

STATE OF MICHIGAN
COURT OF APPEALS

MICHIGAN GAS UTILITIES,

Plaintiff-Appellant,

v

MICHIGAN PUBLIC SERVICE COMMISSION,

Defendant-Appellee,

and

ASSOCIATION OF BUSINESSES
ADVOCATING TARIFF EQUITY,

Appellee.

UNPUBLISHED

February 9, 1999

No. 206234

Public Service Commission

LC No. 00-010960

Before: Fitzgerald, P.J., and Holbrook, Jr. and O'Connell, JJ.

PER CURIAM.

Plaintiff Michigan Gas Utilities, Inc. (MGU) appeals as of right from the opinion and order of the Public Service Commission (PSC) setting rates for MGU's sales of natural gas to its customers in southwestern Michigan. We affirm.

The facts in this case are undisputed. MGU is an operating division of UtiliCorp United, Inc., and is a public utility engaged in the sale, transportation, and distribution of natural gas. MG Ventures, Inc., is also a subsidiary of Utilicorp and an affiliate of MGU. MG Ventures engages in exclusively non-regulated activities, which include propane operations, merchandising, appliance repair service, gas brokering and storage, and administrative services.

MG Ventures operates an appliance repair program known as the "Assured Comfort Protection Program," which was later changed to "Security Guard." At the hearing, PSC staff asserted that MGU provided training to its own employees at a cost of \$110,000, but that only \$9,000 of these costs was charged to MG Ventures, for whom the employees performed appliance repair work. The hearing referee found as fact that the rates charged by MGU to MG Ventures were not adequate to

cover the cost of the training and excluded the difference, or \$101,000, from the operations and maintenance expenses claimed by MGU. In addition, increased revenues received from MG Venture's Service Guard program were attributed to MGU, less \$70,000 for materials and parts.

The hearing referee also adopted the PSC staff position that MG Ventures' net income from gas brokering and administrative services was attributable to MGU. All these functions were performed by MGU employees using MGU resources and facilities. The administrative services involved meter reading, bill preparation, postage, and various other costs. Although MGU sought a rate increase of \$10,547,752, the hearing referee issued a proposal for decision recommending that the PSC authorize a rate increase of only \$2,077,000.

The PSC adopted the hearing referee's decision with regard to his conclusions that the deduction for training expenses and addition of "the net revenues from administrative services, gas brokering, and appliance repair services" The PSC determined that

. . . there is no real separation between MGU and MG Ventures for purposes of these services. MG Ventures does not have its own employees for these services, but carries out business through the use of MGU's employees, who charge the time spent on nonregulated activities to MG Ventures. MG Ventures relies upon the marketing, accounting, administrative, computer operations, and gas supply services of MGU and . . . appear[s] to have no facilities separate from MGU. The advertising bill inserts for the Assured Comfort Program display MGU's logo. Customers are recruited through MGU, and MGU employees perform the vast majority of these services.

The PSC did not, however, consider profits and losses from business activities that were unrelated to the utility, such as MG Ventures' propane operations. Finally, because MGU had not timely provided PSC staff with the financial information necessary to make the adjustment, the PSC rejected MGU's claim that the amount of its investment in MG Ventures' assets was improperly excluded from the rate base.

This Court's review of PSC decisions is limited. All rates, fares, charges, classifications and regulations of the PSC are deemed to be prima facie lawful and reasonable. MCL 462.25; MSA 22.44. On appeal from a decision of the PSC, the utility "has the burden of proving by clear and satisfactory evidence that the PSC's decision is unlawful or unreasonable." *Midland Cogeneration Venture Ltd Partnership v Public Service Comm*, 199 Mich App 286, 313; 501 NW2d 573 (1993), citing MCL 462.26(8); MSA 22.45(8). "A decision of the PSC is unlawful when it involves an erroneous interpretation or application of law, and unreasonable when it is unsupported by the evidence." *Midland Cogeneration, supra* at 313. Although the PSC's factual findings must be supported by competent, material and substantial evidence on the whole record, its rate setting is reviewed for an abuse of discretion. *Id.* at 314-315; *Great Lakes Steel Division of National Steel Corp v Public Service Comm*, 130 Mich App 470, 487; 344 NW2d 321 (1983).

MGU argues in essence that any time the PSC takes income from an unregulated affiliate into account in setting rates, the result is a rate that affords the utility less than a reasonable return on its

investment and is therefore confiscatory. It is worth noting that MGU cites no Michigan cases in support of this proposition, and does not challenge the PSC's factual findings that MG Ventures' operations were being financed in part by MGU, and that MG Ventures had no employees or facilities of its own and relied on MGU's workforce and resources. It is well established that the PSC has broad discretion in determining the allowable expenses that utilities may recover from their ratepayers, and that a utility's financial relationship to, and transactions with, its affiliates may be taken into account in setting rates. As this Court held in *Midland Cogeneration*, *supra* at 314, "When setting rates, the PSC is not bound by any particular formula or method in determining what is just and reasonable, but has broad discretion to determine the factors relevant to its analysis and to make adjustments as necessitated by the particular circumstances of a given case." In a passage particularly applicable to the instant case, this Court stated as follows:

It is well recognized that expenses incurred in transactions between utilities and their affiliates deserve special scrutiny, given the potential lack of arms-length bargaining and improper subsidization of the affiliate's unregulated operations through the utility's rates. The PSC need not assume that the fees charged to a utility by its affiliate are fair, and the utility has the burden of proving the reasonableness of its transaction with its affiliates. [*Id.* at 313-314, citing 64 Am Jur 2d, Public Utilities, § 187, pp 702-703; *Michigan Bell Telephone Co v Public Service Comm*, 85 Mich App 163, 168-169; 270 NW2d 546 (1978); *General Telephone Co v Public Service Comm*, 78 Mich App 528, 534; 260 NW2d 874 (1977)].

In this case, MGU has put forth no evidence to demonstrate the reasonableness of its actions. Because MGU failed to "come forward with some legitimate reason" for transferring its routine administrative activities and other intrinsic operations to MG Ventures, it failed to meet its burden of proof before the PSC. *Midland Cogeneration*, *supra* at 314.

MGU claims that *Midland Cogeneration* is inapplicable to this case because "[c]ustomers have not been charged for a cost or burden in this case and in fact, the PSC attributed \$101,000 of expenses to MG Ventures so that customers would not subsidize MG Ventures' appliance repair business." However, this argument fails to consider that, just as in *Midland Cogeneration*, the utility in this case was seeking to recover those expenses from its customers, and argued before the PSC that it should be able to recover those costs in the form of increased rates. But for the PSC's intervention, MGU's customers would have been subsidizing MG Ventures' appliance repair service.

MGU further contends that this case is distinguishable from *Midland Cogeneration* because the PSC in this case attributed income from certain of MG Ventures' operations to MGU, while in *Midland Cogeneration* the PSC simply disallowed a portion of the fees paid to the affiliate for debt collection services. This Court has not previously addressed the propriety of attributing an affiliate's income to a utility. However, in *Midland Cogeneration*, *supra* at 314, this Court stated that the PSC "is not bound by any particular formula or method" in setting rates, and "has broad discretion to determine the factors relevant to its analysis and to make adjustments as necessitated by the circumstances of a given case." It makes little difference whether a portion of the fees paid to the affiliate is disallowed or whether the profit from the affiliate is imputed to the utility, because the result

either way is to compensate for the utility's attempts to shift its profits to the affiliate to justify rate increases. As we have previously noted, MGU has provided no legitimate business reason for transferring portions of its intrinsic operations to MG Ventures.

Moreover, given the complete lack of separation between MGU and MG Ventures with regard to the included operations, the PSC's decision to impute a portion of MG Ventures' revenues to MGU was not unreasonable. Although MGU argues that the distinction between the corporate entities should not be disregarded in the absence of a showing of fraud or intent to deceive, this misconstrues the burden of proof in utility cases. The PSC does not have to prove fraud or other unlawful intent; rather, as we have stated, the utility has the burden of demonstrating that its transactions with its affiliate are reasonable. *Id.*

MGU next argues that the PSC improperly recognized only those portions of MG Ventures' business that operate at a profit. The PSC set forth a reasonable rationale for attributing income from only some of MG Ventures' operations and not others; only the net revenues from MG Ventures' operations that were integrally related to the utility were included, and income from operations unrelated to the utility was not considered. MGU's claim that the PSC attributed income only from profitable operations and ignored all operational losses is simply not supported by the record. MG Ventures' propane operations, which recorded a profit of \$41,409.67, was among the operations whose revenues were not included. Thus, MGU has not demonstrated that the PSC abused its discretion in this regard.

Similarly, MGU's assertion that the PSC failed to take into account expenses associated with MG Ventures' operations is also unsupported by the record. The PSC imputed only portions of MG Ventures' net revenues to MGU, which by definition exclude expenses, and also recognized \$70,000 in costs and parts in connection with the appliance repair service.

Finally, MGU contends that the PSC erred by failing to include the value of MGU's property investment in MG Ventures in the rate base calculation. In its order denying MGU's motion for rehearing, the PSC rejected this argument, stating as follows:

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. 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. [Citation omitted.]

MGU has provided no authority for the proposition that the PSC is required to conduct its own valuation of property that the utility insists should be included in the calculation of rate base; on the contrary, the burden of proof in this regard is on the utility. *Midland Cogeneration, supra* at 313, citing MCL 462.26(8); MSA 22.45(8). MGU has not met its burden of proving that the PSC's decision was unlawful or unreasonable where the PSC's refusal to consider the value of

MG Ventures' property was solely the result of MGU's failure to provide the information in a timely and understandable manner.

Affirmed.

/s/ E. Thomas Fitzgerald

/s/ Donald E. Holbrook, Jr.

/s/ Peter D. O'Connell