

G-011/GR-92-132 ORDER DENYING RECONSIDERATION AND CLARIFYING
ORDER

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Don Storm	Chair
Tom Burton	Commissioner
Cynthia A. Kitlinski	Commissioner
Dee Knaak	Commissioner
Norma McKanna	Commissioner

In the Matter of the Petition of Peoples Natural Gas Company, a Division of UtiliCorp United, Inc., for Authority to Increase Its Rates for Natural Gas Service in the State of Minnesota

ISSUE DATE: June 11, 1993

DOCKET NO. G-011/GR-92-132

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PROCEDURAL HISTORY

On February 22, 1993, the Commission issued its FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER in the above-captioned matter. In that Order the Commission granted Peoples Natural Gas Company (Peoples or the Company) a general rate increase of \$5,044,589. The Commission accepted the Stipulation Agreement submitted by the parties and made findings on the remaining contested issues. On March 15, 1993, the Residential Utilities Division of the Office of the Attorney General (RUD-OAG) filed a request for reconsideration. The RUD-OAG sought reconsideration of two issues which had been contested by the parties, manufactured gas plant cost recovery and rate case treatment of unbilled revenues.

On March 25, 1993, the Department of Public Service (the Department) filed a reply in support of the RUD-OAG's position on manufactured gas plant costs.

Peoples filed its reply to the RUD-OAG's petition on March 26, 1993.

On April 2, 1993, the Commission issued its ORDER GRANTING RECONSIDERATION for the sole purpose of tolling the twenty day statutory deadline for reconsideration.

On April 28, 1993, the Company filed its base cost of gas and other compliance data as required in the February 22, 1993 Order.

The Commission met to consider the merits of the RUD-OAG's petition for reconsideration on May 20, 1993.

FINDINGS AND CONCLUSIONS

I. Manufactured Gas Plant Cost Recovery

A. The February 22, 1993 Order

In the February 22, 1993 rate case Order, the Commission agreed with the Administrative Law Judge (ALJ) that Peoples' final share of remediation costs for the Rochester manufactured gas plant (MGP) site was a legitimate utility expense, potentially recoverable in rates. The Commission allowed Peoples to record the costs in a deferred debit account until the Company's next general rate case. In that future rate case the Commission will examine the reasonableness and prudence of all remediation expenditures, both initial testing and assessment costs and final remediation costs. Expenditures which are reasonable and prudent will be recovered in rates.

B. Positions of the Parties

1. The RUD-OAG

The RUD-OAG raised four arguments in support of its request for reconsideration of the MGP cost recovery issue. First, the RUD-OAG argued that the Commission had failed to address its own past precedent when it allowed the Company recovery of MGP costs. The RUD-OAG cited a previous Northern States Power Company (NSP) rate case¹ decision, in which the Commission allowed recovery of MGP remediation costs, even though the polluted property was no longer owned by NSP at the time of the rate case. The Commission allowed NSP recovery because the land was used and useful at the time the pollution occurred. The RUD-OAG argued that the Commission failed to address this precedent when it allowed Peoples recovery of MGP costs which had been incurred before the property was owned by Peoples.

The RUD-OAG also argued that the Commission erred when it linked the issue of Company negligence with the concept of "used and useful" in its analysis of the MGP site. The RUD-OAG stated that negligence, or lack of prudence, and a finding that property was not used and useful are separate and alternative grounds for denial of recovery.

¹ In the Matter of the Petition of Northern States Power Company for Authority to Change Its Schedule of Gas Rates for Retail Customers Within the State of Minnesota, G-002/GR-85-282, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (December 30, 1985).

The RUD-OAG restated its claim that Utilicorp, Peoples' parent company, may have paid a reduced price for the subject property in 1985, when it purchased Peoples. The RUD-OAG claimed that Utilicorp may have been aware of potential remediation liability at that time and either assumed the risk in the purchase or received compensation through a reduced purchase price.

Finally, the RUD-OAG stated that the present use of the property as a parking and storage facility is unrelated to the past pollution of the property when it was an MGP facility. From this fact the RUD-OAG drew the conclusion that Peoples' liability was a risk of land ownership which should be borne by shareholders, not ratepayers.

2. Peoples

Peoples argued that the Commission's decision is not inconsistent with prior Commission precedent. In both the NSP case and the present case, the Commission allowed recovery of statutorily imposed costs placed on the utility's property.

Peoples disagreed with the RUD-OAG's assertion that the Commission improperly linked the concepts of negligence and used and useful. According to Peoples, the Commission found that the Company was not negligent and that the property was used and useful utility property.

Peoples stated that the RUD-OAG's arguments regarding the purchase price of the property are factually deficient and that they do not provide a basis for reconsidering the initial Order.

3. The Department

The Department supported the RUD-OAG in its argument regarding the use of the NSP case as precedent. According to the Department, the NSP case requires that a utility seeking recovery of MGP costs must demonstrate that the land was used and useful at the time the pollution occurred.

C. Commission Analysis

1. The Use of Commission Precedent

The RUD-OAG argued that the Commission ignored its own precedent, specifically the December 30, 1985 NSP rate case decision, when it allowed Peoples recovery of MGP costs.

In the NSP case, the Company sought recovery of costs for the investigation, monitoring and cleanup of a coal gasification plant site formerly owned and operated by NSP. At the time of the rate case, the property was no longer owned by NSP and was under development by the City of Faribault as a park.

In the NSP case the Commission noted that it is often difficult to anticipate changes in environmental laws which will require eventual site clean-ups. Although it would be ideal to match ratepayer use perfectly with clean-up costs, such symmetry is often impossible. The Commission found a sufficient nexus between the past costs incurred and present ratepayers from the fact that the property had been used and useful at the time the pollution of the land occurred. Because the clean-up costs were tied to the normal provision of utility service and the property was used and useful in the provision of that service, the MGP clean-up costs were recoverable in rates.

The NSP case therefore stands for the finding that utilities are entitled to recover statutorily imposed cleanup costs which are assessed against utility property which has been found used and useful in the provision of utility service. The NSP property had been sold by the Company prior to the rate case and could therefore not be found used and useful to current ratepayers. The Commission, however, found sufficient support for recovery in the fact that the property had been used and useful at the time of pollution. This finding in no way precludes recovery in the Peoples case, where the property is found currently used and useful in utility service to the ratepayers who will pay the costs of cleanup. The facts in Peoples actually support recovery more clearly than do the facts in NSP.

The Commission finds that the RUD-OAG's arguments based on the NSP case precedent do not warrant reconsideration of the Commission's decision on MGP cost recovery.

2. Negligence and Used and Useful Standards

The RUD-OAG argued that the Commission had improperly mixed the concepts of the utility's prudence and the usefulness of the land when it stated the following in the initial Order:

The ALJ found, and the record shows, that the land at issue has been used and useful for utility purposes since it went into rate base in 1948. Normally, the inquiry would end there; there would be no doubt that expenses arising from ownership of the land (property taxes, special assessments, insurance premiums) are recoverable in rates. Because remediation expenses are so extraordinary, however, and so clearly linked to earlier land uses, it is at least initially attractive to apply the "used and useful" test to the land at the time the need for remediation was created. At that time, the land was not used and useful for Peoples' ratepayers.

In the absence of negligence on the part of the utility, however, this is fundamentally unfair. There are valid state and federal statutes placing clean-up responsibilities on current landowners, whether or not they owned the land when the pollution requiring remediation occurred. These responsibilities flow from land ownership alone. To treat remediation costs differently from other costs related to current land ownership would be result-driven and contrary to general ratemaking principles.

Order at pp. 9-10.

From this passage the RUD-OAG concluded that the Commission was abandoning a two-part requirement that the land be found used and useful in utility service and that the utility be found non-negligent in its use of the land. According to the RUD-OAG, the Commission was stating in this passage that recovery is appropriate, regardless of usefulness, as long as no negligence occurred.

The Commission finds that this strained reading of the initial Order does not raise an issue justifying reconsideration. The Commission made it clear throughout the Order that the utility property was used and useful and that there was no finding of imprudence or negligence on the part of the utility. Since both the used and usefulness test and the prudence test were clearly satisfied in this case, any confusion on the part of the RUD-OAG seems misplaced.

The initial Order makes clear that the Commission found the subject property used and useful for utility service:

the land at issue has been used and useful for utility purposes since it went into rate base in 1948. The land itself clearly meets the used and useful test, and it has for 40 years.

The Historical and Factual Background section of the initial Order at pp. 7-8 clearly supports a finding that the Company was not negligent in its ownership of the subject property. The Commission explains the common use of manufactured gas plants in the United States "from the early 1800's until natural gas pipelines ended the need for them." The Commission notes that Peoples bought the property in 1948, when it was in use not as a manufactured gas plant site but as a parking and storage facility. The Commission points out that the EPA did not inform Peoples until 1987 that there was potential pollution liability connected with the site. Remediation was not formally required until 1990.

The history of the site, as explained by the Commission, does not support any finding of negligence on the part of Peoples. No party raised any serious argument that Peoples had been negligent in its acquisition or use of the site.² The Commission adopted the ALJ's findings, which traced a course of prudent action on the part of the utility. The Commission clearly found that Peoples was not negligent in its use of the former MGP site.

The Commission finds that the RUD-OAG's argument based on the Commission's purported confusion of the negligence and used and useful standards does not warrant reconsideration. The Commission restates and clarifies that Peoples was not negligent or imprudent in its use of the subject property, and that the property was used and useful in utility service.

3. UtiliCorp's Purchase of the Property

The RUD-OAG argued that UtiliCorp may have been "compensated" for future MGP cleanup costs by a reduced price paid for Peoples in 1985. Under this theory, allowing rate case recovery of the costs would amount to double recovery for shareholders.

In its petition for reconsideration the RUD-OAG constructed a scenario for its compensation theory. Peoples knew in 1948 that the property was an MGP site. The RUD-OAG therefore asked the Commission "...[i]n the absence of evidence to the contrary...[to] presume that UtiliCorp, a prudent corporation, inquired of Peoples concerning contingent liabilities." Without reference to the record, the RUD-OAG next concluded that UtiliCorp "...should have known that a MGP site would entail contingent remediation costs."

Based upon this construction, the RUD-OAG urged the Commission to find that rate recovery should be disallowed because UtiliCorp must have been compensated already through a reduced purchase price for Peoples. Although the ALJ's findings refute the RUD-OAG's compensation theory, the Commission should not be persuaded by the ALJ's findings, which "are not evidence." The RUD-OAG did not address the fact that the price UtiliCorp paid for Peoples in 1985 was actually higher than book value.

² There were arguments raised, particularly by the Department, that the Company had been imprudent in its negotiations with other parties concerning potential liability for cleanup. These arguments were addressed to the level of liability for remediation costs, not to the use of the property. The amount of liability will be examined when the Commission analyzes these costs for prudence and reasonableness in the Company's next general rate case.

The Commission remains unpersuaded by the RUD-OAG's arguments for nonrecovery based upon a compensation theory. There is no evidence cited which can support the RUD-OAG's claim. Presented with arguments based on theory rather than fact, the Commission is particularly mindful of the findings of the ALJ, the Commission's appointed factfinder. The Commission agrees with the ALJ that the Company's MGP cleanup costs are recoverable in rates, subject to review for reasonableness and prudence.

The Commission finds that the RUD-OAG's arguments based on a prior compensation theory do not warrant reconsideration.

4. Nexus Between Remediation and the Present Use of the Land

The RUD-OAG stated that the MGP cleanup costs at issue were not caused by the current use of the property as a parking and storage facility. The RUD-OAG concluded from this fact that UtiliCorp's liability for cleanup costs was a risk of land ownership which should be borne by shareholders, not ratepayers.

The Commission remains unconvinced by this argument. The operative phrase for recovery in rates is "used and useful in the provision of utility service." Neither logic nor precedent requires a direct link between the exact use of the property which caused the pollution and the present use of the property which renders it used and useful to the Company. The RUD-OAG's argument does not warrant reconsideration of this issue.

II. Unbilled Revenues

A. The February 22, 1993 Order

In the February 22, 1993 rate case Order, the Commission agreed with the ALJ that there should be no adjustment for accumulated unbilled revenues.

B. Arguments of the RUD-OAG

The RUD-OAG raised three arguments in its request for reconsideration of the issue of unbilled revenues. First, the RUD-OAG argued that the Commission failed to address the RUD-OAG's extraordinary income analysis when the Commission decided against an adjustment for accumulated unbilled revenues. Second, the RUD-OAG restated its position that there is evidence in the record to support an adjustment for unbilled revenues. Third, the RUD-OAG criticized the Commission for its "uncritical" adoption of the ALJ's finding that any adjustment for an accumulation of unbilled revenues could only be speculative in nature.

C. Commission Analysis

In the initial rate case Order, the Commission found that there should be no adjustment for any accumulation of pre-test year unbilled revenues. In so holding, the Commission followed its own precedent, fully explicated in at least seven other Commission opinions. Only a compelling argument or a different set of facts should persuade the Commission to move from its established precedent. In this case, the basic facts are unchanged from prior rate cases in which the RUD-OAG has raised the same arguments. These arguments remain far from compelling.

1. The Extraordinary Income Analysis

The RUD-OAG, through its extraordinary income argument, sought to amortize a portion of \$1,054,122, which represents the balance of unbilled revenues as of the beginning of the test year. The RUD-OAG labeled the income as "extraordinary" because an accumulation was said to have occurred outside of the test year.

The extraordinary income analysis fails if it is understood that past accounting treatment of unbilled revenues has never rendered the income anything other than ordinary utility revenue derived from the sale of gas. The balance of unbilled revenues at the beginning of the test year represents revenues calculated using approved rates for service supplied prior to the test year. There is nothing inherent in the adjustment for the change in test year unbilled revenues, agreed to in the stipulation and adopted by the Commission, which changes that fact. The Company's accounting change to recognize the unbilled balance for financial purposes does not convert the unbilled balance to anything other than revenue calculated under approved rates for service supplied prior to the test year. The recognition for financial purposes does not lead to the receipt of increased amounts of cash, or accelerate the receipt of cash by Peoples. As the Commission stated in the initial Order, and restates today:

[T]he unbilled revenue issue raised by the RUD-OAG involves a proposed recognition of revenues which the Commission has consistently found do not belong to ratepayers.

The Commission is unpersuaded by the RUD-OAG's argument that an adjustment must be made for accumulated unbilled revenues as extraordinary income because the Commission allows adjustments for extraordinary expenses. As previously explained, unbilled revenues represent ordinary income derived from the application of Commission-approved rates in the sale of gas. In contrast, extraordinary expenses are unforeseen expenses not accounted for in test year forecasts. Allowing adjustments for extraordinary expenses in no way requires allowing adjustments for unbilled revenues. In the case of extraordinary expenses, an adjustment

renders a utility whole, allowing it to offset expenses with income to maintain its revenue requirement. If an adjustment is made to include any portion of the unbilled balance in this test year, Peoples would be denied revenues which are needed to offset the costs incurred in providing service prior to the test year.

The Commission has previously rejected the RUD-OAG's argument that the accounting treatment of unbilled revenues under the 1986 Tax Reform Act requires an adjustment for accumulated unbilled revenues in the rate case. A reading of the 1991 Midwest³ rate case final Order might prove helpful. In that Order the Commission rejected the RUD-OAG's Tax Reform Act analysis, among other arguments raised by the RUD-OAG to support a revenue adjustment for unbilled revenues:

Regarding the RUD-OAG's tax argument, the Commission finds that while the IRS now requires the inclusion of unbilled revenues in income, with the initial unbilled revenue balance being recorded as income over four years, this change in taxation does not require a change in the selection of the appropriate test year for regulatory purposes. The Commission's concern, different from that of the Internal Revenue Service (IRS), is to secure a test year that properly matched 12 months of revenues with 12 months of operating expenses and the appropriate income tax expense.

Order at p. 21.

2. The Speculative Nature of Unrecognized Unbilled Revenues

The RUD-OAG argued that the Commission erred when it found the amount of unbilled revenues speculative. The RUD-OAG also urged the Commission to reconsider its decision because its adoption of the ALJ's finding on this matter "violated its duty of independent decision-making."

The RUD-OAG stated that unbilled revenues were not speculative because a figure of \$1,054,122 was supplied by Peoples and agreed to by the parties, including the RUD-OAG. This figure is the amount (after tax adjustments) excluded from the test year for Company billings in approximately the first 15 days of 1992. What is actually speculative, however, is the amount, if any, of unrecognized utility income due to the failure to adjust for

³ In the Matter of the Application of Midwest Gas, a Division of Iowa Public Service Company, for Authority to Change Its Schedule of Gas Rates for Retail Customers Within the State of Minnesota, Docket No. G-010/GR-90-678, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (July 12, 1991).

unbilled revenues during pre-test years. The Commission made this concept clear at p. 16 of the initial Order:

In the 1985 Northern States Power rate case [footnote omitted] the Commission addressed and rejected the argument that accumulated unbilled revenues should be included as revenue because they represent previously unrecognized utility income which has grown and accumulated through the years.

For example, the Company, the RUD-OAG and the ALJ have implied that the unbilled revenue at the beginning of the test year includes revenue that has been unbilled from the very inception of the company. In the Commission's view, that characterization is misleading and inaccurate. Generally, what is unbilled at the end of any month is the electricity that has been consumed since the prior meter reading date. For the earliest unbilled billing cycle, there may be approximately 30 or 31 days of unbilled usage. For another billing cycle, there may be one day of unbilled usage.

Order at p. 35.

As the ALJ stated in this case, to measure such income from the beginning of its booking by the Company, and attempt to chart its growth, would be speculative and unproductive.

The Commission restates and clarifies: what is speculative is not the calculation of unbilled revenues as of the beginning of the test year, but the attempt to reconstruct a history of unrecognized utility income which has somehow accumulated into the amount of unbilled revenues as of the beginning of the test year.

3. The Commission's Adoption of the ALJ's Finding

The RUD-OAG criticized the Commission for its "uncritical" adoption of the ALJ's position regarding the speculative nature of accumulated unbilled revenues. The RUD-OAG quoted City of Moorhead v. Minn. Public Utilities Commission, 343 N.W. 2d 843, 846, in which the Minnesota Supreme Court stated that an agency may not simply "rubber stamp" the findings of a hearing examiner.

The quote from the Moorhead decision must be read in its full context. In the Moorhead case, the Commission rejected a finding of the hearing examiner regarding a utility distribution system. Although the Commission adopted most of the hearing examiner's findings verbatim, the Commission disagreed on inferences and conclusions to be drawn from the facts. The appellants argued that an agency should be bound by the hearing examiner's findings unless those findings are not supported by substantial evidence.

Rejecting the appellants' contention, the Court found that the Commission had acted properly. The Court stated that agencies must employ their expertise to reach independent decisions and must not simply "rubber stamp" the examiner's findings. While the Commission had acted properly, the Court noted that in the future it might be "better practice" for the Commission to articulate reasons for rejecting the hearing examiner's recommendations.

The Moorhead case thus stands for the conclusions that a commission must employ independent decision-making and that a commission may reject an ALJ's findings when its expertise leads it to a different conclusion. While the commission is not required to articulate its reasons for rejection, it is the better practice to do so.

Application of the Moorhead decision to the Commission's initial Order shows that the Commission acted entirely properly. Throughout the Order, the Commission demonstrated its independent decision-making. Although the Moorhead Court only found that it was better practice to articulate reasons for **rejection** of a hearing examiner's findings, the Commission in its initial Order fully explained the reasoning of its **adoption** of the hearing examiner's opinion. Since rejection of the factfinder's opinion would require a higher level of explanation than would adoption, the Commission clearly met and exceeded the Moorhead standard in its initial Order.

In a 1986 opinion, the Minnesota Court of Appeals stated that a board or commission may adopt an ALJ's findings without further findings:

[The appellant's] argument that the Board's decision is invalid because it did not include its findings and conclusions is without merit. There is no valid reason a Board cannot adopt the findings of an administrative law judge when it agrees with them. To require that accurate findings be redrafted would be elevating form over substance.

Proetz v. Minnesota Board of Chiropractic Examiners, 382 N.W. 2d 527, 532 (Minn. App. 1986).

Here, the Commission went beyond the requirement of the Proetz case and stated its reasoning for adoption of the ALJ's finding. The Commission strongly disagrees with the RUD-OAG's contention that the Commission "violated its duty of independent decision-making" in the initial Order.

The RUD-OAG's argument regarding the Commission's adoption of the ALJ's opinion does not merit reconsideration.

ORDER

1. The RUD-OAG's request for reconsideration of the Commission's February 22, 1993 Order is denied.
2. Interested parties who wish to comment on the Company's base cost of gas and other filings submitted in compliance with the February 22, 1993 Order shall do so within 15 days of the date of this Order.
3. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

(S E A L)