

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)
MICHIGAN GAS UTILITIES for a gas cost)
recovery reconciliation proceeding for the) Case No. U-10982-R
12-month period ended December 31, 1996.)
_____)

At the April 12, 1999 meeting of the Michigan Public Service Commission in Lansing,
Michigan.

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

OPINION AND ORDER

On February 28, 1997, UtiliCorp United Inc., d/b/a Michigan Gas Utilities, (MGU) filed an application to reconcile its gas cost recovery (GCR) revenues and expenditures pursuant to 1982 PA 304, MCL 460.6h et seq.; MSA 22.13(6h) et seq., (Act 304) for the 12-month period ended December 31, 1996.

At a prehearing conference on April 9, 1997, Administrative Law Judge Theodora M. Mace (ALJ) granted leave to intervene to the Association of Businesses Advocating Tariff Equity (ABATE), the Residential Ratepayer Consortium, and the Attorney General. The Commission Staff (Staff) also participated. The ALJ conducted evidentiary hearings on June 3 and November 24, 1997 and February 12, 1998. Thereafter, MGU, the Attorney General, and the Staff filed briefs, and the same parties as well as ABATE filed reply briefs.

During the proceedings, the parties agreed to a partial settlement, which left only one issue unresolved. For the other issues, the partial settlement computed an underrecovery plus interest through year-end 1996 of \$11,803,985 and provided for the roll-in of this amount into MGU's 1997 GCR plan.¹ The Commission approved the partial settlement agreement in an order issued on September 30, 1997.

The one unresolved issue is MGU's request for cost recovery of overrun charges it incurred for unauthorized usage of gas taken from two interstate pipelines, ANR Pipeline Company (ANR) and Panhandle Eastern Pipe Line Company (Panhandle), during the first six days of February 1996. ANR's overrun bill was \$241,030, and Panhandle billed a total of \$534,751 in overrun charges. Of the Panhandle charges, \$56,930 represented an overrun of 5,693 million British thermal units (MMBtu) attributable to the usage of MGU's GCR customers on February 2, 1996. The partial settlement in this case authorized MGU to recover this amount, leaving total overrun charges of \$718,851 to be disputed. In addition, MGU acknowledged that it had billed a total of \$146,027 to two of its end-use transportation customers for their unauthorized gas usage in February 1996 and conceded that it would be appropriate to apply that amount as a setoff against its proposed cost recovery. Tr. 304-05, 314-15. MGU further conceded that \$88,000 that it collected as a penalty for supplier nonperformance would be an appropriate setoff. Id. at 69-70, 315-16.

¹Inexplicably, the actual amount shown as rolled in for the 1996 underrecovery in MGU's 1997 GCR reconciliation was \$12,460,151, not \$11,803,985. January 6, 1999 order, Case No. U-11192-R, Settlement Agreement, Attach. A, revised Ex. A-6, p. 1, l. 22. The larger amount is MGU's proposed underrecovery (without disallowances), as filed in the application in this case (commencing the 1996 GCR reconciliation). The computations required by this order include an adjustment for this discrepancy.

The event causing the overrun charges was unusually cold weather in MGU's service territory during February 1-6, 1996. As a consequence, a surge in weather-sensitive loads caused MGU's system demand to exceed the gas supplies delivered to the system, which consisted of MGU's interstate pipeline entitlements, withdrawals from storage, and nominations of gas purchased by transportation customers for scheduled delivery to MGU's system. Unauthorized gas from the interstate pipelines made up the deficit.

As already noted, GCR customers' usage exceeded their supply entitlements by 5,693 MMBtu on February 2, 1996, but they did not use more than the gas supplied on their behalf on any other day. However, transportation customers as a whole consumed more gas than their deliveries to MGU's system on each of the six days. MGU indicated that transportation customers' aggregate load exceeded total nominations on each day in amounts ranging from 4,574 MMBtu to 33,420 MMBtu. The total transportation customer overrun for the six-day period was 99,163 MMBtu. A large share of the overrun can be attributed to those transportation customers purchasing their gas supply from MG Ventures, a marketer affiliated with MGU. According to Exhibit S-19, a discovery response provided by MGU, the amount by which usage exceeded nominations for MG Ventures' customers during the period was 58,813 MMBtu.² MG Ventures' marketing activities served more transportation customers and load than any other marketer serving customers connected to MGU's system.

²In rebuttal, MGU submitted Exhibit A-28, which revises Exhibit S-19 by increasing the daily amounts shown as nominated by MG Ventures. MGU represented that Exhibit A-28 reflects the \$88,000 credit for supplier nonperformance as well as other adjustments that are not fully explained on the record. Tr. 369-74. MGU witness Harry F. Ono stated that the nominations shown in Exhibit A-28 did not reflect actual gas deliveries to MGU's system. Tr. 373. MG Ventures' net deficiency, according to Exhibit A-28, was 20,597 MMBtu.

On May 26, 1997, the ALJ issued a Proposal for Decision (PFD) recommending that the disputed overrun charges be disallowed. The ALJ addressed the issue in light of two standards. First, she noted that the GCR clause in MGU's tariff "specifically excludes . . . [c]ontract, tariff and other penalties, unless the customers of the Company *benefit* as a result of payment of such penalties." MGU's tariff M.P.S.C. No. 6, Original Sheet No. B-62.00 (emphasis added). Second, the ALJ noted that the legal standard for cost recovery in Act 304 is whether the cost is reasonable and prudent. MCL 460.6h(12)-(14); MSA 22.13(6h)(12)-(14). Accordingly, the ALJ inquired, first, whether the overrun charges paid by MGU benefited GCR customers and, second, whether MGU could have avoided the charges by taking reasonable and prudent actions permitted under its tariffs. PFD at 10-11.

In arguing that the overrun charges benefited its GCR customers, MGU explained that it determined how much pipeline capacity it needed to procure on the basis of a peak design day. As a result of this analysis, MGU made a cost/benefit determination to assume the risk of incurring some pipeline overrun charges under extreme weather conditions so long as paying occasional charges would be less costly than the reservation charges necessary to procure additional capacity entitlements. MGU added that the Commission approved MGU's peak design day in the September 12, 1996 order in Case No. U-10982, MGU's 1996 GCR plan case.

The ALJ rejected MGU's claim that GCR customers benefited from the overrun charges. She stated that the order adopting MGU's GCR plan did not actually approve the overrun charges, but instead addressed MGU's efforts to modify the tariff language excluding "contract, tariff and other penalties" from the definition of the booked cost of gas. (The order did not alter the tariff language.) She also found that, except for \$56,930 associated with GCR usage, the overrun charges

were caused by transportation customers' excess usage. She stated that if MGU wants to seek recovery of transportation-related costs, it should raise the issue in a base rate case. PFD at 12-14.

The ALJ further found that MGU failed to take reasonable and prudent measures to avoid the pipeline overrun charges. In making this finding, the ALJ identified two actions that MGU could have taken under its tariffs to prevent the overruns from occurring. First, she stated that MGU could have chosen to enforce the maximum daily quantity (MDQ) tariff provisions, which place a ceiling on the amount that transportation customers may nominate each day for delivery to MGU's system. Although the tariffs require transportation customers to maintain a monthly balance between their nominations and usage, there are no adverse consequences to a customer for imbalances over lesser periods within a given month, so long as balance is achieved at month-end. The ALJ reasoned that if MGU had held each transportation customer to its MDQ, the customers would have been more likely to nominate consistent amounts each day instead of relying on their ability to nominate greater amounts later in the month to "catch up" with their cumulative monthly usage. *Id.* at 20.

As a second reason for finding unreasonable conduct on MGU's part, the ALJ found that MGU's affiliation with MG Ventures exacerbated transportation customers' consumption patterns in early February. The ALJ stated that MGU gave MG Ventures preferential treatment by acquiescing in MG Ventures' failure to nominate enough gas on behalf of the transportation customers it supplied. She added that the affiliation was a disincentive for MGU to penalize transportation customers or otherwise attempt to deter them from excess usage. *Id.* at 21-22.

In summary, the ALJ found that the pipeline unauthorized overrun charges did not benefit GCR customers and that MGU's actions were unreasonable and imprudent. She recommended that the Commission disallow the overrun charges remaining at issue.

On June 9, 1998, MGU and the Staff filed exceptions. On June 23, 1998, MGU, the Staff, ABATE, and the Attorney General filed replies to exceptions.

Of the two standards discussed in the PFD, the first raises a threshold issue: whether the unauthorized overrun charges paid by MGU to the pipelines for excess usage by transportation customers are a cost of gas that may be recovered in the GCR factor. Act 304 authorizes the Commission to approve a utility's GCR clause for the limited purpose of "allow[ing] the utility to recover the booked costs of gas sold by the utility if incurred under reasonable and prudent policies and practices." MCL 460.6h(1)(b); MSA 22.13(6h)(1)(b). The statute also provides that a GCR reconciliation case shall determine "the amounts actually expensed and included in the cost of gas sold by the gas utility." MCL 460.6h(12); MSA 22.13(6h)(12). If the overrun charges are not a cost of gas within the meaning of Act 304, it is not necessary to evaluate the reasonableness and prudence of the events and actions that resulted in the charges.

The GCR clause in MGU's tariff incorporates the provisions of Act 304 and elaborates on the meaning of "booked costs of gas sold." The tariff provides in relevant part:

B10.1 Applicability of clause.

All rates for gas service, unless otherwise provided in the applicable rate schedule, shall include a Gas Cost Recovery Factor to allow the Company to recover the booked costs of gas sold by the Company if incurred under reasonable and prudent policies and practices.

B10.2 Booked cost of gas sold.

* * *

(2) Booked cost of gas sold as used in this rule specifically excludes the following items:

* * *

(d) Contract, tariff and other penalties, unless the customers of the Company benefit as a result of payment of such penalties.

MGU's tariff M.P.S.C. No. 6, Sheets Nos. B-61.00 to -62.00. MGU's transportation tariff states that the GCR clause does not apply to transportation service. Ex. A-25.³

In its exceptions, MGU argues that it should recover the unauthorized overrun charges as a GCR cost of gas because GCR customers benefited from the activities that gave rise to the charges. MGU provides three reasons why it believes that GCR customers benefited, all relating to the fact that it provides service to both sales and transportation customers on a single integrated system that combines transmission, distribution, storage, and production functions.

One benefit, according to MGU, is that, in determining how much pipeline capacity it needs to serve combined peak day customer loads, it avoids paying for additional capacity that would be required to serve the GCR load by itself under extreme weather conditions. To illustrate, MGU states that it would have cost more than \$880,000 per year in interstate pipeline reservation charges to pay for the additional capacity needed to cover the 5,693 MMBtu excess of actual GCR consumption over peak day plan coverage on February 2, 1996. MGU says that this exceeds by far the actual overrun charges that the pipelines assessed at \$10 per thousand cubic feet (Mcf). MGU argues that, by approving its 1996 GCR plan in the September 12, 1996 order in Case No. U-10982, the Commission found the peak design day to be reasonable, notwithstanding the foreseeable risk of incurring some overrun charges.

MGU's second claim of a GCR benefit is that serving both transportation and GCR customers on an integrated basis keeps the distribution system pressurized and operational. MGU also says

³Exhibit A-25 provides excerpts of tariffs in effect during February 1996. Since 1996, tariff provisions addressing curtailment have been substantially revised, in part to address situations similar to this case. Noncurrent tariff sheets that were in effect during 1996 are cited in this order by reference to Exhibit A-25.

that GCR customers have temporary access to positive imbalances held in storage for transportation customers.⁴

The third GCR benefit identified by MGU is that transportation rates pay for some storage costs that would otherwise be recovered in sales customers' base rates. MGU says that the transportation rate component covering the storage services used to provide monthly load balancing is \$0.0759 per Mcf, which provides annual revenues of more than \$1.5 million. Without this benefit, MGU claims, sales customers' base rates would increase to cover those costs. MGU notes that transportation customers pay for storage regardless of whether they actually use their storage capacity.

Although the Staff and the Attorney General acknowledge that all rate classes benefit from customer diversity and operational reliability, they contend that it does not follow that overrun charges incurred to maintain service to transportation customers should be assigned to GCR customers. The Staff and the Attorney General say that the cost responsibility of GCR customers was fully discharged when the partial settlement permitted MGU to recover \$56,930 of the charges associated with the GCR-related portion of the overrun.

The Attorney General notes that MGU's transportation tariff permitted it to redeliver positive imbalances to transportation customers only when the utility's "best efforts" will accommodate the redelivery.⁵ In this view, the "best efforts" tariff condition means that, on peak days, when all

⁴Positive imbalances are the unused gas accumulated on a transportation customer's account at the month-end of prior months. During 1996, MGU's transportation tariff limited positive imbalances to 10% of the customer's annual contract quantity. Since then, tariff provisions relating to load balancing have been substantially revised.

⁵A transportation customer's "balance" of its usage with nominations on its account is determined at the end of each month. The positive imbalance, if any, is carried forward to the next month and redelivered to the customer if MGU can effect a withdrawal of the gas from storage on a "best efforts" basis.

storage withdrawal capabilities are necessary to meet GCR loads, MGU should limit transportation customers' daily usage to the gas they actually nominate. The Attorney General reasons that the tariff makes MGU responsible for its service to transportation customers on peak days. The Attorney General contends that MGU was in a position to decide how to meet that responsibility, whether by enforcing existing tariffs, seeking tariff revisions to provide more restraints on transportation loads, or simply choosing to absorb the additional costs, but that it could not shift the costs to GCR customers.

The Attorney General contends that the September 12, 1996 order in Case No. U-10982 is consistent with this position. The Attorney General explains that MGU's peak design day accounts only for GCR customers by balancing GCR loads with supplies available to them under design conditions and assumes that transportation customers' usage will be in balance with their nominations.

The Attorney General explains that the storage component in transportation rates compensates MGU for the storage costs necessary to provide monthly load balancing. Thus, the Attorney General says, transportation customers obtain what they pay for in base rates and do not confer any benefit on GCR customers. If MGU believes that transportation rates provide too much compensation and in effect subsidize storage costs belonging to sales customers, the Attorney General says, the solution is to file a rate case.

A basic premise of the definition of the booked cost of gas in both Act 304 and MGU's GCR clause is that gas costs should be recovered through the GCR factor only if they were actually incurred to supply gas to GCR customers. As recognized in MGU's tariffs, transportation customers do not pay the GCR factor because they procure their own gas supply. MGU did not incur the disputed portion of the overrun charges to supply gas to GCR customers, but it did so as a

consequence of the actions of transportation customers during the first six days of February 1996. MGU's responsibility under Act 304 to ensure an adequate supply of gas for GCR customers does not mean that it may charge them for the demands placed on its system by non-GCR transportation loads.

MGU's deployment of an integrated system to provide both transportation and sales service is not a justification for recovering the pipeline overrun charges from GCR customers. As originally developed, MGU's local distribution system provided service to all of the retail end-use customers connected to it. With the advent of unbundled transportation service in the mid-1980s, the primary change in the operation of the system was that MGU relinquished the responsibility for procuring the gas supply for that portion of its load switching to unbundled service. However, the introduction of transportation services and rates did not materially change the types or scale of efficiencies and customer benefits that MGU had previously achieved by combining the loads of all retail customers (and which it continues to achieve by serving both types of customer on an integrated system). Instead, setting rates became a process of allocating system costs between sales and transportation customers in proportion to the demands they place on the system and the benefits they receive from it.⁶ Consequently, it is not accurate for MGU to say that transportation customers confer a benefit on GCR customers by paying rates that offset GCR customers' cost of service. Transportation customers' allocation of storage costs covers the services that MGU provides in the form of load balancing. Sales customers pay for their own allocated share of storage costs in their base rates.

⁶For the history of the development of unbundled transportation service and rates, see the April 20, 1989 order in Case No. U-8788.

MGU's position would effectively shift costs to a subset of customers that did not cause them to be incurred or otherwise receive the tangible benefit of using the gas. Residual costs of providing transportation service cannot be booked to the GCR cost of gas simply because there is no other provision in rates for recovering them. If MGU believes that its rates are not adequate to recover some types of costs, that is a matter appropriate to address in a rate case.

If, as MGU claims, the taking of unauthorized pipeline gas was necessary to maintain system pressure and reliability in February 1996, the only benefit for GCR customers (apart from their use of 5,693 MMBtu of the overruns on February 2) was common to all customers connected to the system. GCR pass-through of the \$56,930 portion of the charges fully resolves the question of how to apportion the cost responsibility for the overrun charges. Cost responsibility for the remaining charges cannot be assigned to customers who did not consume the gas or cause the overruns to occur.

Although MGU claimed otherwise, the September 12, 1996 order in Case No. U-10982, MGU's GCR plan case, is consistent with the Commission's determination in this reconciliation that GCR customers' cost responsibility does not encompass overrun charges incurred to maintain service to transportation customers. In the order, the Commission rejected a proposed revision to MGU's GCR clause to permit the recovery of overrun charges, stating: "As currently drafted, MGU's GCR clause permits reimbursement of overrun charges if the utility establishes that such charges were incurred as a result of reasonable and prudent management decisions." Order at 9. However, the Commission did not address the issue in the context of transportation customers, but it focused on GCR-related overruns. The scenario described by MGU in the plan case was that it might rely on "additional options, including the unauthorized taking of gas from a pipeline, to avoid an interruption of gas service to its GCR customers." Id. at 8.

For these reasons, the Commission reaches the conclusion that the unauthorized pipeline overrun charges caused by the usage of transportation customers during the first six days of February 1996 is not a cost of gas sold to GCR customers within the meaning of Act 304. Similarly, the overrun charges were not appropriately booked as a cost of gas under MGU's GCR clause, nor did they benefit GCR customers, as required to avoid the cost exclusion for contract or tariff penalties. Therefore, the Commission adopts the disallowance proposed by the Staff.

The determination that the overrun charges were not a booked GCR cost makes it unnecessary to evaluate the parties' arguments relating to whether MGU's actions or omissions in February 1996 were reasonable and prudent. However, one of the issues raised by the Staff is noteworthy. The evidence in this case is persuasive that, at a minimum, MGU's relationship with MG Ventures acted as a disincentive against actively seeking measures to discourage excess usage on the part of transportation customers. Overruns that may have been caused or aggravated by an affiliate relationship are a serious concern because they have the potential to distort the competitive marketplace for unbundled gas services and to subsidize an affiliate with preferential treatment that comes at the expense of other MGU customers. Reconciliation issues created by the dealings of a public utility with an unregulated affiliate warrant a more searching level of scrutiny and impose a commensurately greater burden on the party seeking to demonstrate the fairness of affiliate dealings.

Of the \$718,851 in disputed unauthorized overrun charges that MGU incurred in February 1996, \$146,961 were not billed or booked until March 1997. In accordance with the recommendation of the Staff, the partial settlement in this case carried the charges booked in 1997 forward to the 1997 GCR plan year. In the January 6, 1999 order in Case No. U-11192-R, MGU's 1997 GCR reconciliation case, the Commission approved a settlement agreement, which states that overrun

charges booked in 1997 that have not otherwise been accounted for are \$58,961.⁷ The settlement provides that these charges will be treated in the manner specified in this order for the unauthorized overrun charges booked in 1996.

Because MGU's 1997 GCR reconciliation was concluded in Case No. U-11192-R, the next available proceeding for rolling in the disallowances and adjustments required by this order is Case No. U-11542-R, MGU's 1998 GCR reconciliation. Attachment A to this order computes the roll-in required by this order, including the adjustment discussed in note 1. Attachment A also computes the effect of the overrun charges booked in March 1997 in accordance with the provisions of the settlement in Case No. U-11192-R. The net effect of the roll-in is a reduction in GCR costs of \$755,970, which includes interest up to January 1, 1998.

In its final exception, MGU argues that the ALJ erred in denying its motion to strike the supplemental testimony of Staff witness William G. Aldrich. MGU argues that Mr. Aldrich's prefiled testimony was without adequate foundation, irrelevant, and speculative.

MGU's challenges are not so much claims that Mr. Aldrich's statements lack probative value, but instead they dispute the accuracy or validity of his statements. The Commission does not agree that Mr. Aldrich's testimony lacks relevance in the sense that the word is used in MRE 401 and finds that the ALJ properly admitted the testimony.

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.; 1982 PA 304, as amended, MCL 460.6h et seq.;

⁷\$146,961 booked charges in March 1997, less \$88,000 supplier nonperformance penalty.

MSA 22.13(6h) 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 AACCS, R 460.17101 et seq.

b. The unauthorized pipeline overrun charges remaining in dispute after the partial settlement approved in the Commission's September 30, 1997 order should be disallowed.

c. The ALJ properly admitted Staff witness Aldrich's supplemental prefiled testimony.

THEREFORE, IT IS ORDERED that:

A. The unauthorized pipeline overrun charges remaining in dispute after the partial settlement agreement approved in the Commission's September 30, 1997 order are disallowed.

B. UtiliCorp United Inc., d/b/a Michigan Gas Utilities, shall roll the overrecovery balance computed in Attachment A to this order into its 1998 GCR reconciliation 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, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ John G. Strand
Chairman

(S E A L)

/s/ David A. Svanda
Commissioner

By its action of April 12, 1999.

/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

By its action of April 12, 1999.

Its Executive Secretary

In the matter of the application of)
MICHIGAN GAS UTILITIES for a gas cost)
recovery reconciliation proceeding for the)
12-month period ended December 31, 1996.)
_____)

Case No. U-10982-R

Suggested Minute:

“Adopt and issue order dated April 12, 1999 disallowing certain unauthorized pipeline overrun charges in the gas cost recovery reconciliation filed by UtiliCorp United Inc., d/b/a Michigan Gas Utilities, for 1996, as set forth in the order.”