a Regional Transmission Organization
MPSC	Michigan Public Service Commission
Non-utility	An entity that is not a public utility. Its conditions of service, prices of goods and services and other operating related matters are not directly regulated by the MPSC or the FERC.
NRC	Nuclear Regulatory Commission
Production tax credits	Tax credits as authorized under Sections 45K and 45 of the Internal Revenue Code that are designed to stimulate investment in and development of alternate fuel sources. The amount of a production tax credit can vary each year as determined by the Internal

	Revenue Service.
Proved Reserves	Estimated quantities of natural gas, natural gas liquids and crude oil that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reserves under existing economic and operating conditions.
PSCR	A power supply cost recovery mechanism authorized by the MPSC that allows Detroit Edison to recover through rates its fuel, fuel-related and purchased power expenses.

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Securitization	Detroit Edison financed specific stranded costs at lower interest rates through the sale of rate reduction bonds by a wholly owned special purpose entity, the Detroit Edison Securitization Funding LLC.
SFAS	Statement of Financial Accounting Standards
Stranded Costs	Costs incurred by utilities in order to serve customers in a regulated environment that absent special regulatory approval would not otherwise be recoverable if customers switch to alternative energy suppliers.
Subsidiaries	The direct and indirect subsidiaries of DTE Energy Company
Synfuels	The fuel produced through a process involving chemically modifying and binding particles of coal. Synfuels are used for power generation and coke production. Synfuel production generates production tax credits.
Unconventional Gas	Includes those oil and gas deposits that originated and are stored in coal bed, tight sandstone and shale formations.

Units of Measurement

Bcf	Billion cubic feet of gas
Bcfe	Conversion metric of natural gas, the ratio of 6 Mcf of gas to 1 barrel of oil.
kWh	Kilowatthour of electricity
Mcf	Thousand cubic feet of gas
MMcf	Million cubic feet of gas
MW	Megawatt of electricity
MWh	Megawatthour of electricity

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Forward-Looking Statements

Certain information presented herein includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve certain risks and uncertainties that may cause actual future results to differ materially from those presently contemplated, projected, estimated or budgeted. Many factors may impact forward-looking statements including, but not limited to, the following:

- the higher price of oil and its impact on the value of production tax credits or the potential requirement to refund proceeds received from synfuel partners;
- the uncertainties of successful exploration of gas shale resources and inability to estimate gas reserves with certainty;
- the effects of weather and other natural phenomena on operations and sales to customers, and purchases from suppliers;
- economic climate and population growth or decline in the geographic areas where we do business;
- environmental issues, laws, regulations, and the cost of remediation and compliance, including potential new federal and state requirements that could include carbon and more stringent mercury emission controls, a renewable portfolio standard and energy efficiency mandates;
- nuclear regulations and operations associated with nuclear facilities;
- implementation of electric and gas Customer Choice programs;
- impact of electric and gas utility restructuring in Michigan, including legislative amendments;
- employee relations, and the negotiation and impacts of collective bargaining agreements;
- unplanned outages;
- access to capital markets and capital market conditions and the results of other financing efforts which can be affected by credit agency ratings;
- the timing and extent of changes in interest rates;
- the level of borrowings;
- changes in the cost and availability of coal and other raw materials, purchased power and natural gas;
- effects of competition;
- impact of regulation by the FERC, MPSC, NRC and other applicable governmental proceedings and regulations, including any associated impact on rate structures;
- contributions to earnings by non-utility subsidiaries;
- changes in and application of federal, state and local tax laws and their interpretations, including the Internal Revenue Code, regulations, rulings, court proceedings and audits;

- the ability to recover costs through rate increases;
- the availability, cost, coverage and terms of insurance;
- the cost of protecting assets against, or damage due to, terrorism;
- changes in and application of accounting standards and financial reporting regulations;
- changes in federal or state laws and their interpretation with respect to regulation, energy policy and other business issues;
- uncollectible accounts receivable;
- binding arbitration, litigation and related appeals;
- changes in the economic and financial viability of our suppliers, customers and trading counterparties, and the continued ability of such parties to perform their obligations to the Company;
- timing, terms and proceeds from any asset sale or monetization; and
- implementation of new processes and new core information systems.

New factors emerge from time to time. We cannot predict what factors may arise or how such factors may cause our results to differ materially from those contained in any forward-looking statement. Any forward-looking statements speak only as of the date on which such statements are made. We undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events.

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DTE ENERGY COMPANY
Management s Discussion and Analysis
of Financial Condition and Results of Operations

OVERVIEW

DTE Energy is a diversified energy company with 2006 revenues in excess of $9 billion and approximately $24 billion in assets. We are the parent company of Detroit Edison and MichCon, regulated electric and gas utilities engaged primarily in the business of providing electricity and natural gas sales, distribution and storage services throughout southeastern Michigan. We operate five energy-related non-utility segments with operations throughout the United States.

Net income in the first quarter of 2007 was $134 million, or $.76 per diluted share, compared to net income of $136 million, or $.76 per diluted share, in the first quarter of 2006. The decrease in net income is primarily due to lower earnings at the Electric Utility, Energy Trading and Corporate & Other segments, offset by higher earnings at the Gas Utility, Power and Industrial Projects and Synthetic Fuel segments.

The items discussed below influenced our current financial performance and may affect future results:

- Effects of weather and collectibility of accounts receivable on utility operations;
- Impact of regulatory decisions on our utility operations;
- Investments in our Unconventional Gas Production business;
- Results in our Power and Industrial Projects business;
- Results in our Energy Trading business;
- Synfuel-related earnings;
- Outcome of monetization efforts in our non-utility businesses; and
- Cost reduction efforts and required capital investment.

UTILITY OPERATIONS

Our Electric Utility segment consists of Detroit Edison, which is engaged in the generation, purchase, distribution and sale of electricity to approximately 2.2 million customers in southeastern Michigan.

Our Gas Utility segment consists of MichCon and Citizens Fuel Gas Company (Citizens). MichCon is engaged in the purchase, storage, transmission, distribution and sale of natural gas to approximately 1.3 million residential, commercial and industrial customers in the State of Michigan. MichCon also has subsidiaries involved in the gathering and transmission of natural gas in northern Michigan. Citizens distributes natural gas in Adrian, Michigan to approximately 17,000 customers.

Weather - Earnings from our utility operations are seasonal and very sensitive to weather. Electric utility earnings are primarily dependent on hot summer weather, while the gas utility s results are primarily dependent on cold winter weather. During the first quarter of 2007, we experienced colder weather than in the first quarter of 2006. Additionally, we frequently experience various types of storms that damage our electric distribution infrastructure resulting in power outages. Restoration and other costs associated with storm-related power outages lowered pretax earnings by approximately $15 million in the first quarter of 2007 as compared to 2006.

Receivables - Both utilities continue to experience high levels of past due receivables, especially within our Gas Utility operations, primarily attributable to economic conditions and a lack of adequate levels of

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assistance for low-income customers.

We have taken aggressive actions to reduce the level of past due receivables, including increasing customer disconnections, contracting with collection agencies and working with the State of Michigan and others to increase the share of low-income funding allocated to our customers. During the three months ended March 31, 2007, we did not sell any previously written-off accounts, while in the first quarter of 2006, we sold previously written-off accounts of $44 million, resulting in a gain and net proceeds of $2 million. The gain was recorded as a recovery through bad debt expense, which is included within Operation and maintenance expense. While our levels of past due receivables remain high, we experienced a decrease in our allowance for doubtful accounts expense for the two utilities to approximately $29 million for the three months ended March 31, 2007, compared to $40 million for the corresponding period of 2006.

The April 2005 MPSC gas rate order provided for an uncollectible true-up mechanism for MichCon. The uncollectible true-up mechanism enables MichCon to recover ninety percent of the difference between the actual uncollectible expense for each year and $37 million after an annual reconciliation proceeding before the MPSC. The MPSC approved the 2005 annual reconciliation on December 21, 2006 allowing MichCon to surcharge $11 million beginning in January 2007. We filed the 2006 annual reconciliation with the MPSC in the first quarter of 2007 requesting recovery of $34 million. The following table provides the current amount outstanding and status of each respective year:

(in Millions)

Year	Balance at March 31, 2007	Balance at December 31, 2006	Current Regulatory Filing Status
2005 (1)	$ 8	$ 11	Approved in December 2006; actively billing customers
2006 (2)	34	34	Reconciliation filed with the MPSC in March 2007
2007 (2)	13		Accruing; reconciliation filing scheduled for first quarter 2008
Total	$ 55	$ 45	

(1) Classified as a current unbilled receivable

(2) Classified as a long-term regulatory asset

Regulatory activity Pursuant to the February 2006 MPSC order in Detroit Edison s rate restructuring case and the August 2006 MPSC order in the settlement of the show cause case, Detroit Edison filed a general rate case on April 13, 2007 based on a 2006 historical test year. The filing with the MPSC requests a $123 million, or 2.9%, average increase in Detroit Edison s annual revenue requirement for 2008. See Note 6 of the Notes to Consolidated Financial Statements.

In March 2006, the MPSC issued an order directing Detroit Edison to show cause by June 1, 2006 why its retail electric rates should not be reduced in 2007. The MPSC issued an order approving a settlement agreement in this proceeding on August 31, 2006. The order provided for an annualized rate reduction of $53 million for 2006, effective September 5, 2006. Beginning January 1, 2007, and continuing until April 13, 2008, one year from the filing of the general rate case on April 13, 2007, rates were reduced by an additional $26 million, for a total reduction of $79 million annually. Detroit Edison experienced a rate reduction of approximately $18 million in the three months

ended March 31, 2007 as a result of this order. The revenue reduction is net of the recovery of the amortization of the costs associated with the implementation of the Performance Excellence Process. The settlement agreement provides for some level of realignment of the existing rate structure by allocating a larger percentage of the rate reduction to the commercial and industrial customer classes than to the residential customer classes.

NON-UTILITY OPERATIONS

We have made significant investments in non-utility asset-intensive businesses. We employ disciplined investment criteria when assessing opportunities that leverage our assets, skills and expertise. Specifically, we invest in targeted energy markets with attractive competitive dynamics where meaningful

scale is in alignment with our risk profile. A number of factors have impacted our non-utility businesses including the effect of oil prices on the synthetic fuel business, losses and impairments from certain power generation assets and waste coal recovery and landfill gas recovery businesses, and earnings volatility in our energy trading business. As part of a strategic review of our non-utility operations, we are considering various actions including the sale, restructuring or recapitalization of various non-utility businesses which we expect may generate at least $800 million in cash proceeds in 2007. In estimating the expected cash proceeds, we have considered the potential cost to resolve certain inter-company and third party arrangements. These arrangements are currently at below market prices.

The primary source of recent investment capital in our non-utility operations has been cash flow from the synfuel business. See the Outlook section for information on sources of cash flows from the synfuel business.

Coal and Gas Midstream

Coal and Gas Midstream consists of Coal Transportation and Marketing and the Pipelines, Processing and Storage businesses.

Coal Transportation and Marketing provides fuel, transportation and rail equipment management services. We specialize in minimizing fuel costs and maximizing reliability of supply for energy-intensive customers. Additionally, we participate in coal marketing and coal-to-power tolling transactions, as well as the purchase and sale of emissions credits. We perform coal mine methane extraction, in which we recover methane gas from mine voids for processing and delivery to natural gas pipelines, industrial users, or for small power generation projects.

We are continuing to build our capacity to transport greater amounts of western coal and to expand into coal terminals to allow for increased coal storage and blending. We are currently involved in a contract dispute with BNSF Railway Company that has been referred to arbitration. Under this contract, BNSF transports western coal east for Detroit Edison and the Coal Transportation and Marketing business. We have filed a breach of contract claim against BNSF for the failure to provide certain services that we believe are required by the contract. An arbitration hearing in this matter ended in April 2007. A decision which is subject to an appeal process is expected in June 2007. While we believe we will prevail on the merits in this matter, a negative decision could have an adverse effect on our ability to grow the Coal Transportation and Marketing business as currently contemplated.

Pipelines, Processing and Storage owns a partnership interest in an interstate transmission pipeline, six carbon dioxide processing facilities and two natural gas storage fields. The pipeline and storage assets are primarily supported by stable, long-term fixed price revenue contracts. The assets of these businesses are well integrated with other DTE Energy operations. Pursuant to an operating agreement, MichCon provides physical operations, maintenance and technical support for the Washington 28 and Washington 10 storage facilities.

Pipelines, Processing and Storage is continuing its steady growth plan of expansion of storage capacity in Michigan, with two new expansions and expanding and building new pipeline capacity to serve markets in the Midwest and northeast United States.

Unconventional Gas Production

Our Unconventional Gas Production business is engaged in natural gas exploration, development and production primarily within the Antrim shale in the northern lower peninsula of Michigan and the Barnett shale in north Texas. We are an experienced operator in the Antrim shale where we manage one of the industry s largest inventories of proved gas shale reserves. We continue to expand our operations in the Barnett shale basin in north Texas, where recent leasehold acquisitions have increased our total leasehold acreage to 89,808 acres (80,530 net of interest of others.) Current natural gas prices provide attractive opportunities for our Unconventional Gas Production business segment. We continue to develop properties in both areas as we explore monetization alternatives. We are exploring the sale of a portion of our Unconventional Gas Production assets which will allow us to monetize value from our more mature holdings, while retaining the ability to benefit from the upside of our earlier stage holdings.

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Antrim shale We intend to develop existing acreage using the latest vertical and horizontal drilling and fracture stimulation techniques. Our long-term fixed-price obligations for production of Antrim continue to expire in 2007. This will create opportunities to remarket Antrim production at significantly higher current market rates. As of March 31, 2007, we have a series of cash flow hedges for 84.3 Bcf of anticipated Antrim gas production through October 2013 at an average price of $3.92 per Mcf.

Barnett shale - We anticipate significant opportunities in our existing Barnett shale acreage and expect continued extension of producing areas within the basin. We are currently in the test and development phase for unproven and recently acquired Barnett shale acreage.

Current natural gas prices and successes within the Barnett shale are resulting in more capital being invested into the region. The competition for opportunities and goods and services may result in increased operating costs. However, our experience in the Antrim shale and our experienced Barnett shale personnel provide an advantage in addressing potential cost increases. We invested approximately $27 million in the first quarter of 2007 and expect to invest a combined amount of approximately $150 million to $170 million in our unconventional gas business in 2007.

As a component of our risk management strategy for our Barnett shale reserves, we hedged a portion of our proved developed producing reserves to secure an attractive investment return. As of March 31, 2007, we have a series of cash flow hedges for 7.7 Bcf of anticipated Barnett gas production through 2010 at an average price of $7.61 per Mcf.

Power and Industrial Projects

Power and Industrial Projects is comprised primarily of projects that deliver utility-type services to industrial, commercial and institutional customers, and biomass energy projects. We provide utility-type services using project assets usually located on the customers premises in the steel, automotive, pulp and paper, airport and other industries. These services include pulverized coal and petroleum coke supply, power generation, steam production, chilled water production, wastewater treatment and compressed air supply. We own and operate three gas-fired peaking electric generating plants and a biomass-fired electric generating plant and operate one additional gas-fired power plant under contract. Additionally, we own a gas-fired peaking electric generating plant that was taken out of service in September 2006. We develop, own and operate landfill gas recovery systems throughout the United States. We produce metallurgical coke from two coke batteries. The production of coke from our coke batteries generates production tax credits.

We are exploring the combination of a sale of an equity interest in, and recapitalization of, some of the assets of the Power and Industrial Projects business, including the sale or restructuring of the power generation assets. In February 2007, we entered into an agreement to sell our Georgetown peaking electric generating facility. The sale is subject to receipt of regulatory approval and is expected to close in the second half of 2007.

Energy Trading

Energy Trading focuses on physical power and gas marketing and trading, structured transactions, enhancement of returns from DTE Energy s power plants and the optimization of contracted natural gas pipelines and storage capacity positions. Our customer base is predominantly utilities, local distribution companies, and other marketing and trading companies. We enter into derivative financial instruments as part of our marketing and hedging activities. Most of the derivative financial instruments are accounted for under the mark-to-market method, which results in earnings recognition of unrealized gains and losses from changes in the fair value of the derivatives. We utilize forwards, futures, swaps and option contracts to mitigate risk associated with our marketing and trading activity as well as for proprietary trading within defined risk guidelines. Energy Trading provides commodity risk management services to the other businesses within DTE Energy.

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Significant portions of the electric and gas marketing and trading portfolio are economically hedged. The portfolio includes financial instruments and gas inventory, as well as contracted natural gas pipelines and storage capacity positions. Most financial instruments are deemed derivatives, whereas the gas inventory, pipelines and storage assets are not derivatives. As a result, this segment may experience earnings volatility as derivatives are marked-to-market without revaluing the underlying non-derivative contracts and assets. This results in gains and losses that are recognized in different accounting periods. We may incur mark-to-market accounting gains or losses in one period that will reverse in subsequent periods when transactions are settled. We are exploring strategic options for the energy trading business.

Synthetic Fuel

Synthetic Fuel Operations

We are the operator of nine synthetic fuel production facilities throughout the United States. Synfuel plants chemically change coal and waste coal into a synthetic fuel as determined under the Internal Revenue Code. Production tax credits are provided for the production and sale of solid synthetic fuel produced from coal and are available through December 31, 2007. The synthetic fuel plants generate operating losses which we expect to be offset by production tax credits. The value of a production tax credit is adjusted annually by an inflation factor and published annually by the Internal Revenue Service (IRS). The value is reduced if the Reference Price of a barrel of oil exceeds certain thresholds.

Recognition of Synfuel Gains

To optimize income and cash flow from the synfuel operations, we sold interests in all nine of the facilities, representing 91% of the total production capacity as of March 31, 2007. Proceeds from the sales are contingent upon production levels and the value of credits generated. Gains from the sale of an interest in a synfuel project are recognized when there is persuasive evidence that the sales proceeds have become fixed or determinable, the probability of refund is considered remote and collectibility is assured. In substance, we receive synfuel gains and reduced operating losses in exchange for tax credits associated with the projects sold.

The gain from the sale of synfuel facilities is generally comprised of fixed and variable components. The fixed component represents note payments, is not subject to refund, and is recognized as a gain when earned and collectibility is assured. The variable component is based on an estimate of tax credits allocated to our partners and is subject to refund based on the annual oil price phase-out. The variable component is recognized as a gain only when the probability of refund is considered remote and collectibility is assured.

Contractual Partners Obligations

Our partners reimburse us (through the project entity) for the operating losses of the synfuel facilities, referred to as capital contributions. In the event that the tax credit is phased out, we are contractually obligated to refund an amount equal to all or a portion of the operating losses funded by our partners. To assess the probability and estimate the amount of refund, we use valuation and analysis models that calculate the probability of the Reference Price of oil for the year being within or exceeding the phase-out range. Since we expect to be in a production tax credit phase out position in 2007, we have recorded a reserve of $16 million for partners capital contributions in the first quarter of 2007 as compared to a reserve of $40 million in the first quarter of 2006. In the 2007 first quarter, we recorded a reduction in the reserve of $22 million for a prior year true up.

Crude Oil Prices

The Reference Price of a barrel of oil is an estimate by the IRS of the annual average wellhead price per barrel for domestic crude oil. The value of the production tax credit in a given year is reduced if the Reference Price of oil over the year exceeds a threshold price and is eliminated entirely if that same Reference Price exceeds a phase-out price. During 2007, the annual average wellhead price is projected to

be approximately $6 less than the New York Mercantile Exchange (NYMEX) price for light, sweet crude oil. The actual or estimated Reference Price and beginning and ending phase-out prices per barrel of oil for 2006 and 2007 are as follows:

	Reference Price	Beginning Phase-Out Price	Ending Phase-Out Price
2006 (actual)	$59.68	$55.06	$69.12
2007 (estimated)	Not Available	$56	$70

The NYMEX daily closing price of a barrel of oil for the three months ended March 31, 2007 averaged approximately $66, which is approximately equal to a Reference Price of $60 per barrel, which we estimate to be within the phase-out range. The actual tax credit phase-out for 2007 will not be certain until the Reference Price is published by the IRS in April 2008. There is a risk of at least a partial phase-out of the production tax credits in 2007, which could adversely impact our results of operations, cash flow, and financial condition.

Hedging of Synfuel Cash Flows

As discussed in Note 2 of the Notes to Consolidated Financial Statements, we have entered into derivative and other contracts to economically hedge a portion of our synfuel cash flow exposure to the risk of oil prices increasing. The derivative contracts are marked-to-market with changes in fair value recorded as an adjustment to synfuel gains. To manage our exposure in 2007 to the risk of an increase in oil prices that could substantially reduce or eliminate synfuel sales proceeds, we entered into a series of derivative contracts covering a specified number of barrels of oil. The derivative contracts involve purchased and written call options that provide for net cash settlement at expiration based on the 2007 calendar year average NYMEX trading prices for light, sweet crude oil in relation to the strike prices of each option. If the average NYMEX prices of oil in 2007 are less than approximately $60 per barrel, the derivatives will yield no payment. If the average NYMEX prices of oil exceed approximately $60 per barrel, the derivatives will yield a payment equal to the excess of the average NYMEX price over these initial strike prices, multiplied by the number of barrels covered, up to a maximum price of approximately $76 per barrel. These contracts are based on various terms to take advantage of increases in oil prices. We recorded pretax mark-to-market gains of $4 million during the three months ended March 31, 2007 and gains of $47 million during the three months ended March 31, 2006. The fair value changes are recorded as adjustments to the gain from selling interests in synfuel facilities and are included in the Asset gains and losses, reserves and impairments, net line item in the Consolidated Statement of Operations. We paid approximately $50 million for 2006 hedges, for which we received payments of approximately $156 million upon settlement of these hedges in January 2007. Through March 31, 2007, we paid approximately $113 million for 2007 hedges which will provide protection for a significant portion of our cash flows related to synfuel production during 2007.

Risks and Exposures

Since there is the likelihood that the Reference Price for a barrel of oil will reach the threshold at which synfuel-related production tax credits began to phase-out, we defer gain recognition associated with variable and certain fixed note payments until the probability of refund is remote and collectibility is assured. All or a portion of the deferred gains will be recognized when and if the gain recognition criteria is met. During the three months ended March 31, 2007 and 2006, fixed gains recognized totaled $33 million and $22 million, respectively. During the three months ended March 31, 2007 variable gains recognized totaled $6 million, whereas we recognized variable losses totaling $8 million for the comparable 2006 three month period. Gains and losses recognized in both three month periods were impacted by prior year true ups.

Additionally, we may establish reserves for potential refunds of amounts related to partners capital contributions associated with operating losses allocated to their account. In the event of a tax credit phase-out, we are contractually obligated to refund to our partners all or a portion of the operating losses funded by our partners. During the three months ended March 31, 2007, we refunded approximately $8 million to our partners, representing $5 million of capital contributions and $3 million related to variable gains.

Cash from synfuel activity is at risk of a phase-out of the production tax credits. We expect approximately $900 million of synfuel-related cash impacts from 2007 through 2009, which consists of cash from operations, asset sales and proceeds from option hedges, and approximately $500 million of tax credit carryforward utilization and other tax benefits that are expected to reduce future tax payments. The expected cash flow of approximately $900 million is economically hedged against the movement in oil prices. In addition, a goodwill write-off of up to $4 million will likely be required in 2007 due to the inability to generate new production tax credits after 2007 and the resulting discontinuance of synfuel production. We have fixed notes receivable associated with the sales of interests in the synfuel facilities. A partial or full phase-out of production tax credits could adversely affect the collectibility of our receivables and likely reduce our ability to execute our investment and growth strategy.

OPERATING SYSTEM AND PERFORMANCE EXCELLENCE PROCESS

We continuously review and adjust our cost structure and seek improvements in our processes. Beginning in 2002, we adopted the DTE Energy Operating System, which is the application of tools and operating practices that have resulted in operating efficiencies, inventory reductions and improvements in technology systems, among other enhancements. Some of these cost reductions may be returned to our customers in the form of lower PSCR charges and the remaining amounts may impact our profitability.

As an extension of this effort, in mid-2005, we initiated a company-wide review of our operations called the Performance Excellence Process. The overarching goal has been and remains to become more competitive by reducing costs, eliminating waste and optimizing business processes while improving customer service. Many of our customers are under intense economic pressure and will benefit from our efforts to keep down our costs and their rates. Additionally, we will need significant resources in the future to invest in the infrastructure necessary to compete. Specifically, we began a series of focused improvement initiatives within our Electric and Gas Utilities, and our corporate support function. The process is rigorous and challenging and seeks to yield sustainable performance to our customers and shareholders. We have identified the Performance Excellence Process as critical to our long-term growth strategy. In order to fully realize the benefits from the Performance Excellence Process, it is necessary to make significant up-front investments in our infrastructure and business processes. The costs to achieve (CTA) in 2006 exceeded our savings, but we expect to realize sustained net cost savings beginning in 2007.

In September 2006, the MPSC issued an order approving a settlement agreement that allows Detroit Edison and MichCon, commencing in 2006, to defer the incremental CTA. Further, the order provides for Detroit Edison and MichCon to amortize the CTA deferrals over a ten-year period beginning with the year subsequent to the year the CTA was deferred. Detroit Edison deferred approximately $102 million of CTA in 2006 as a regulatory asset and began amortizing deferred 2006 costs in 2007 as the recovery of these costs was provided for by the MPSC in the order approving the settlement in the show cause proceeding. Amortization of prior year deferred CTA costs amounted to $2.5 million during the three months ended March 31, 2007. During the three months ended March 31, 2007, CTA costs of $13 million were deferred. MichCon cannot defer CTA costs at this time because a recovery mechanism has not been established.

CAPITAL INVESTMENT

We anticipate significant capital investment across all of our business segments. Most of our capital expenditures will be concentrated within our utility segments. Our electric utility currently expects to invest approximately $4.3 billion, including increased environmental requirements and reliability enhancement projects during the period of 2007 through 2011. Our gas utility currently expects to invest approximately $1.0 billion on system expansion, pipeline safety and reliability enhancement projects through the same period. We recently launched a six-year, approximately $330 million, advanced metering infrastructure project that involves the replacement and/or modification of some 4 million electric and gas customer meters. We plan to seek regulatory approval to include these capital expenditures within our regulatory rate base consistent with prior treatment.

ENTERPRISE BUSINESS SYSTEMS

In 2003, we began the development of our Enterprise Business Systems (EBS) project, an enterprise resource planning system initiative to improve existing processes and to implement new core information systems, relating to finance, human resources, supply chain and work management. As part of this initiative, we are implementing EBS software including, among others, products developed by SAP AG and MRO Software, Inc. The first phase of implementation occurred in 2005 in the regulated electric fossil generation unit. The second phase of implementation began in April 2007. The conversion of data and the implementation and operation of EBS will be continuously monitored and reviewed and should ultimately strengthen our internal control structure and lead to increased cost efficiencies. Although our implementation plan includes detailed testing and contingency arrangements to ensure a smooth and successful transition, we can provide no assurance that complications will not arise that could interrupt our operations. Through March 2007, we spent approximately $375 million on this project and we anticipate spending an additional approximately $10 million in 2007 as the remaining system elements are developed and implemented. We expect the benefits of lower costs, faster business cycles, repeatable and optimized processes, enhanced internal controls, improvements in inventory management and reductions in system support costs to outweigh the expense of our investment in this initiative.

OUTLOOK

The next few years will be a period of rapid change for DTE Energy and for the energy industry. Our strong utility base, combined with our integrated non-utility operations, position us well for long-term growth. Due to the enactment of the Energy Policy Act of 2005 and the repeal of the Public Utility Holding Company Act of 1935, there are fewer barriers to mergers and acquisitions of utility companies at the federal level. However, the expected industry consolidation, resulting in the creation of large regional utility providers, has been recently impacted by actions of regulators in certain states affected by the proposed transactions.

Looking forward, we will focus on several areas that we expect will improve future performance:

- continuing to pursue regulatory stability and investment recovery for our utilities;
- managing the growth of our utility asset base;
- enhancing our cost structure across all business segments;
- improving our Electric and Gas Utility customer satisfaction; and
- investing in businesses that integrate our assets and leverage our skills and expertise.

Along with pursuing a leaner organization, we anticipate approximately $900 million of synfuel-related cash impacts from 2007 through 2009, which consists of cash from operations and proceeds from option hedges, and approximately $500 million of tax credit carryforward utilization and other tax benefits that are expected to reduce future tax payments. The redeployment of this cash represents a unique opportunity to increase shareholder value and strengthen our balance sheet. We expect to use such cash and the potential cash from monetization of certain of our non-utility assets and operations to reduce debt and repurchase common stock, and to continue to pursue growth investments that meet our strict risk-return and value creation criteria. Our objectives for cash redeployment are to strengthen the balance sheet and coverage ratios to improve our current credit rating and outlook, and to have any monetizations be accretive to earnings per share.

RESULTS OF OPERATIONS

Net income in the first quarter of 2007 was $134 million, or $.76 per diluted share, compared to net income of $136 million, or $.76 per diluted share, in the first quarter of 2006. The following sections provide a detailed discussion of the operating performance and future outlook of our segments.

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Segments realigned In the third quarter of 2006, we realigned the non-utility segment Power and Industrial Projects business unit to separately present the Synthetic Fuel business. In the fourth quarter of 2006, we separated the Fuel Transportation and Marketing segment into Coal and Gas Midstream and Energy Trading. See Note 9 of the Notes to Consolidated Financial Statements for further information on this realignment.

(in Millions, except per share data)	**2007**	2006
Net Income by Segment:		
Electric Utility	**$ 40**	$ 59
Gas Utility	**67**	50
Non-utility Operations:		
Coal and Gas Midstream	**12**	13
Unconventional Gas Production	**2**	1
Power and Industrial Projects	**4**	(23)
Energy Trading	**1**	28
Synthetic Fuel	**38**	21
Corporate & Other	**(30)**	(13)
Income (Loss) from Continuing Operations:		
Utility	**107**	109
Non-utility	**57**	40
Corporate & Other	**(30)**	(13)
	134	136
Discontinued Operations		(1)
Cumulative Effect of Accounting Change		1
Net Income	**$ 134**	$ 136

ELECTRIC UTILITY

Our Electric Utility segment consists of Detroit Edison.

Factors impacting income: Net income decreased $19 million in the first quarter of 2007 primarily due to increased depreciation and amortization expenses, higher operation and maintenance expenses, and an increase in reserves.

	Three Months Ended March 31	
	2007	2006
(in Millions)		
Operating Revenues	**$ 1,094**	$ 1,050
Fuel and Purchased Power	**354**	309
Gross Margin	**740**	741
Operation and Maintenance	**348**	344
Depreciation and Amortization	**182**	167
Taxes Other Than Income	**72**	69
Asset (Gains), Losses and Reserves, Net	**7**	
Operating Income	**131**	161
Other (Income) and Deductions	**71**	75
Income Tax Provision	**20**	27
Net Income	**$ 40**	$ 59
Operating Income as a Percent of Operating Revenues	**12%**	15%

Gross margin declined $1 million in the first quarter of 2007 due to lower rates resulting primarily from the August 2006 settlement in the MPSC show cause proceeding that provided for an annualized rate reduction of $53 million effective in September 2006 and an additional annualized rate reduction of $26 million effective in January 2007. Gross margins were also lower due to poor economic conditions, partially offset by higher margins due to returning sales from electric Customer Choice and the impacts of colder weather in the first quarter of 2007. Revenues include a component for the cost of power sold that is recoverable through the PSCR mechanism.

The following table displays changes in various gross margin components relative to the comparable prior period:

Increase (Decrease) in Gross Margin Components Compared to Prior Year	**Three Months**
(in Millions)	
Weather related margin impacts	**$ 8**
Return of customers from electric Customer Choice	**17**
Service territory economic performance	**(14)**
Impact of MPSC rate orders	**(18)**
Other, net	**6**
Decrease in gross margin	**$ (1)**

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	Three Months Ended March 31	
Power Generated and Purchased	**2007**	2006
(in Thousands of MWh)		
Power Plant Generation		
Fossil	**10,557**	9,308
Nuclear	**2,428**	2,197
	12,985	11,505
Purchased Power	**1,233**	1,513
System Output	**14,218**	13,018
Less Line Loss and Internal Use	**(784)**	(825)
Net System Output	**13,434**	12,193
Average Unit Cost ($/MWh)		
Generation (1)	**$ 15.41**	$ 14.66
Purchased Power	**$ 63.88**	$ 50.42
Overall Average Unit Cost	**$ 19.62**	$ 18.82

(1) Represents fuel costs associated with power plants.

(in Thousands of MWh)	Three Months Ended March 31	
	2007	2006