

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)	
MICHIGAN CONSOLIDATED GAS COMPANY)	Case No. U-13898
for authority to increase its rates and for other relief.)	
_____)	

In the matter of the application of)	
MICHIGAN CONSOLIDATED GAS COMPANY)	Case No. U-13899
for approval of depreciation accrual rates and other)	
related matters.)	
_____)	

At the September 29, 2009 meeting of the Michigan Public Service Commission in Lansing, Michigan.

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

OPINION AND ORDER

History of Proceedings

On September 30, 2003, Michigan Consolidated Gas Company (Mich Con) filed an application, with supporting testimony and exhibits seeking a general rate increase in the annual amount of \$193.6 million in Case No. U-13898. As part of its application, Mich Con requested authority to recover in rates its share of a control premium¹ paid by its parent company, DTE

¹A control premium is the additional acquisition premium paid to “take control” of a business and is calculated as the difference in the purchase price of the company to be acquired and its market value immediately before the acquisition was announced. 7 Tr 936.

Energy Company (DTE), for the purchase of MCN Energy Group (MCN). DTE paid an aggregate amount of \$2.488 billion for MCN, including a total acquisition premium of \$1.478 billion² over the depreciated original cost of MCN of \$1.01 billion. Of this total premium, DTE paid an initial acquisition premium³ of \$585 million and an additional control premium of \$893 million. DTE allocated 28% (\$250 million) of the \$893 million control premium to its subsidiary Mich Con and assigned 66% to The Detroit Edison Company (Detroit Edison), another DTE subsidiary. Detroit Edison and Mich Con did not ask for rate recovery of any portion of the acquisition premium. The Commission denied Detroit Edison's request to recover its share of the control premium in its November 23, 2004 order in Case No. U-13808 (November 23 order). Detroit Edison appealed.

On April 28, 2005, the Commission issued an opinion and order (April 28 order) in these consolidated cases that authorized Mich Con to increase its revenues by \$60.76 million. The Commission denied recovery of the control premium for Mich Con, as it had done in Detroit Edison's case.

On June 17, 2005, Mich Con filed a petition for rehearing in which it argued, among other things, that the Commission should authorize recovery of its portion of the MCN control premium. On July 19, 2005, the Commission issued an order in which it approved the company's revised off-system transportation rates but otherwise denied Mich Con's petition for rehearing.

²In Case No. U-13898, Mich Con claimed that the total control premium was \$1.7 billion. 2 Tr 287-288.

³An acquisition premium is "the amount paid above 'book cost' or 'depreciated original cost' to acquire utility property previously devoted to public service." June 29, 1990 order in Case No. U-9323, p. 19. The term "acquisition premium" is used interchangeably to describe the premium paid for plant, stock, or both; however, the term "control premium" refers specifically to a stock purchase premium and an "acquisition adjustment" specifically describes a plant purchase premium.

On August 18, 2005, Mich Con filed a claim of appeal with the Court of Appeals in Docket No. 264556. On July 3, 2007, the Court of Appeals issued its opinion in Detroit Edison's appeal of the November 23 order. *See, Attorney General v Public Service Comm*, 276 Mich App 216; 740 NW2d 685 (2007), *rev'd in part, aff'd in part on other grounds*, 483 Mich 993 (2009) (Court of Appeals' decision). The Court determined that the Commission had erred in disallowing Detroit Edison's recovery of its share of the control premium, holding:

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

Attorney General v Public Service Comm, 276 Mich App 235-236.

On August 15, 2007, the Commission and several other parties to Case No. U-13808 filed applications for leave to appeal the Court of Appeals' decision to our Supreme Court. On September 19, 2008, leave to appeal was granted.

On August 7, 2007, while the Commission's application for leave to appeal the Court of Appeals' decision was pending before the Supreme Court, Mich Con filed a motion with the Court of Appeals for peremptory reversal of the April 28 order. Mich Con argued that because the only issue in its appeal was the Commission's decision to deny recovery of the MCN control premium and because the Court had reversed the Commission on this issue in the Detroit Edison case, Mich Con was entitled to peremptory reversal under MCR 7.211(C)(4) and MCR 7.215(J)(1). On September 6, 2007, the Court of Appeals ordered, "in lieu of deciding the motion for peremptory reversal, the opinion and order of the MPSC is VACATED and this case is REMANDED to the

MPSC for reconsideration in light of *Attorney General v Pub Service Comm.*” The Court did not retain jurisdiction.

On May 1, 2009, the Supreme Court reversed the Court of Appeals on the control premium issue. Our Supreme Court held, “The Court of Appeals did not give due deference to the PSC’s findings of fact and Edison failed to meet its burden [to show by clear and satisfactory evidence that the order of the commission complained of is unlawful or unreasonable]. Accordingly, we reinstate the PSC’s decision excluding the control premium costs from Edison’s general rates.” *Attorney General v Public Service Comm*, 483 Mich 993; 764 NW2d 272 (2009) (Supreme Court decision). On June 26, 2009, the Court denied Detroit Edison’s motion for reconsideration. *Attorney General v Public Service Comm*, 483 Mich 1120; 766 NW2d 872 (2009).

On June 1, 2009, Mich Con filed a Motion for Commission Decision and Remand for Control Premium Recovery and a supporting brief. On June 18, 2009, Attorney General Michael A. Cox (Attorney General), the Association of Businesses Advocating Tariff Equity (ABATE), and the Commission Staff (Staff) filed responses to Mich Con’s motion.

Positions of the Parties

Mich Con argues that in the September 7, 2007 remand order, the Court of Appeals “left MichCon’s rates intact and remanded for the Commission to develop new rates on reconsideration. The Court’s order did not give the Commission a blank slate to reconsider other rate case issues. The remand was simply for reconsideration of a further rate increase for MichCon, based on the existing record, in light of *In re Application of Detroit Edison Co.*” Mich Con’s brief, pp. 1-2. Mich Con argues that because the Court of Appeals did not retain jurisdiction, the Court’s intent was to reverse the Commission’s findings on the control premium issue and remand the case for a rate increase to cover some or all of the control premium expense. Citing *Consumers Power Co v*

Public Service Comm, 78 Mich App 581, 585-86; 261 NW2d 10 (1977), Mich Con asserts that, “If the Court thought that the Commission could support its refusal to allow a control premium recovery by MichCon, then the Court would have remanded this case to the Commission for a supplemental opinion, and retained jurisdiction.”

Mich Con argues that the Supreme Court’s decision was based only on the record in that case and that the holding left intact the majority of the Court of Appeals’ decision. Mich Con claims that the Court of Appeals’ decision reversed the Commission on three alternative grounds: 1) “the decision ignored the substantial savings that resulted from the acquisition and merger, and, by denying recovery of the cost of the investment, denied Edison its right to earn a reasonable rate of return on its investment in providing service;” 2) “the PSC failed to apply the ‘net benefit’ standard it articulated in a previous case for determining whether Edison should be allowed to recover control premium costs;” and 3) “the PSC’s decision is not supported by competent, material, and substantial evidence on the whole record.” According to Mich Con, only the third finding was reversed by the Supreme Court decision.

Mich Con notes that the two justices dissenting from the Supreme Court decision opined that “no one disputes that Edison may attempt to substantiate savings in its next general rate case to recover a portion of the control premium.” Mich Con asserts that because the Supreme Court’s decision does not preclude Detroit Edison from obtaining recovery of the control premium under the remaining standards in the Court of Appeals’ decision in pending and future rate cases, Mich Con is also entitled to obtain control premium recoveries in this case and future rate cases. According to Mich Con, “The record in this case fully substantiates net savings for MichCon’s customers, and therefore compels a control premium recovery[.]”

Mich Con argues that the April 28 order was unlawful and unreasonable because the company fully substantiated that its customers have received a net benefit through lower costs resulting from the MCN acquisition. Mich Con provided a summary of its direct and rebuttal evidence from the record in the case that it claims shows a clear net benefit to Mich Con customers resulting from the DTE merger with MCN. Nevertheless, according to Mich Con, the Commission failed to apply the “well established and binding” net benefits test to the evidence in the instant case. Mich Con’s brief, p. 11. Citing *In re Complaint of Consumers Energy Co*, 255 Mich App 496, 501; 660 NW2d 785 (2002), Mich Con asserts that the Commission may not deviate from its own rules to achieve a desired result in a particular case.

Mich Con also argues that, “The Commission was inconsistent when it first recognized merger cost savings with respect to the Guardian Building and Customer Information System (and reduced customers’ rates for these merger cost savings by not allowing MichCon to recover its prudent long-term investments in these assets), but then asserted that it did not believe there were any merger cost savings (and therefore refused to allow MichCon’s recovery of its portion of the control premium costs were incurred to produce overall cost savings).” Mich Con’s brief, p. 14. Mich Con adds that the Commission’s recognition of savings, while failing to recognize associated costs, violates the due process rights of utilities.

Finally, Mich Con argues that, contrary to the Staff’s position, Mich Con’s control premium recovery should not be reduced for MCN’s tax losses and should include amortization of the control premium principal. According to Mich Con, there was no basis for the Staff to assume a connection between the tax losses and the merger control premium. Mich Con asserts that because MCN’s book value already reflected the value of the tax losses, these losses were also reflected in MCN’s market value. Mich Con maintains that the Staff’s proposal to exclude any amortization of

the control premium is also inappropriate, since the record demonstrates significant and permanent cost reductions, including the net reduction of over 800 employees. Mich Con adds that its proposed 40-year amortization is fully supported by the record and in accordance with decisions by other state regulatory commissions. Mich Con requests that the Commission act with “all due speed” to comply with the Court of Appeal’s September 6, 2007 remand order and issue a decision on the amount and timing of Mich Con’s control premium recovery.

In response to Mich Con’s motion, the Staff argues that the Supreme Court’s decision concerning the control premium recovery directly affects this case. The Staff points out that although the Court of Appeals remanded Mich Con’s case for reconsideration “in light of” its decision in the Detroit Edison case, the Supreme Court’s decision reversed that part of the Court of Appeals’ ruling. The Staff adds that the Commission denied Mich Con’s request for control premium recovery for some of the same reasons that it denied Detroit Edison’s request. According to the Staff, the Commission could issue another order denying Mich Con’s request for recovery of the MCN control premium confident that appellate courts would uphold that order. If, however, the Supreme Court alters or amends its order on reconsideration, it may have unintended consequences in the Mich Con case if the Commission issues an order on remand before the Supreme Court’s decision on Detroit Edison’s motion for reconsideration. The Attorney General concurs that Mich Con’s motion should be held in abeyance until the Supreme Court addresses Detroit Edison’s motion.⁴

ABATE notes that the Commission has already taken the position that the Supreme Court’s decision did not leave intact any part of the Court of Appeals’ decision on the control premium issue.

⁴The Staff’s and the Attorney General’s replies to Mich Con’s motion were filed on June 18, 2009, a week before the Court denied Detroit Edison’s motion for reconsideration.

ABATE argues that, contrary to Mich Con's claims, the evidence did not support the company's request for recovery of its portion of the control premium. ABATE points to testimony by its expert witness that showed that the part of Mich Con's expenses that were expected to decrease as a result of the merger, actually increased at a rate above inflation after the merger.

ABATE contends that the Commission essentially found that Mich Con failed to meet its burden to show that the benefits of the merger outweighed the cost of the control premium and that the Supreme Court agreed. ABATE adds that although the Supreme Court did not specifically address the "independent legal grounds" for authorizing control premium recovery for Mich Con (or for Detroit Edison in future rate cases) it was not necessary for the Court to do so. According to ABATE, all of its alleged bases for reversing the Commission (e.g., that the Commission ignored the synergy savings and that the Commission failed to apply the net benefits standard to the record) were evidentiary matters "clearly and inextricably intertwined with that Court's determination as to whether the Commission's determination was supported by competent, material, and substantial evidence on the entire record." ABATE's reply brief, p. 7. ABATE argues that "The Supreme Court obviously recognized, when granting leave on the issue of whether the Commission's U-13808 Order was supported by competent, material, and substantial evidence on the whole record, that its determination on that issue would resolve all issues relating to the control premium, as it did." ABATE's reply brief, p. 8.

Discussion

The Commission finds that Mich Con's motion should be granted and that the relief requested should be denied.

As Mich Con correctly points out, the Commission held in abeyance the remand from the Court of Appeals, awaiting final resolution of the control premium issue first decided in

Case No. U-13808. Our Supreme Court reversed the Court of Appeals' decision on the control premium issue in its entirety and reinstated the Commission's decision, holding that the Commission properly excluded recovery of the control premium from Detroit Edison's rates. Essentially, the Supreme Court held that Detroit Edison failed to show that the Commission's order was unlawful or unreasonable, a long-standing requirement for challenging a Commission order:

Appellate review of PSC orders is narrow in scope. All rates, fares, regulations, practices, and services prescribed by the PSC are deemed prima facie to be lawful and reasonable. MCL 462.25. The party attacking an order of the PSC bears the burden of proving by clear and satisfactory evidence that the order is unlawful or unreasonable. MCL 462.26(8). A decision of the PSC is unlawful when it involves an erroneous interpretation or application of the law and it is unreasonable when it is unsupported by the evidence. *ABATE v. PSC*, 219 Mich. App. 653, 659, 557 N.W.2d 918 (1996). To the extent that the decision is based on findings of fact, the challenger must show that those findings are not supported by competent, material, and substantial evidence on the whole record. *Id.* This Court gives due deference to the administrative expertise of the PSC, and will not substitute its judgment for that of the PSC.

Worldcom Network Services, Inc v Public Service Com'n, 255 Mich App 361, 365; 661 NW2d 611 (2003).

Mich Con argues that the order on remand from the Court of Appeals, specifically the fact that the Court did not retain jurisdiction, requires the Commission to provide some recovery of the control premium in this case. Mich Con's sole support for this argument is the Court of Appeals' decision in *Consumers Power Co, supra*. The Commission finds that Mich Con's reliance on this decision is not well taken. In *Consumers Power Co*, the Commission failed to provide sufficient detailed findings of fact in its order to permit the Court to determine "if the Commission's ruling was supported by competent, material and substantial evidence on the whole record." *Consumers Power Co, supra*, p. 585. In contrast, the April 28 order discussed the evidence, both in favor of and against control premium recovery:

In Mich Con's view, the yearly control premium amount to be included in customer rates is substantially less than the cost-saving synergies that Mich Con's ratepayers enjoy because of the merger. All of these purported savings are based upon Mich Con's subjective valuations of related costs and the company's projections of future events. Mich Con's witness, Daniel G. Brudzynski, its Vice President and Controller, testified regarding the ratepayer benefits that flow from the merger. He testified that upon the merger, the combined companies immediately achieved operating synergies through economies of scale and scope, the combination of its corporate headquarters and staff, and the leveraging of its contiguous and overlapping service territories; these synergies improved customer satisfaction and increased efficiencies of the combined companies' workforce. Much of these purported synergies were achieved through a "shared services" approach and the overwhelming majority of this value was created by centralizing staff and combining the two separate, yet overlapping, electric and gas staff functions. This staff combination was achieved through an early retirement option and a voluntary resignation offer, resulting in a net reduction of 811 employees. Moreover, Mr. Brudzynski testified, the combined companies achieved lower information technology costs and combined supply chain operations.

Based on the company's projections and assumed costs, Mich Con states that it achieved at least \$18.6 million in labor and benefit cost savings during 2002, and the company projects that these labor and benefit cost savings will increase to at least \$24.8 million by the 2005 test year. Exhibit A-13, Schedule H-1 contains an extensive listing of Mich Con's projected O&M cost savings for the test year and the four years preceding the test year. Mich Con argues that the projected level of O&M cost savings for the test year—\$24.8 million—is above its proposed \$24.4 million control premium expense; thus, benefits to ratepayers substantially exceed costs to ratepayers and the Commission must allow the company to recover the control premium.

ABATE argues that Mich Con's ratepayers are not receiving net benefits from the merger. ABATE does not separately quantify each changed O&M expense. Rather, ABATE argues that even considering the possible merger synergies, Mich Con's net O&M expense from the 2002 historical base year to the 2005 test year is escalating at 2.15% per year, which is above the projected rate of inflation. [See, Exhibit I-91; 4A Tr 1356 - 1358.] ABATE states that the merger does not provide Mich Con's ratepayers with benefits that one would reasonably expect; controllable O&M expense should be declining, not increasing at a rate in excess of inflation. Given this state of affairs, ABATE argues that it is unreasonable to include the control premium when calculating Mich Con's test-year rates. The Attorney General supports ABATE's position.

In its brief and reply brief, the Staff argued that the control premium, itself, should be lower than that proposed by Mich Con. In the Staff's view, approximately \$160 million in MCN tax losses utilized by DTE during the period

of 2001 through 2003 should be treated as a reduction in the price paid by DTE for MCN. This has the effect of lowering the control premium allocated to Mich Con, and lowering the amount of control premium expense that would appear in the test year to approximately \$11 million, net of taxes. The Staff would not amortize the balance over 40 years as proposed by Mich Con, arguing that this type of amortization in [sic] not consistent with [Financial Accounting Standard] FAS No. 142. The Staff noted that substantial customer confusion and dissatisfaction occurred as a result of the combination of the Mich Con and Detroit Edison customer billings system and that the Commission opened an investigation into allegations of poor customer service quality by both Mich Con and Detroit Edison. [See, 2 Tr 315-322, and the record in Case No. U-13287.] The Staff noted that the net reduction of the number of employees produced many of the purported central staff synergies; however, after the initial reduction in employees, the companies' employee count has increased. In the Staff's view, because of employee productivity losses, Mich Con's projected merger-related savings are overstated for 2004 and beyond. The Staff would allow its reduced control premium level to be recovered from ratepayers.

The ALJ did not adopt the Staff's position. Rather, he determined that overall the net benefits purported to flow to ratepayers from the merger did not eclipse the costs asked to be borne by them. In its exceptions, the Staff supports the ALJ's elimination of the control premium expense from the test year.

April 28 order, pp. 56-61.

The Commission then made findings of fact based on the evidence in the record:

After review of the testimony, exhibits, and arguments, the Commission is simply not persuaded that the alleged benefits flowing to Mich Con's ratepayers outweigh the costs that Mich Con seeks to recover through the test-year control premium amortization expense—even at the Staff's reduced level. Mich Con's exhibits and testimony attempt to solidify the projected cost savings related to the "synergies" flowing from the combined and reduced staffs and operations of the two utilities. However, the Commission finds that the projected numbers depend upon assumptions of employee counts, labor and benefit expenses, and continued gains in employee productivity that may or may not happen. Telling is the company's admission that much of the initial "synergy" savings was created by staff early retirements and voluntary resignations—the company states that it right-sized itself into a lean, cost-efficient utility. [2 Tr 280.] However, the employee count soon needed to increase—and in the Commission's view, it is doubtful that the alleged cost savings will continue at the rate projected by the company. Mich Con testified that the labor force in the companies' centralized customer service departments is higher now than it was for the total of the two companies before the merger. [2 Tr 215.] The Commission finds speculative the quantitative data and cost data underlying Mich Con's projections of merger-related synergy savings.

The Commission also finds persuasive ABATE's argument that regardless of the synergies alleged by Mich Con, the company's controllable O&M expenses have grown in excess of the rate of inflation, which is counterintuitive to any conclusion that the merger results in net benefits to Mich Con's ratepayers. Additionally, ratepayer benefits are not only measured in cost savings, they are measured in customer service quality as well. It cannot be properly argued that the transition to combined billing went smoothly; Case No. U-13287 was begun due to the deluge of complaints received by the Commission from Mich Con and Detroit Edison customers. For all of these reasons, the Commission finds that the benefits projected by Mich Con to flow to its ratepayers due to the merger of DTE and MCN do not outweigh the cost of the acquisition premium expense requested to be recovered by Mich Con in the 2005 test year. Accordingly, the Commission finds that the test year should not include such an expense.

April 28 order, pp. 62-63.

Unlike the circumstances in *Consumers Power Co*, the Court of Appeals did not remand this case because the April 28 order lacked discussion of the evidence supporting the Commission's decision, but on the basis of the Court of Appeals' decision in the Detroit Edison case, a decision that was subsequently reversed by the Supreme Court.

Next, Mich Con argues that the Supreme Court's decision was based only on the record in that case and that the Supreme Court's decision left intact the Court of Appeals' finding that the Commission's order was "unlawful and unreasonable" because, "the decision ignored the substantial savings that resulted from the acquisition and merger, and, by denying recovery of the cost of the investment, denied Edison its right to earn a reasonable rate of return on its investment in providing service. Second, the PSC failed to apply the 'net benefit' standard it articulated in a previous case for determining whether Edison should be allowed to recover control premium costs." Mich Con's brief, p. 4, citing 276 Mich App, pp. 237-238. According to Mich Con, only the portion of the Court of Appeal's decision that found that the Commission's decision was not based on competent, material, and substantial evidence on the whole record was reversed by the Supreme Court's decision.

The Commission disagrees with this interpretation of the Supreme Court's holding. As ABATE points out, the issues concerning the purported savings resulting from the MCN merger or the application of the net benefits test are evidentiary ones that were subsumed into the Supreme Court's holding that Detroit Edison failed to meet its burden to show that the Commission's decision was unreasonable because it was not supported by the record. As discussed above, there was sufficient testimony in the record to effectively rebut Mich Con's claims regarding "synergy savings" resulting from the MCN merger.

Finally, Mich Con points to language in the dissenting opinion that the company claims supports its contention that it may raise the control premium issue in future Detroit Edison or Mich Con rate cases. The Commission disagrees that any support can be found in the dissent from the Supreme Court's decision noting that language from a dissenting opinion is "neither precedential nor binding." *Rohde v Ann Arbor Public Schools*, 265 Mich App 702, 707; 698 NW2d 402 (2005).

The Commission finds that Mich Con's remaining arguments concerning the Staff's proposed reduction in control premium recovery due to MCN's tax losses and the company's proposed amortization period are moot in light of the above conclusions.

THEREFORE, IT IS ORDERED that:

A. Michigan Consolidated Gas Company's motion for Commission decision on remand for control premium recovery is granted.

B. The April 28, 2005 order in Case Nos. U-13898 and U-13899 authorizing Michigan Consolidated Gas Company to increase its annual gas revenues by \$60,756,000 and denying its request to collect a control premium for DTE Energy Company's acquisition of MCN Energy Group is reaffirmed.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, under MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

Orjiakor N. Isiogu, Chairman

Monica Martinez, Commissioner

Steven A. Transeth, Commissioner

By its action of September 29, 2009.

Mary Jo Kunkle, Executive Secretary