

STATE OF MICHIGAN
COURT OF APPEALS

MICHIGAN CONSOLIDATED GAS COMPANY,

Appellant,

v

MICHIGAN PUBLIC SERVICE COMMISSION,
ATTORNEY GENERAL, and MICHIGAN
COMMUNITY ACTION AGENCY
ASSOCIATION,

Appellees.

UNPUBLISHED
November 21, 2006

No. 262888
Michigan Public Service
Commission
LC Nos. 00-013060;
00-013060-R

Before: Whitbeck, C.J., and Sawyer and Jansen, JJ.

PER CURIAM.

This case concerns the accounting of the amount that appellant Michigan Consolidated Gas Company (MichCon) was permitted to recover from appellee Michigan Public Service Commission (MPSC) for gas that MichCon delivered to its customers in December 2001 but did not bill for until January 2002. MichCon sought to recover at the January rate of \$4.38 per thousand cubic feet (Mcf). The MPSC concluded that MichCon could only recover at the December 2001 fixed rate of \$2.95 per Mcf and, accordingly, issued an opinion and order concluding that MichCon had over-recovered its 2002 gas recovery costs by \$42,609,726, plus interest of \$1,458,366, for a total of \$44,068,091. MichCon appeals as of right. We affirm.

I. Basic Facts And Procedural History

A. Overview

The MPSC conducts annual gas recovery proceedings pursuant to MCL 460.6h, *et seq.* Usually, a gas cost recovery (GCR) rate is set anew at the beginning of every year and is used to charge consumers for gas during the year. The rate is based primarily on a utility's projection of anticipated costs. A reconciliation proceeding takes place at the end of the year to reconcile revenues with actual costs. If actual costs exceed revenues collected, then the utility is allowed to impose a surcharge. By contrast, when revenues exceed actual costs the utility must grant a credit or refund.

However, under a pilot program, MichCon's GCR rate was fixed for three years, from January 1999 through December 2001, and reconciliation proceedings did not take place for those years. This case involves the reconciliation proceeding for the following year, 2002. MichCon asserts that, consistent with generally accepted accounting practices and consistent with the MPSC's treatment of its billings in reconciliation proceedings dating back 20 years, MichCon's December 2001 gas deliveries, which it billed in January 2002 at the January 2002 GCR rate of \$4.38 per Mcf, should be compensated at the January 2002 GCR rate rather than the December 2001 fixed rate of \$2.95 per Mcf. Accordingly, MichCon claims that the over-recovery amount of \$42,609,726 should be adjusted downward by \$26.1 million. Appellees take the position that, because of the pilot program, this is an atypical situation and that the December 2001 deliveries should be compensated at the fixed rate, regardless of typical or past billing and accounting practices.

B. The 1999-2001 Pilot Program

On April 28, 1998, the MPSC issued an order approving MichCon's application for the voluntary experimental pilot program.¹ This pilot program included a 36-month (January 1, 1999 through December 31, 2001) GCR rate freeze at \$2.95 per Mcf. It also suspended MichCon's GCR clause for this same period, meaning that MichCon did not have to propose an annual GCR plan (the process that leads to establishment of the annual GCR rate) and that the annual reconciliation would not be conducted during this three-year period. The order also provided that the January to December 1998 GCR period would be subject to reconciliation as usual. The December 1998 unbilled revenues were billed in January 1999 at the fixed GCR rate. However, the 1998 revenues were subsequently reconciled.²

C. The 2002 GCR Rate

Because the pilot program was ending, a new GCR rate had to be established for the coming year, 2002. Thus, in August 2001, MichCon filed an application for approval of a GCR plan, five-year forecast and monthly GCR factor (rate).³ In the face of disputes about the amount of this rate and cognizant that MichCon needed a rate for its 2002 billings, the MPSC issued a temporary order, authorizing MichCon to implement a temporary GCR factor of no more than \$3.62 per Mcf for January 2002. The order authorized a GCR factor of no more than \$4.38 per Mcf for the remaining months of 2002. The lower rate for January reflected the MPSC's concern that ratepayers would face "rate shock" with a more significant jump in January. Notably, the MPSC stated:

Despite the numerous arguments presented by the parties regarding the treatment of unbilled revenues for volumes delivered in December 2001 but billed in January 2002, the [MPSC] concludes that this is not an appropriate issue for

¹ Case No. U-11682.

² Case No. U-11455-R.

³ Case No. U-13060.

determination in an order approving a temporary GCR factor. The issue involves the reconciliation of GCR revenues with gas costs, which will occur after the close of the GCR period. It would not be appropriate to prejudge that issue based on the record developed for consideration of the temporary factor. Accordingly, the [MPSC] will not make a determination of the unbilled revenue issue until the parties have had an opportunity to develop a record on that issue in the reconciliation case.

Additionally, the MPSC adopted MichCon's proposal that it be permitted to record a "regulatory asset" equal to the difference between \$4.38 and \$3.62, multiplied by the December 2001 unbilled volumes. The MPSC specifically stated that this temporary order "does not adjudicate any prudence or accounting issues that may arise during the GCR plan or the reconciliation factors" and that the temporary factor "is not indicative of any predetermination of the appropriateness of the GCR factor proposed by MichCon or of the arguments presented regarding unbilled revenues."

The Attorney General moved for rehearing. The MPSC granted rehearing on, among other issues, the grant of the regulatory asset. In a proposal for decision, the Administrative Law Judge (ALJ) concluded that, due to an under billing of approximately 480,000 customers in January, the January under-billed amounts were added to February bills, resulting in rate shock in February. Further, the ALJ concluded that there was an inadequate basis for granting the request to record a regulatory asset.

In February 2003, MichCon filed an application to reconcile its GCR revenues and expenses for January 1, 2002 through December 31, 2002.⁴ The MPSC then issued the opinion and order at issue in this case, addressing both Case No. U-13060 and Case No. U-13060-R. The MPSC summarized MichCon's arguments regarding unbilled revenues as follows:

MichCon argued that its December 2001 unbilled revenues should be treated the same as end of the year unbilled revenues have from the inception of its GCR clause. According to MichCon, the GCR factor in effect on the date a bill is *rendered* is applied to the entire bill, regardless of when the gas was actually consumed. MichCon maintained that its December 2001 unbilled revenues must therefore be priced at the January 2002 rate because nothing in its application in Case No. U-11682[, by which it sought approval for the three-year pilot program,] provided for a different treatment. In fact, the company noted that the treatment it proposed for its December 2001 unbilled revenues was the same approach approved in Case No. U-11455-R, its last reconciliation case prior to the rate freeze. Further, MichCon asserted that its December 1998 unbilled volumes were the first month of the 36-month period for the frozen factor billed at \$2.95 per Mcf so that November 2001 was the 36th month of the period. Therefore, if the December 2001 unbilled revenues are calculated using the \$2.95 factor, MichCon

⁴ Case No. U-13060-R.

would erroneously be forced to apply the fixed price for 37 months, contrary to the Case No. U-11682 application. In addition, MichCon stated that the December 2001 unbilled revenues have already undergone [MPSC] review pursuant to its 2001 annual income sharing reconciliation.^[5]

Regarding the unbilled revenues, the MPSC held:

MichCon contends it should recover \$4.38 per Mcf for the unbilled volumes while the [MPSC] Staff, the Attorney General, the [Residential Ratepayers Consortium] RRC, and the ALJ have all agreed that \$2.95 per Mcf is the appropriate amount. Though the specifics of managing the unbilled revenues at the close of the fixed-rate period was not specifically addressed in the Case No. U-11682 order [authorizing the pilot program], MichCon's interpretation that it only applied through November 2001 is contrary to the text of the order and the intent of the [MPSC]. The most persuasive and telling fact in this determination is MichCon's promise to assume risk for 36 months of gas purchases while the fixed rate was in effect. As the Staff, the Attorney General, and the RRC indicate, the December 1998 unbilled volumes were reconciled in the 1998 reconciliation case (Case No. U-11455-R) and all associated costs of gas were recovered therein. As a result, MichCon did not face any risk for these volumes, and its argument to the contrary is not well-taken. Further, MichCon's argument that 2002 income sharing proceedings brought the December 2001 revenues under [MPSC] review is also unpersuasive. Therefore, in order to comply with the requirements of Case No. U-11682, MichCon's December 2001 unbilled volumes must be calculated at \$2.95 per Mcf and the corresponding amount removed from 2002 revenues. Such determination obviates the need for reliance on a regulatory asset.

MichCon is not being ordered to alter its long-standing billing procedures or retroactively change the rate charged to customers. The [MPSC] is merely solidifying its intent in Case No. U-11682 that the \$2.95 per Mcf fixed rate applies to volumes consumed from January 1, 1999 through December 31, 2001 because that is the period MichCon was free of GCR rate regulation.

Regarding the propriety of the regulatory asset, the MPSC did not directly say whether there was an inadequate basis for granting it. However, the MPSC noted that although a regulatory asset "in most circumstances could be construed as providing sufficient probability of recovery," here, it was intended "as a temporary mechanism to allow MichCon to continue serving customers into 2002" while the record pertaining to the December 2001 unbilled revenues was being developed. The MPSC viewed the regulatory asset as "an integral part of the final outcome of the unbilled revenues issue in this reconciliation proceeding."

⁵ Case No. U-12893.

II. Recovery Of 2001 Unbilled Revenue

A. Standard Of Review

In *Attorney Gen v Michigan Pub Service Comm*, this Court stated:

The standard of review for PSC orders is narrow and well-defined. Pursuant to MCL 462.25, all rates, fares, charges, classification and joint rates, regulations, practices, and services prescribed by the PSC are presumed, *prima facie*, to be lawful and reasonable. A party allegedly aggrieved by an order of the PSC has the burden of proving by clear and satisfactory evidence that the order is unlawful or unreasonable. To establish that a PSC order is unlawful, the appellant must show that the PSC failed to follow a mandatory statute or abused its discretion in the exercise of its judgment. An order is unreasonable if it is arbitrary, capricious, or not totally supported by the evidence.

A final order of the PSC must be authorized by law and supported by competent, material, and substantial evidence on the whole record.

We defer to the PSC's administrative expertise, and will not substitute our judgment for that of the PSC. We give great weight to any reasonable construction of a regulatory scheme that the PSC is empowered to administer, but we may not abandon our responsibility to interpret statutory language and legislative intent. We do not afford the same measure of deference to an agency's initial interpretation of new legislation as we do to a longstanding interpretation. "Whether the PSC exceeded the scope of its authority is a question of law that we review *de novo*."^[6]

B. Statutory Authorization

Subsections 12 and 13 of MCL 460.6h require that revenues from customers for gas be annually reconciled with the utility's costs of buying that gas, by ordering a refund or credit if consumers paid too much, or by authorizing the utility to recover an additional amount if consumers paid too little. MichCon asserts that this refers only to revenues recovered and actual expenses for the given reconciliation year and that it does not authorize the MPSC to reconcile revenues recovered with gas delivered in a prior year, and more particularly in this case, December 2001. In other words, MichCon asserts that the MPSC was not authorized to use this reconciliation case to retroactively change the accounting practices applicable to the 2001 unbilled revenues. MichCon therefore maintains that the final order was not authorized by law.

MCL 460.6h(12) calls for reconciling "the revenues recorded pursuant to the gas cost recovery factor"—which would include the revenues collected for December 2001 using the

⁶ *Attorney General v Michigan Pub Service Comm*, 269 Mich App 473, 479-480; 713 NW2d 290 (2005) (citations omitted).

January 2002 GCR factor—“and the allowance for cost of gas included in the base rates established in the latest commission order for the gas utility with the amounts actually expensed and included in the cost of gas sold by the gas utility.” Typically, the revenues collected in January for December of a prior year would be addressed in the reconciliation proceeding for that prior year. Thus, when reconciliation takes place for the subsequent year, there is nothing left to reconcile for the prior year. In this case, however, there is an amount that needs reconciliation since, under the pilot program, there was no reconciliation for 2001, but revenues were collected in January 2002 for December 2001.

Notably, MCL 460.6h(12) also states: “The commission shall consider any issue regarding the reasonableness and prudence of expenses for which customers were charged if the issue could not have been considered adequately at a previously conducted gas supply and cost review.” Here, one could conclude that one issue regarding the reasonableness and prudence of actual expense for December 2001 was whether actual expense should control at all given the fixed rate. It follows that the MPSC did in fact have jurisdiction to entertain reconciling the January 2002 revenues recorded at \$3.62 per Mcf with the amounts actually spent in December 2001. In making that determination, the MPSC could conclude that the amounts actually spent did not control reconciliation since a fixed rate was in place for the period at issue. Viewed in this way, subsection 12 conferred authority on the MPSC to address the December 2001 unbilled revenues issue in the 2002 reconciliation proceeding.

C. Inconsistency And Modification

MichCon argues that the MPSC’s decision was inconsistent with its initial approval of the pilot program in that the MPSC never previously stated that unbilled revenues accounting practices would be changed. Thus, MichCon argues, the MPSC impermissibly modified the pilot program. We disagree.

This Court gives great weight to any reasonable construction of a regulatory scheme that the MPSC is empowered to administer.⁷ In this case, the MPSC’s treatment of the December 2001 unbilled revenues and its construction of the pilot program were reasonable. The MPSC approved a three-year pilot program in which MichCon was to freeze its rates for three years, 1999 to 2001. There was to be a reconciliation proceeding for 1998, but no reconciliation proceeding for the years 1999, 2000, or 2001. A reconciliation proceeding was held in 1999 to reconcile 1998 revenues and expenses. Thus, although MichCon originally billed ratepayers for 1998 December unbilled revenues at the fixed January 1999 rate, MichCon was not, in effect, compensated for December 1998 revenues at the fixed rate. Rather, the 1998 revenues and expenses were reconciled so that MichCon did not realize a profit or loss based on the price of gas for 1998.

Accordingly, the MPSC reasonably determined that January 1999 was effectively the first month in which the fixed rate applied. If the rate was to be fixed for three years, per the MPSC’s

⁷ *Attorney Gen., supra* at 479-480, citing *Champion’s Auto Ferry, Inc v Public Service Comm*, 231 Mich App 707-708; 588 NW2d 153 (1998).

approval of the pilot program, then the fixed rate would have to apply for a full three years, including the final month of that three-year period, December 2001. If MichCon were permitted to recover for December 2001 unbilled revenues at the higher, January 2002 GCR rate, it would not have to bear the risk of the fixed rate for a full three-year period, as it had proposed in its application for the pilot program and as the MPSC approved.

MichCon's assertion that the MPSC's treatment of unbilled revenues resulted in a modification of the pilot program is unfounded. There was some ambiguity in the application for and order approving the pilot program with respect to the unbilled revenues issue; but the MPSC did not change the pilot program. Rather, it merely construed what was intended regarding the December 2001 unbilled revenues when an issue arose. Construing the application and order adversely to a challenging party is not akin to altering the order.

D. Substantial, Competent, And Material Evidence

We also conclude that there was substantial, competent, and material evidence to support this treatment of the unbilled revenues. George R. Stojic, the Supervisor of the Tariff Section of the Competitive Energy Division of the MPSC, summarized the "unbilled revenue" issue as follows:

What has been called the unbilled revenue issue concerns the proper interpretation of the Commission's U-11682 order that granted Michigan Consolidated's (MichCon) request for a three year freeze of gas prices at \$2.95. MichCon interprets the U-11682 order as freezing gas prices at \$2.95 for all *billed* volumes between January 1, 1999 and December 31, 2001. Staff has interpreted the U-11682 order as freezing gas prices at \$2.95 for all *consumed* volumes. This would include all the billed volumes that MichCon has included plus volumes consumed in December, 2001, the last month of the three-year freeze, but not billed until January of 2002 ("the unbilled revenues").

Stojic went on to explain that the staff position was that "all volumes *consumed* during the three year freeze[, including December 2001 unbilled volumes,] should be priced at \$2.95 frozen factor." He stated:

The basis for Staff's position is MichCon's request in its U-11682 application. In that case, MichCon requested a three year GCR suspension and implementation [of] a frozen \$2.95 factor for that three year period. For the year prior to the three year freeze, 1998, MichCon was allowed full recovery of its full 1998 cost of gas. Therefore the only way to ensure that the frozen factor would be effective for the full three year period (January 1, 1999 to December 31, 2001) would be to apply the \$2.95 frozen factor to all volumes of gas consumed during that full three year period. Staff's position has been that the freeze should not be based on whether or not MichCon's billing system is able to bill its customers for gas consumed during the three year period before the three year period expires. In order to have a full three year freeze, it is necessary for the December 2001 gas consumption that is unbilled at the end of that month to also be billed at the frozen factor of \$2.95.

In its application, MichCon asserts that “Under the Plan’s fixed gas rate proposal, MichCon is at risk for all gas commodity costs during the three year experimental program” (pp 14 and 15 of the application). The term “all commodity costs” appearing in the application suggests that the U-11682 order addressed all consumed volumes, not just billed volumes. Without a full three year freeze, MichCon would not be at risk for all gas commodity costs during the three year experimental program. MichCon would only be at risk for gas commodity costs during the three year experimental program for those volumes in which its billing system had time to issue a bill. . . .

Stojic also noted that there was precedent for this position, in that with a similar program, Consumers Energy “recognized that in order to have the rate freeze be in effect for the full three years that the MPSC ordered, it would be necessary to continue to bill the frozen factor for gas consumed in the last month of its freeze but not billed until the first month following the freeze. Therefore, Consumers Energy extended its frozen factor for one month beyond the 36 month freeze.”

MichCon’s attempts to discredit this testimony as not compelling. MichCon takes issue with Stojic’s reliance on the phrase “MichCon is at risk for all gas commodity costs during the three year experimental Program,” which appeared in the pilot program application. Stojic looked to this phrase as authority for the conclusion that the three-year freeze should apply to consumed volumes, not billed volumes. MichCon asserts that this phrase appeared in a paragraph that had nothing to do with accounting for unbilled revenues. However, accounting was not mentioned in the application at all. The application indicated that MichCon would be at risk for three years for “commodity costs.” If the focus were on billing, as opposed to the cost of the commodity during those three years, and unbilled revenues were billed at a risk free January 2002 rate, MichCon would not have borne such a risk. Moreover, the “billed volumes” do not correlate with the “commodity costs” as directly as the consumed volumes. Thus, there is no reason to question the MPSC’s reliance on Stojic’s testimony as support for its conclusion.

MichCon also asserts that Stojic was not personally involved in the pilot program process and, therefore, could not have spoken to the parties’ intent at that time. It characterizes his testimony as “mere speculation.” However, Stojic’s testimony was based on documents that supported the staff’s determination of how unbilled revenues should be compensated. We conclude that this testimony was not speculative.

E. Tariff Rule B10(c)(3)

MichCon argues that the MPSC’s decision is inconsistent with the MPSC’s approval of tariff rule B10(c)(3). MichCon asserts that this rule required MichCon to bill all customers the same rate in January 2002 for gas consumed in December 2001 and gas consumed in January 2002. However, MichCon did in fact bill all its customers the same rate in January 2002. This case does not concern the January billings per se, but rather the reconciliation of revenues from that billing with amounts actually expensed for gas. MichCon does not explain why the tariff rule would or should have any impact on this reconciliation proceeding.

F. Regulatory Asset

MichCon argues that “the recording of a ‘regulatory asset’ essentially reflects a utility’s right to eventually obtain the amount recorded.” Here, the December 20, 2001, order allowed MichCon to record a regulatory asset to reflect the difference between the \$4.38 per Mcf it was to collect for the rest of 2002 and the \$3.62 per Mcf it was to collect in January, multiplied by the December 2001 unbilled volumes. We note that, with the January rate, the MPSC was apparently attempting to protect consumers from a rate shock based on the jump from the three-year fixed rate to \$4.38 per Mcf in a typically cold month. Its primary purpose in allowing the regulatory asset was to put MichCon on an even footing while the unbilled revenues issue was resolved. In the December 20, 2001 order, the Commission stated:

The Commission is cognizant of MichCon’s argument that the temporary rate being approved for January 2002 could have an impact on Mich Con’s recorded revenues in 2001. The Commission’s temporary factor determination for 2002 is not intended to have any impact on Mich Con’s recorded revenues or earnings in 2001. MichCon presented an alternative proposal in its brief that acknowledged the Commission could avoid such an impact by allowing Mich Con to recognize a regulatory asset This places Mich Con in the same position it would have been absent this temporary order, while still enabling customers of Mich Con to experience a more moderate rate change in January 2002.

The MPSC also stated in the temporary order that it was not adjudicating “any prudence or accounting issues that may arise during the GCR plan or the reconciliation factors,” and that the temporary factor “is not indicative of any predetermination of the appropriateness of the GCR factor proposed by MichCon or of the arguments presented regarding unbilled revenues.” If MichCon was to be put in the same position by the regulatory asset, and the temporary order creating it expressly stated that the issue of December 2001 unbilled revenues was being left open, there can be no error in the MPSC’s determination that the regulatory asset in this instance did not carry any assurances of collection in the event that the unbilled revenues issue was determined adversely to MichCon.

III. Conclusion

We conclude that the MPSC’s decision, allowing recovery for December 2001 unbilled revenues at the 1999 to 2001 fixed rate of \$2.95 per Mcf, was not unlawful or unreasonable.

Affirmed.

/s/ William C. Whitbeck

/s/ David H. Sawyer

/s/ Kathleen Jansen