STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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| In the matter of the application of<br>**MICHIGAN GAS UTILITIES** for<br>authority to increase its rates for<br>natural gas service and for other relief. | )<br>)<br>)<br>)<br>) | Case No. U-10960 |

At the August 25, 1997 meeting of the Michigan Public Service Commission in Lansing, Michigan.

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

**ORDER DENYING REHEARING**

On March 27, 1997, the Commission issued an order increasing by $1,704,000 annually the retail gas rates of Michigan Gas Utilities (MGU), a division of Utilicorp United Inc. (Utilicorp). The order also redesigned several of MGU's rate schedules, adopted new rules and regulations concerning the sale, distribution, and transportation of natural gas, called for submission of a report concerning the creation of an external fund to cover certain liabilities, and initiated a proceeding to establish service curtailment and gas diversion rules for MGU.

On April 28, 1997, MGU filed a petition for rehearing or reopening regarding the Commission's findings related to gas supply services expenses, affiliated company revenues, daily balancing, and the return on common equity.

On May 19, 1997, the Commission Staff (Staff), Attorney General Frank J. Kelley (Attorney General), the Association of Businesses Advocating Tariff Equity (ABATE), North Star Steel Company (North Star), and Alchem Aluminum, Inc., (Alchem)[1] filed responses to MGU's petition.

Rule 403 of the Commission's Rules of Practice and Procedure, 1992 AACS, R 460.17403, provides that a petition for rehearing may be based on claims of error, newly discovered evidence, facts or circumstances arising after the hearing, or unintended consequences resulting from compliance with the order. A petition for rehearing is not merely another opportunity for a party to argue a position or to express disagreement with the Commission's decision. Unless a party can show the decision to be incorrect or improper because of errors, newly discovered evidence, or unintended consequences of the decision, the Commission will not grant a rehearing.

Gas Supply Services

In its March 27, 1997 order, the Commission reduced MGU's proposed operation and maintenance expense by $505,000 for certain services provided by Utilicorp's Gas Supply Services (GSS), which is a separate cost center within Utilicorp's corporate structure. The Commission noted that the expense for GSS was allocated to MGU by its parent corporation and that MGU appeared to have little ability to influence the types or amount of the expenses allocated. The Commission found that there had been significant increases in the affiliated company charges to MGU for which there was no adequate explanation. Accordingly, the Commission found that MGU had failed to meet its burden of demonstrating that the projected GSS costs are reasonable and prudent.

[1]These last three parties--ABATE, North Star, and Alchem--presented a unified position and were represented by the same counsel. This order will refer to these parties as ABATE.

MGU argues that the Commission's decision has the consequence of prohibiting the company from recovering its reasonable and prudent GSS costs for rent and equipment depreciation. It claims that the Commission's order is factually erroneous in its determination that MGU failed to adequately quantify or support the increased costs that it argues resulted from Federal Energy Regulatory Commission (FERC) Order No. 636.[2] It further claims that the Commission failed to acknowledge MGU's Exhibit A-90, which it submitted in rebuttal to the Staff's position. MGU argues that because it has amply supported its proposed GSS costs for the test year, the Commission acted in an arbitrary and unlawful manner by failing to adopt the company's position.

MGU further argues that the Commission should not impose what the company terms a "punitive disallowance" for any failure on the company's part to provide information. MGU insists that the record demonstrates that the consolidation of its gas supply function in the corporate GSS benefits customers and avoids cost increases that otherwise would have occurred due to FERC Order No. 636. It asserts that the Commission fundamentally misapprehended the company's position that it had transferred significant additional functions to GSS without the need to add personnel.

The Staff responds that MGU merely reargues the position it took in this case under the guise that the Commission's findings are factually erroneous. The Staff states that the Commission's March 27, 1997 order in this case reflects the Commission's full consideration of all arguments and evidence supporting MGU's position before finding the record inadequate to justify adopting the company's position. The Staff argues that the reasons for the disallowance are supported by the testimony of Susan Crimmins Devon,

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[2] Pipeline Service Obligations and Revisions to Regulations Governing Self-implementing Transportation Under Part 284 of the FERC's Regulations, 61 FERC ¶ 61,272 (1992), reh den 62 FERC ¶61,007 (1993).

Chief Auditor for the Commission's Gas Division, as well as by cross-examination of company witnesses.

The Commission finds that MGU fails to meet the requirements for rehearing, because it merely reargues the position that it took with respect to this issue. The Commission fully considered and rejected MGU's arguments in the March 27, 1997 order. The exhibit that MGU asserts the Commission ignored is specifically mentioned in the order as part of the description of MGU's arguments. See, Order, p. 35. The Commission is not persuaded that it misapprehended the record or MGU's position regarding this issue. Rather, after considering the record and the arguments of the parties, the Commission determined that MGU had failed to adequately support its position. The Commission rejected MGU's arguments that the Staff's position was based on erroneous information, because it found that any defect was the result of MGU's reluctance or refusal to provide timely, accurate, and complete information that the Staff requested. The Commission finds no reason to reverse its determination that "[e]ven in its rebuttal testimony, MGU failed to quantify or support with specifics the increased costs it claims resulted from FERC Order No. 636." Order, p. 36. MGU's claim to achieving efficiencies through the consolidation of gas supply services does nothing to explain the 62% increase in expense related to those services. Accordingly, the Commission concludes that MGU's request for rehearing on this issue must be denied.

Affiliated Company Revenues

The Commission adopted the Staff's proposal to include, as part of MGU's net operating income, net revenues derived from certain services provided by one of the utility's nonregulated affiliates, MG Ventures. MGU claims that the Commission's finding is based on legal and factual error. The company further claims that the Commission's decision effectively ignores the distinct corporate identities of MGU and its affiliate and erases the distinction between regulated and nonregulated enterprises.

MGU argues that the Commission has improperly attributed the benefit of nonutility business revenues to MGU's regulated service customers. MGU asserts that its customers have no right or entitlement to the revenues generated by nonutility investments. Rather, MGU argues, the Commission should separate the regulated and nonregulated portions of the business so that it does not improperly assert jurisdiction over nonregulated activities. Otherwise, MGU argues, nonregulated business losses might be attributed to the company as well.

MGU further argues that the close connection between the regulated and nonregulated portions of its operations does not justify the Commission's decision. It states that although the employees involved in providing the services are UtiliCorp employees, only some are MGU employees. It insists that the investment in the nonutility businesses is UtiliCorp's, not MGU's.

Moreover, MGU argues, the Commission failed to consider the property used to provide these nonregulated services, and failed to increase the rate base or recognize an increased risk to account for the UtiliCorp investment. MGU argues that, by attributing MG Venture revenues to MGU without considering other rate making components, the

Commission set MGU's rates unreasonably low.  In MGU's view, the Commission's action assigns the benefits of a nonregulated business to regulated business customers, and thereby deprives MG Ventures of those benefits and effectively precludes MG Ventures from engaging in the business.

Finally, MGU argues, the Commission's decision concerning these revenues violates public policy in this changing utility environment in two respects.  First, MGU asserts, it destroys MG Ventures' viability as a corporate entity and its incentive to change and evolve in order to maintain or increase its earnings.  Second, MGU claims, the Commission's decision negatively affects the company's incentive to diversify, thereby creating a loss of efficient use of assets that could reduce costs for regulated customers.

The Staff responds that MGU has merely reasserted the arguments that the Commission addressed in the March 27, 1997 order and has not asserted any legitimate claim of error.  It asserts that Ms. Devon's expert testimony that the results of her audit and prior Commission precedent support the disallowance is a sufficient basis on which to rest the Commission's decision.

The Staff further asserts that the Commission's decision does not preclude MGU from engaging in nonregulated businesses.  Rather, the Commission's concern is properly with just and reasonable rates.  The Staff argues that if utility assets are used to engage in nonregulated businesses, it may be necessary to include revenues from those businesses within the rate setting process to protect ratepayers from cross-subsidizing the nonregulated activities.

Finally, the Staff asserts that MGU has ignored record evidence when it claims that no party suggested that allocation of expenses for commonly shared employees was not possible in this case, or that MGU failed to allocate expenses properly between these regulated and nonregulated activities.  The Staff points to its initial brief and reply brief in which it discussed the reasons to believe that the cost allocations proposed by MGU did not accurately reflect the reality of the operations.

The Commission finds that MGU has not met the standard for granting rehearing on this issue.  The company has merely reargued its position and stated its disagreement with the Commission's decision.  The Commission found in the March 27, 1997 order that the Staff's proposal was consistent with the Commission's treatment of similar programs operated by Michigan Consolidated Gas Company (Mich Con) and Consumers Energy Company (Consumers).  The Commission further found that the record reflected no real separation between MGU and MG Ventures for purposes of these services and that MG Ventures appeared to have no facilities separate from MGU.  In addition, the Commission noted that the Assured Comfort Program bill inserts display MGU's logo, customers are recruited through MGU, and MGU employees perform the vast majority of these services.  Finally, the Commission determined that, based on the record before it, no further adjustments need be made to the Staff's proposed disallowance.  See, Order, pp. 46-47.

The Commission is not persuaded that the record evidence requires reversing those findings or making further adjustments to the disallowance.  The Commission rejects MGU's argument that the Commission erred when it failed to include MG Ventures investment in rate base. Despite MGU's argument that it provided the information to the Staff, the record reflects that it failed to do so in a timely manner and in a form that the Staff could use to discern where the figures came from and what they represented.  See, 13 Tr. 2193 and 2196-2197.  Moreover, the company did nothing to place on the record its calculation of property values that might allow the Commission to discern the appropriate amount to be added to rate base. Thus, the Commission concludes that MGU complains of an alleged harm that it created and did nothing to correct when it had the opportunity to do so.

<u>Daily Balancing</u>

In its April 20, 1989 order in Case No. U-8788, the Commission agreed with MGU's claim that "few, if any, transportation customers use a steady draw of gas, [thus creating] a mismatch between interstate pipeline deliveries and actual customer use" on MGU's system. Order, p. 7. It was therefore decided that transportation customers should be entitled to some storage service under their contracts with MGU. This led to the creation of an authorized tolerance limit (ATL) equal to 10% of a transportation customer's annual contract quantity (ACQ) and concurrently called for the recovery from these customers of the costs associated with each thousand cubic feet (Mcf) of this incidental storage. The order in Case No. U-8788 went on to require that all determinations regarding whether a transportation customer's use of MGU's storage system had stayed within that 10% range, thus avoiding the assessment of volumetric penalties,[3] were to be based on month-end storage balances. <u>Id</u>., p. 9.

In the present case, MGU proposed eliminating monthly balancing and asked to institute daily balancing instead. Rather than offering the 10% of ACQ imbalance build-

[3]MGU was authorized to charge $0.10 per Mcf per month for the storage of any month-end balance of gas exceeding the customer's ATL. Conversely, if during any month the measured volume of gas delivered into MGU's system on behalf of a transportation customer (minus gas in kind) was less than the measured volume of gas consumed by the customer, the month-end difference was deemed unauthorized gas usage and subject to a charge equal to $10 per Mcf plus the then designated sales rate for all such unauthorized use. Nevertheless, because positive daily balances could be netted against negative daily imbalances on a month-end basis, both the likelihood and magnitude of those potential charges were reduced.

up on its system, it sought permission to require each transportation customer to keep its gas usage within plus or minus 10% of the volume of gas nominated by the customer for delivery into MGU's system on that particular day. Under MGU's proposal, a daily scheduling charge would be imposed on any customer that consumed less than 90% or more than 110% of the volume of gas nominated for that day. At the time that MGU filed its application in this case, the utility estimated that the daily scheduling charge would be approximately $0.32 per Mcf.

The Attorney General, ABATE, and the Staff all opposed MGU's request for daily balancing. Administrative Law Judge Robert E. Hollenshead (ALJ) agreed with these parties and recommended that the Commission reject MGU's proposal. In reaching his conclusion, the ALJ found that the utility "failed to effectively demonstrate a need" for daily balancing and that MGU's proposed replacement for the 10% ATL was "unworkable and not understandable." Proposal for Decision, pp. 77-78. In its March 27, 1997 order, the Commission concluded that it should adopt the ALJ's recommendations regarding daily balancing and reject the utility's various proposals concerning this issue. Like the ALJ, the Commission indicated that its conclusion was "attributable in large measure to shortcomings in MGU's evidentiary presentation." Order, p. 96.

MGU requests that the Commission reopen the record to receive additional evidence regarding the need for daily balancing. Specifically, MGU seeks to offer into evidence the direct testimony and exhibits of Harry F. Ono that were previously submitted in Case No. U-10982-R, the utility's 1996 gas cost recovery reconciliation case. According to MGU, this additional evidence (appended as Attachment D to the petition) will show that (1) its transportation customers used much more gas during peak periods of 1996 than they had nominated, (2) the higher-than-expected usage by these customers contributed to MGU's being out of balance with regard to its interstate gas suppliers, and (3) this led the interstate suppliers to impose pipeline overrun charges on MGU, thus raising the utility's average cost of gas. The utility goes on to contend that because "this additional evidence was unavailable at the time MGU filed its rate case, was not available for supplementing the record, and was not merely overlooked or neglected by MGU," reopening the record is justified. MGU's petition, p. 8.

MGU further contends that, notwithstanding the Commission's ruling to the contrary, its daily balancing proposal was both understandable and workable. According to MGU, "concerns as to clarity of definitions and notice [requirements] can be addressed by adding provisions to the tariff." Id., pp. 9-10. Finally, MGU contends that the Commission was simply incorrect in rejecting the utility's contention that its proposal would increase competition and customer choice. MGU therefore asserts that reopening and rehearing are justified with regard to the issue of daily balancing.

In response, the Staff and ABATE both contend that the additional evidence MGU wants to introduce by reopening the record was fully available for use by the utility during the rate case proceeding. Specifically, the Staff points out that the substance of the proposed testimony from Mr. Ono focuses on the results of a peak day occurring in early February 1996, as well as other events that took place that same week. Similarly, ABATE notes that a majority of the overrun charges cited in that testimony occurred between December 1995 and March 1996. Because cross-examination of MGU's direct case did not commence until March 25, and because the record did not close until June 21, 1996, these parties argue that MGU could have easily included this information as part of its presentation, had it so desired.  In support of this argument, ABATE points out that one of the witnesses presented by MGU, Daniel Warnock, was shown during cross-examination to be the person "most familiar with the operational characteristics of MGU's system with respect to balancing on the interstate pipelines and what MGU pays or has paid to the pipelines for scheduling charges and penalties."  ABATE's response, pp. 2-3 [citing, e.g., 5 Tr. 579, 583, 587-588; 7 Tr. 1097.]  The Staff and ABATE therefore contend that MGU's request to reopen the record is not justified and should be rejected.

These two parties go on to argue that, with regard to the Commission's findings (1) that the daily balancing program proposed in this case was neither understandable nor workable and (2) that its implementation was not shown as being likely to increase competition and customer choice, no valid basis has been offered in support of MGU's request for rehearing.  The Staff and ABATE note that, in its petition, MGU merely refers to the same record evidence and reasserts the same arguments that were previously considered and rejected in this case.  Because the utility offers nothing new on these issues, they contend, MGU's request for rehearing should also be rejected.

The Commission finds that MGU has not presented anything that would justify either reopening the record or granting rehearing concerning the utility's daily balancing proposal.  Information regarding pipeline overrun charges for December 1995 through March 1996 was available to MGU and could have been presented for consideration, had the utility so desired.  Thus, the fact that MGU may have incurred significant overrun charges between February 1 and 6, 1996 (over 6 weeks prior to the presentation of its direct case, and nearly 4½ months before the close of the record) cannot reasonably be construed to constitute newly discovered evidence requiring a reopening of the record.

As for MGU’s other assertions regarding its daily balancing proposal, they represent nothing more than the utility’s attempt to reargue positions previously considered and rejected by the Commission. The Commission therefore finds that granting reopening or rehearing regarding the issue of daily balancing would be inappropriate.

Return on Common Equity

In his PFD, the ALJ recommended setting MGU’s return on common equity at 11%, which is the high end of the 10.5% to 11% range established by Staff witness Brian L. Ballinger. In its March 27, 1997 order, the Commission rejected that recommendation and set the authorized rate of return at 10.75%, the midpoint of that range. MGU argues that the Commission erred when it granted the Staff’s exception to the ALJ’s recommendation despite the fact that the ALJ had recommended that the Commission adopt a rate of return within the Staff’s proposed range. In MGU’s view, the Staff should not be heard to complain when the ALJ recommends adoption of a position within the range that the Staff recommended. MGU’s arguments suggest that the Commission must, by law, adopt the ALJ’s recommendation in the absence of a “legitimate exception.” MGU’s petition for rehearing, p. 13. MGU argues that the ALJ had properly taken into consideration evidence of higher average authorized returns for other utilities and the range of returns most recently authorized by the Commission. Additionally, MGU argues, the ALJ’s decision is supported by record evidence that long-term bond costs were rising.

Furthermore, MGU argues, the Commission’s decision comes 17 months after MGU initially requested relief, a time during which long-term interest rates, and hence the overall cost of equity, increased. If the Commission were to adjust the recommended rate of return, argues MGU, it should have adjusted it upward due to these changes in the financial markets.

Moreover, MGU complains, the Commission's decision to authorize MGU to earn 10.75% on equity conflicts with the Commission's findings concerning other utilities. For example, MGU points out that the Commission authorized an 11.6% return for Consumers in Case No. U-10755 and an 11.5% return for Mich Con in Cases Nos. U-10149 and U-10150. Additionally, MGU points out that the Staff recommended that the Commission authorize an 11.5% or 12% return on common equity for Peninsular Gas Company (Peninsular) in Case No. U-11127.[4]

The Staff responds that the Commission's determination regarding the appropriate authorized rate of return on equity is reasonable and supported by Mr. Ballinger's expert testimony. Despite MGU's argument that the Staff's exception was not appropriate, given the ALJ's adoption of a rate of return within the Staff's proposed range, the Staff notes that the Commission has discretion to determine the appropriate rate of return, even if no exception is taken to the ALJ's recommendation. However, the Staff points out, MGU placed its rate of return at issue by excepting to the ALJ's recommendation.

To MGU's complaint that its rate of return on common equity does not match or exceed the authorized rates of return established for other utilities, the Staff points out that those rates were set at different times and under different circumstances. Moreover, although MGU's authorized rate of return on common equity may be lower than that authorized for Mich Con and Consumers, the overall rate of return is lower for both of those other companies than it is for MGU as a result of this case.

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[4]The Commission authorized Peninsular to earn 12% on common equity in its July 31, 1997 order in Case No. U-11127.

The Commission finds that MGU has not met the requirements for granting rehearing on this issue. The Commission considered the record evidence and all of the arguments presented when it determined the appropriate rate of return on equity for MGU. Contrary to MGU's argument, nothing in the statute prohibits the Commission from reviewing the recommendations of the ALJ, even in the absence of exceptions. Rather, MCL 24.281; MCL 3.560(181) contemplates the possibility that the proposed decision may change upon "review by action of the agency." Nor is the Commission persuaded that the authorized rate of return for other companies requires a result different from that reached in the March 27, 1997 order. MGU has not established that the circumstances surrounding the cited cases are substantially similar such that authorizing a different return on equity for MGU is unreasonable or unjust.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCL 462.2 et seq.; MSA 22.21 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; MSA 22.1 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; MSA 22.13(1) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACS, R 460.17101 et seq.

b. The petition for rehearing or reopening filed by MGU should be denied.

THEREFORE, IT IS ORDERED that the petition for rehearing or reopening filed by Michigan Gas Utilities 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, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ John G. Strand
Chairman

( S E A L )

/s/ John C. Shea
Commissioner

/s/ David A. Svanda
Commissioner

By its action of August 25, 1997.

/s/ Dorothy Wideman
Its Executive Secretary

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

Chairman

Commissioner

Commissioner

By its action of August 25, 1997.

Its Executive Secretary

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| In the matter of the application of<br>**MICHIGAN GAS UTILITIES** for<br>authority to increase its rates for<br>natural gas service and for other relief. | )<br>)<br>)<br>)<br>) | Case No. U-10960 |

Suggested Minute:

> "Adopt and issue order dated August 25, 1997 denying the petition for rehearing filed by Michigan Gas Utilities, as set forth in the order."