

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)	
MICHIGAN CONSOLIDATED GAS COMPANY's)	Case No. U-13342
2001 income sharing calculation.)	
_____)	

At the May 18, 2004 meeting of the Michigan Public Service Commission in Lansing,
Michigan.

PRESENT: Hon. J. Peter Lark, Chair
Hon. Robert B. Nelson, Commissioner
Hon. Laura Chappelle, Commissioner

OPINION AND ORDER

I.

HISTORY OF PROCEEDINGS

On March 29, 2002, the Michigan Consolidated Gas Company (Mich Con) filed its 2001 income sharing calculation as provided for in the April 28, 1998 order in Case No. U-11682 and the related performance standards adopted in the October 12, 1998 order in Case No. U-11782. Mich Con's filing reflected a return on equity that was less than the return necessary for income sharing to occur, consequently, Mich Con asserted that no income sharing with its customers was necessary.

Subsequently, the Commission Staff (Staff) filed a request for a hearing. The basis of the Staff's request was an apparent dispute with the company over the proper treatment of a 2001 pipeline refund. The Staff docketed a series of letters between Mich Con and the Staff concerning

the issue. According to the Staff, Mich Con included the pipeline refund in its earnings sharing calculation while the Staff asserts that the refund should be refunded to Mich Con's sales and transportation customers through Mich Con's standard refund procedures. By order dated July 10, 2002, the Commission granted the Staff's request for a hearing and directed Mich Con to file a refund methodology in the event that a refund is ordered. Under protest, Mich Con filed a methodology on August 14, 2002.

A prehearing conference was held on August 28, 2002 before Administrative Law Judge Daniel E. Nickerson, Jr. (ALJ). In attendance were Mich Con, the Staff, the Association of Businesses Advocating Tariff Equity (ABATE), and Attorney General Jennifer M. Granholm (Attorney General).¹ At the conference, ABATE's and the Attorney General's interventions were granted.

On October 31, 2002, the Staff and Mich Con filed a settlement agreement permitting Mich Con to retain 50% of the pipeline refund and return the remaining 50% to customers. The Attorney General and ABATE each filed objections to the settlement on November 14, 2002 arguing that the refund, in its entirety, should be returned to customers, with interest.

After further discussions, the contested settlement was withdrawn. Consequently, the Staff abandoned its settlement position to share the pipeline refund 50/50 with Mich Con. The Staff's position in the contested proceeding is that the entire pipeline refund should be returned to customers.

On March 13, 2003, Mich Con filed its rebuttal testimony and a hearing was held for purposes of cross-examination on April 24, 2003. All parties to the proceeding filed their initial briefs on

¹On January 1, 2003, Michael A. Cox succeeded Ms. Granholm as Attorney General.

May 15, 2003. The Attorney General filed its reply brief on May 28, 2003. All remaining parties filed their reply briefs on May 29, 2003.

The ALJ issued his Proposal for Decision (PFD) on July 24, 2003. The Staff filed its exceptions to the PFD on August 4, 2003. The Attorney General and Mich Con filed their exceptions on August 6, 2003. ABATE did not file exceptions. All parties to the proceeding, however, filed replies to exceptions on August 20, 2003.

II.

POSITIONS OF THE PARTIES

The Staff

The Staff argues that on December 28, 2001, Mich Con received a refund from Panhandle Eastern Pipeline Company (Panhandle) in the amount of \$765,742.34 that should be returned to Mich Con's sales and transportation customers. The refund is the result of a September 13, 2001 order in the Federal Energy Regulatory Commission Docket No. RP98-40-028, directing the pipeline refund of Kansas ad valorem taxes covering the period of October 3, 1983 through June 28, 1988. The Staff believes that the refund should have been addressed in a separate proceeding under Mich Con's tariff Rule B11, Refund Procedure.

The Staff admits that a pipeline refund would typically be treated as a reduction to the cost of gas sold in the month in which it was received. Staff Initial Brief, p. 3. However, the Staff argues, that because Mich Con's gas cost recovery (GCR) clause was suspended during December 2001, when the Kansas ad valorem tax refund was received, the proper treatment of the funds are subject to Mich Con's Rule B11. Rule B11 states in relevant part:

During the suspension period, pipeline or other supplier refunds or charges shall be reflected as adjustments to the Cost of Gas Sold in the month received, unless the refunds or charges are applicable to periods prior to January 1, 1999,

and pursuant to Michigan Public Service Commission Staff review, become an issue in a separate proceeding before the Commission. The Company will comply with Commission orders regarding the allocation and disposition of pipeline refunds or charges included in separate proceedings and any other refunds or charges.

The Staff believes that the exception in Rule B11 applies and the Staff has properly made the refund allocation an issue before the Commission. The Staff is concerned that under Mich Con's proposal, ratepayers would not receive the pipeline refund because Mich Con would retain the entire refund to help offset 2001 operating losses.

The Staff recommends that Mich Con refund the full amount of \$765,742.34 to Mich Con's current GCR and transportation customers based upon the methodology set forth in Mich Con's August 14, 2002 filing, updated to reflect 2001 calendar year data. The Staff recommends using 2001 as a proxy period for purposes of allocation because the historical refund period is very old and the amount of the refund is small. For convenience, and to reduce administrative costs, the Staff further recommends that the amount due to GCR customers be rolled into Mich Con's 2002 GCR plan year and treated as a reduction to the cost of gas sold as of January 1, 2002, the same way that Mich Con refunded the Kansas ad valorem tax in Case No. U-11455-R. The Staff recommends that the amount due to transportation customers should be retained in Mich Con's refunds pending account until the balance is significant enough to warrant a refund. Until that time, the Staff states that Mich Con should continue to accrue interest on the funds at Mich Con's return on equity rate of 11.5%. Of paramount importance to the Staff is that the full amount of the refund be returned to customers rather than retained by the company since it was the customers that were ultimately overcharged by the Kansas ad valorem tax from 1983 through 1988.

Mich Con

Mich Con asserts that the December 28, 2001 refund in question was received during the period that the GCR clause was suspended and therefore the amount should be treated as an offset to the cost of gas sold. Consequently, Mich Con treated the Kansas ad valorem tax refund as an adjustment to its cost of gas in the month received and reflected it as such in its 2001 income sharing calculation. Mich Con further asserted that it did not have earnings subject to sharing, meaning that no portion of the Kansas taxes paid by Mich Con's customers would be returned to them.

Mich Con admits that the refund is applicable to a period prior to 1999 and that the Staff requested a review under Rule B11. Mich Con, however, denies that there is anything in the Commission's order in Case No. U-11682, suspending Mich Con's GCR clause, or in Mich Con's Rule B11, that requires it to refund this money to its customers. Rule B11 only indicates that the Commission will determine the allocation and disposition of the refund. With that said, Mich Con argues that "the law of this case must be determined from prior Commission orders that have addressed pipeline refunds." Mich Con Initial Brief, p. 3.

Mich Con argues that Commission orders have approved the disposition of pipeline refunds in a manner consistent with the regulatory process in place at the time the company received the refund. By way of example, Mich Con asserts that in 1986 it received a pipeline refund applicable to a time when Mich Con did not have a GCR clause, but nevertheless allocated and distributed the refund under the GCR regulatory process in place at the time the refund was received. Mich Con Initial Brief, fn. 2, citing, Case No. U-8038-R. Moreover, Mich Con's witness testified that Mich Con, before, during, and after the GCR clause suspension period, always booked the cost of gas sold amount in the month it was received. Mich Con argues that there is no evidence to suggest

that the Commission's order suspending Mich Con's GCR clause, or its Rule B11, changed this approach.

Mich Con is also quick to point out that receipt of a pipeline refund by the utility does not mean that ratepayers will receive a refund. Mich Con characterizes the Staff's position as inappropriately assuming that this refund must be returned to ratepayers and failing to consider any offsetting pipeline charges. Mich Con asserts that this is contrary to long-standing Commission treatment of pipeline refunds.

Mich Con argues that the income sharing mechanism was the regulatory process in place at the time the refund was received. Consequently, the refund should be reflected in Mich Con's 2001 income sharing filing. Mich Con argues that the income sharing mechanism properly incorporated the value of the refund along with other factors that offset the refund, resulting in no refund to its customers. Mich Con argues that this process is entirely consistent with Commission precedent.

Additionally, Mich Con argues that if the Commission applies the GCR process to determine the disposition of this refund, it must consider other offsetting charges and credits and consider the long-term effects of such a policy. Mich Con is critical of the Staff's position arguing that the Staff is only recognizing the refund part of the equation. For instance, Mich Con contends that its witness testified that there were payments made to pipelines during the GCR clause suspension period that pertained to periods prior to the suspension but were booked in the month in which those costs were paid. Mich Con Brief, pp. 5-6. Mich Con argues that the refund should be offset by these payments, at least \$129,000 worth, and that only the net amount should be refunded to customers. If any netted amount exists, Mich Con supports the use of the refund methodology proposed in its August 14, 2002 filing.

Mich Con, however, cautions against this approach. Not only would this approach break with long-standing precedent, Mich Con argues, but it would also create significant administrative burdens. Mich Con contends that, to be consistent, rather than applying credit or charges to the booked cost of gas sold in the month received, all supplier invoices pertaining to the GCR clause suspension period would need to be tracked and reflected as adjustments to Mich Con's net income. Mich Con argues that the long-standing method has worked well and, absent evidence that the new process is reasonable, should not be changed.

Attorney General

The Attorney General argues that the entire pipeline refund should be returned to customers, with interest. The Attorney General contends that the facts and the law support this conclusion. Relying largely on authority presented in a 1985 Michigan Attorney General Opinion, the Attorney General asserts that the law supports a strong public policy that pipeline refunds should be passed along to the utility customer that paid the higher rate and that the utility is merely a conduit for funds belonging to the customer. Attorney General Brief, pp. 7-8, citing, OAG 1985 No. 6315, p. 153, August 27, 1985. Additionally, the Attorney General provided a number of examples where this Commission in previous cases approved the refund of the Kansas tax to customers either by application or settlement agreement. Id., p. 9, citing, Cases Nos. U-13257, U-12123-R, and U-12889.

The Attorney General contends that the only "equitable distribution" of the refund is to return it to Mich Con's customers. Id., at p. 12. To not do so, the Attorney General contends, would be a windfall to the company at the customers' expense.

The Attorney General also takes issue with Mich Con's position that the refund should be offset by other pipeline charges that were booked during the GCR clause suspension period but

applied to time periods prior to the suspension. The Attorney General argues that Mich Con admitted that it failed to notify the Staff pursuant to the Rule B11, Refund Procedure, about any other refunds or charges received during the GCR clause suspension but pertained to periods before the suspension. Consequently, the Attorney General contends, Mich Con waived any claim to offsets. Id., pp. 12-13. Additionally, because Mich Con has failed to conduct the research necessary to identify all such refunds and charges that would fit into this category, the Attorney General argues that Mich Con has failed to present all the information necessary to support its position on offsets. The Attorney General also contends that Mich Con failed to make any mention of offsets in its proposed refund methodology that it was required to file prior to the hearing.

Lastly, the Attorney General asserts that the Commission should grant a further hearing on the issue of an interest penalty. The Attorney General contends that Mich Con's witness admitted that he believed there are other refunds and/or charges that were booked during the suspension period that pertained to periods prior to the suspension, however, he never saw any other notice being provided to the Commission. The Attorney General argues that under the Rule B11, Refund Procedure, a failure by the company to report a refund by the prescribed deadline shall result in an interest penalty of 50% over the authorized rate of return on common equity. Thus, the Attorney General contends, Mich Con admitted to violating Rule B11 and, therefore, further hearing is warranted.

ABATE

ABATE contends that the appropriate and lawful treatment of the pipeline refund is to return it to Mich Con's customers, with interest. ABATE argues that it was Mich Con's customers who paid the Kansas tax and therefore they should get it back. To allow Mich Con to keep the funds,

ABATE argues, would be against the law, against the public interest, in violation of Mich Con's tariff, and would constitute unjust enrichment.

ABATE contends that refunds made to a utility by one of its suppliers is the property of the utility's ratepayers. ABATE's Brief, p. 4, citing, 18 ALR2d 1343. ABATE argues that Michigan has followed this rule and cites a 1945 case involving Consumers Power Company where the Commission held that impounded funds were the property of the ultimate customers of natural gas and that the utility had no proprietary interest in them. Id., citing, In Re: Consumers Power Co, 61 PUR NS 257, 260 (1945). ABATE contends that other courts have followed this principle as well. Id., pp. 5-6.

To allow Mich Con to reflect the refund in its 2001 income sharing calculation, ABATE argues, would constitute unlawful and unjust enrichment of Mich Con. ABATE contends that the pipeline refund represents restitution for contributions to the Kansas tax. Allowing Mich Con to keep these funds would represent conversion of property. Consequently, ABATE believes that Mich Con should return these funds to customers as restitution, based on a quasi-contractual theory, to ensure that justice is obtained.

Finally, ABATE asserts that Mich Con's tariff requires that the Commission make a determination about the proper distribution of the refund. Referring to Rule B11, Refund Procedure, ABATE contends that because the refund pertained to periods prior to January 1, 1999, the monies should not have been unilaterally applied to the cost of gas sold in the month received by Mich Con. ABATE agrees with the Staff recommendation to refund the full amount of the refund, plus interest, to Mich Con's current sales and transportation customers using the methodology set forth in the August 14, 2002 filing, updated to reflect 2001 calendar year data for both sales and transportation customers.

III.

PROPOSAL FOR DECISION

The ALJ agreed with the Staff, the Attorney General, and ABATE and recommended that the Commission order Mich Con to refund \$765,742.34, plus interest, to its current sales and transportation customers. The ALJ further recommended that Mich Con refund the monies to customers using the methodology set forth in its August 14, 2002 filing.

After providing a brief history of the Kansas ad valorem tax, the ALJ reasoned that there would be little disagreement about the proper treatment of this pipeline refund if the refund occurred while the GCR clause was in effect. “The proper treatment undoubtedly would require MichCon to distribute the pipeline refund to its customers.” PFD at p. 8.

By order dated April 28, 1998, the Commission approved an application that suspended Mich Con’s GCR clause for a three-year period. In implementing the suspension, Mich Con’s Rule B11, Refund Procedure, was modified for the suspended GCR clause period. As modified, Rule B11 stated, in part, “[D]uring the suspension period, pipeline or other supplier refunds or charges shall be reflected as adjustments to the Cost of Gas Sold in the month received, *unless the refunds or charges are applicable to periods prior to January 1, 1999.*” (Emphasis added).

The ALJ found that the modified Rule B11 “was inserted to ensure MichCon customers received proper credit for pipeline refunds covering periods prior to the GCR clause suspension-period; regardless of when the actual refund was received.” PFD at p. 8. The ALJ found that while Mich Con received the pipeline refund at issue in 2001, during the GCR clause suspension period, the refund covered the period between 1983 and 1988. Consequently, the ALJ determined that the exception in Rule B11 applied and the refund should have been submitted to the Commission for proper allocation.

The ALJ further examined Commission precedent to determine the proper treatment of the pipeline refund. The ALJ relied upon the 1945 case involving Consumers Power Company, *In Re Consumers Power Company*, 61 PUR NS 257 (1945), whereby the Commission had to make a determination about the allocation of certain monies from Panhandle. In that case, the Commission determined that the money belonged to the ultimate customers of the gas utility company and that neither the pipeline nor the local distribution company had any proprietary interest in the funds. Id.

The ALJ found the underlying legal principle espoused in the Consumers case to be persuasive and recommended a similar outcome. He believes that the pipeline refund belongs to Mich Con ratepayers and not Mich Con itself. The ALJ further noted that this is consistent with the accepted general rule of utility law stating that a refund made to a utility by one of its suppliers of good or services represents the property of the utility's ratepayers. PFD at p. 11, citing, 18 ALR2d 1343 and *In Re Consumers*, supra.

Exceptions to the PFD were filed. While nevertheless agreeing with the conclusion of the PFD, the Staff filed a short document clarifying some of the facts as they appeared. The Attorney General also agreed with the ALJ's conclusion but excepted to the fact that the PFD did not address any interest penalty against Mich Con for failing to follow Rule B11, Refund Procedure. Mich Con's exceptions, however, were more numerous. Mich Con took issue with the facts as presented in the PFD, as well as the application of law. Mich Con also took issue with the fact that the PFD does not consider Mich Con's evidence of offsetting charges.

IV.

DISCUSSION

After a thorough review of the record, the Commission is persuaded that Mich Con should refund the \$765,742.34 pipeline refund, plus interest, to its current sales and transportation customers.² The Commission believes that Mich Con appropriately notified the Staff about the refund, and that the Staff appropriately made the allocation of the refund an issue before the Commission pursuant to Mich Con's Rule B11, Refund Procedure. As such, it is left to the Commission to determine the proper treatment of these funds.

The Commission finds that the modified Rule B11 was intended to provide an opportunity to consider the proper treatment of pipeline refunds that pertained to time periods prior to Mich Con's GCR clause suspension. While typically pipeline refunds are reflected as adjustments to the cost of gas sold in the month received, the modified Rule B11 creates an opportunity for the Commission to apply an exception to this general principle. Rule B11, by its own terms, foresaw the possibility of Mich Con receiving pipeline refunds during the GCR clause suspension that pertained to prior periods. In accounting for this, the rule expressly provides the Commission an opportunity to conduct a proceeding and direct the allocation of the refund. Based upon the facts of this case, the Commission finds that an exception to the general principle is warranted.

² Today, the Commission issued an order in a similar proceeding involving Consumers Energy Company (Consumers), Case No. U-12752-R. The Commission likewise found that the entire Kansas tax refund should be returned to customers despite Consumers' arguments that the Commission's May 22, 2000 decision in Case No. U-12227 should control. In Case No. U-12227, the Commission agreed to a 50/50 sharing of a Kansas tax refund between Consumers and its customers at a time when the utility did not have a GCR mechanism in place with which to make the refund. In that proceeding, however, the Commission approved a settlement agreement that, by its own terms, cannot be relied upon as having any precedential value in subsequent proceedings.

If Mich Con is permitted to apply the pipeline refund as an adjustment to the cost of gas sold in the month received, a month when Mich Con's GCR clause was suspended, Mich Con's customers would not benefit from this refund. The Commission finds that this would be an unjust and unreasonable result. It was Mich Con's customers, not Mich Con, who overpaid for natural gas due to the imposition of the Kansas tax. It should be Mich Con's customers, not Mich Con, who benefit from the return of those monies. Consequently, the Commission directs Mich Con to make the refund to its sales and transportation customers.

The Commission, however, is persuaded that an offset to this refund is appropriate as argued by Mich Con. During its testimony, Mich Con identified two supplier charges made during the GCR clause suspension period that applied to time periods prior to the suspension totaling \$129,000. Rule B11, Refund Procedure, speaks not only to refunds, but also to supplier charges. While the rule only requires notice to the Staff of supplier refunds, the rule permits charges to become an issue in a separate proceeding before the Commission as well. Mich Con made these charges an issue in this proceeding. Mich Con, however, chose not to conduct an exhaustive review of its records to identify all such potential charges. Mich Con's failure was at its own peril. The Commission stated in its order setting this matter for hearing that "all issues necessary to effectuate those refunds be addressed in the hearing." July 10, 2002 order, Case No. U-13342, p. 2.

Nevertheless, Mich Con did present limited evidence of pertinent supplier charges booked during the GCR clause suspension that pertained to time periods prior to the GCR clause suspension. As a matter of fairness, if the Commission is going to allocate refunds to customers who overpaid for natural gas prior to the GCR clause suspension, the Commission should allocate similar charges to customers who likewise underpaid. The Commission finds that Rule B11

encompasses this possibility and directs the Panhandle refund to be offset by the \$129,000 worth of supplier charges presented by Mich Con.

Lastly, the Commission is not persuaded that an interest penalty is warranted. As discussed above, the Attorney General contends that Mich Con's witness admitted that there are other "credits and/or charges" similar to the Kansas tax refund that went unreported, and that this constitutes a violation of Rule B11. The Commission notes, however, that Rule B11 only mandates the reporting of pipeline or other supplier refunds to the Staff. There is no similar requirement for charges. Consequently, if Mich Con's witness is correct that only "charges" were not reported, Mich Con would not be in violation of Rule B11, and no interest penalty is warranted. If, however, supplier refunds were not reported, the Commission would consider this a violation of Rule B11. The Commission understands that in some instances suppliers choose to distribute refunds through bill credits and if such credits were not reported to the Staff during the GCR clause suspension period, the Commission will deem it a violation of Rule B11 and penalty interest will apply.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCL 462.2 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1999 AC, R 460.17101 et seq.

b. Mich Con should refund to its sales and transportation customers the \$765,742.34 Panhandle refund, with interest, as offset by the \$129,000 in supplier charges identified by Mich Con in its direct testimony.

c. Mich Con should make the refund in accordance with its August 14, 2002 filing in this proceeding, updated to reflect 2001 calendar year data.

d. The amount due to GCR customers should be rolled into Mich Con's 2004 GCR plan year and treated as a reduction to the cost of gas sold as of January 1, 2004, the same way that Mich Con refunded the Kansas ad valorem tax in Case No. U-11455-R.

e. The amount due to transportation customers should be retained in Mich Con's refunds pending account until the balance is significant enough to warrant a refund. Until that time, Mich Con should continue to accrue interest on the funds at Mich Con's return on equity rate of 11.5%.

THEREFORE, IT IS ORDERED that:

A. Michigan Consolidated Gas Company shall refund to its sales and transportation customers the \$765,742.34 Panhandle Eastern Pipeline Company refund, with interest, as offset by the \$129,000 in supplier charges identified by the company in its direct testimony.

B. Michigan Consolidated Gas Company shall make the refund in accordance with its August 14, 2002 filing in this proceeding, updated to reflect 2001 calendar year data.

C. The amount due to gas cost recovery customers shall be rolled into Michigan Consolidated Gas Company's 2004 gas cost recovery plan year and treated as a reduction to the cost of gas sold as of January 1, 2004.

D. The amount due to transportation customers shall be retained in Michigan Consolidated Gas Company's refunds pending account until the balance is significant enough to warrant a refund. Until that time, Michigan Consolidated Gas Company shall continue to accrue interest on the funds at its return on equity rate of 11.5%.

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
issuance and notice of this order, pursuant to MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ J. Peter Lark

Chair

(S E A L)

/s/ Robert B. Nelson

Commissioner

/s/ Laura Chappelle

Commissioner

By its action of May 18, 2004.

/s/ Mary Jo Kunkle

Its Executive Secretary

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.

MICHIGAN PUBLIC SERVICE COMMISSION

Chair

Commissioner

Commissioner

By its action of May 18, 2004.

Its Executive Secretary

In the matter of the application of)
MICHIGAN CONSOLIDATED GAS COMPANY's)
2001 income sharing calculation.)
_____)

Case No. U-13342

Suggested Minute:

“Adopt and issue order dated May 18, 2004 directing Michigan Consolidated Gas Company to issue a refund to its sales and transportation customers, as set forth in the order.”