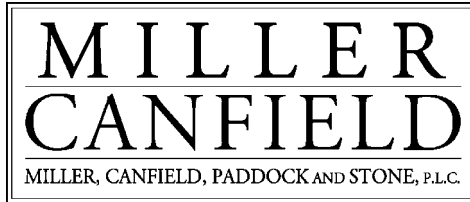


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July 10, 2006

Mary Jo Kunkle
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
Lansing, MI 48911

Re: MPSC Case No. U-14561 [paperless]

Dear Ms. Kunkle:

Enclosed for electronic filing is the Reply Brief of SEMCO Energy Gas Company, Michigan Gas Utilities Corporation, Northern States Power Company, d/b/a Xcel Energy, and Wisconsin Public Service Corporation. Also enclosed is a Proof of Service. If you should have any questions, please advise.

Very truly yours,

Sherri Wellman

Digitally signed by Sherri Wellman
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US, O = Miller Canfield
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Sherri A. Wellman

SAW/lab

cc: Donald Dahl
Annette Gardiner
Karl Hoesly

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter, on the Commission's own motion,)
to investigate the appropriateness of instituting a) Case No. U-14561
surcharge to assist in the funding of the)
Gas Technology Institute.)

PROOF OF SERVICE

STATE OF MICHIGAN)
)ss
COUNTY OF INGHAM)

Lisa A. Becker, being first duly sworn, deposes and says that on July 10, 2006, she served a true copy of the ***Reply Brief of SEMCO Energy Gas Company, Michigan Gas Utilities Corporation, Northern States Power Company, d/b/a Xcel Energy, and Wisconsin Public Service Corporation*** upon the attached service list by electronic mail.

Lisa Becker Digitally signed by Lisa Becker
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Lisa A. Becker

Subscribed and sworn before me
on this 10th day of July, 2006.

Edith Loomis Digitally signed by Edith Loomis
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Edith D. Loomis, Notary Public
State of Michigan, County of Ingham
My Commission Expires: December 5, 2006

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STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter, on the Commission's own motion,)	
to investigate the appropriateness of instituting)	
a surcharge to assist in the funding of the Gas)	Case No. U-14561
<u>Technology Institute.</u>)	

**REPLY BRIEF OF SEMCO ENERGY GAS COMPANY, MICHIGAN GAS
UTILITIES CORPORATION, WISCONSIN PUBLIC SERVICE CORPORATION
AND NORTHERN STATES POWER COMPANY, A WISCONSIN CORPORATION**

On June 22, 2006, SEMCO Energy Gas Company, Michigan Gas Utilities Corporation, Wisconsin Public Service Corporation and Northern States Power Company, a Wisconsin Corporation, d/b/a Xcel Energy (collectively referred to as the "Natural Gas Companies") jointly filed their Initial Brief in this proceeding. On that same date, the Attorney General, Association of Businesses Advocating Tariff Equity ("ABATE"), Consumers Energy Company, the Gas Technology Institute ("GTI"), Michigan Consolidated Gas Company, and the Michigan Public Service Commission Staff also filed initial briefs. The time for filing reply briefs has been scheduled for July 10, 2006.

Pursuant to the established schedule, the Natural Gas Companies are filing a joint reply to the jurisdictional issues raised by ABATE. The non-responsiveness of the Natural Gas Companies to all other issues raised by the parties in their initial briefs should not necessarily be interpreted as concurrence with those positions. Instead, the Natural Gas Companies continue to promote their positions as expressed in their June 22 Initial Brief.

I. The Michigan Public Service Commission Possesses the Necessary Jurisdiction to Reflect Voluntary Contributions Made by Gas Utilities to GTI Research Projects Recoverable from All Ratepayers in the Utilities' Rates.

At pages 7 through 11 of its initial brief, ABATE asserts that the Commission lacks jurisdiction to “raise rates for ‘voluntary funding’” of GTI research projects. Specifically, ABATE asserts that “[t]here is no statute or regulation authorizing this Commission to levy mandatory rate increases on customers for ‘voluntary funding’ of GTI. (p 8 of ABATE’s brief). These assertions, as regarding the Commission’s authority to reflect voluntary contributions made by gas utilities to GTI research projects in rates, are without merit and should be rejected.¹

The Commission’s ratemaking authority is plenary; the courts have determined that the Commission “has broad authority to set just and reasonable rates”. See generally, Attorney General v Public Service Comm, 231 Mich App 76; 585 NW2d 310 (1993). The Public Utilities Commission Act, 1919 PA, as amended, MCL 460.51 et seq, which abolished the Railroad Commission and transferred the Railroad Commission’s powers to the newly-created Public Utilities Commission², sets forth in Section 4 thereof, the powers and duties of the Commission:

“[J]urisdiction shall be deemed to extend to and include the control and regulation, including the fixing of rates and charges, of all public utilities within this state producing, transmitting, delivering or furnishing steam for heating or power, or gas for heating or lighting purposes for the public use.
MCL 460.54

¹ This position does not contradict the Natural Gas Companies’ opinion that the Commission lacks the necessary jurisdiction to require natural gas utilities to fund GTI. Funding is a management decision; therefore, funding by the natural gas utilities, if any, is to be on a voluntary basis as determined by each natural gas company.

² The Public Service Commission Act, 1939 PA 3, as amended, MCL 460.1 et. seq., abolished the Public Utilities Commission and created the present Commission.

The Michigan Supreme Court in Union Carbide Corp v Consumers Power Co, 431 Mich 135; 428 NW2d 322 (1988) held that power granted in the above quoted section is the power to fix utility rates and charges, and as described by Ms. Devon in her testimony, cost recovery of voluntary contributions made by natural gas utilities to GTI would be through base rates set in each of the utilities' future rate cases³. 3 Tr 171. Moreover, as described by Ms. Devon, the Commission's regulations for uniform system of accounts envision accounting for costs associated with voluntary utility contributions to GTI:

"Q. Does the Michigan Public Service Commission's Uniform System of Accounts for Major and Non-major Gas Utilities (USOA) define Research and Development (R&D)?

A. Yes, per Section I. General Instructions, (1) Definitions, paragraph 31.B: "Research and Development" in the case of major utilities means expenditures incurred by natural gas companies either directly or through another person or organization (such as **research institute**, industry association, foundation, university, engineering company or similar contractor) in pursuing research and development activities including experiment, design, installation, construction or operation. Such research and development costs should be reasonably related to the existing or future utility business, broadly defined, of the company or to the environment in which it operates or expects to operate. The term includes but is not limited to: all such costs incidental to the design, development or implementation of an experimental facility, a plant process, a product, a formula, an invention, a system or similar items, and the improvement of already existing items of a like nature; amounts expended in connection with the proposed development and/or proposed delivery of substitute or synthetic gas supplies (alternate fuel sources for example, an experimental coal gasification plant or an experimental plant synthetically producing gas from liquid hydrocarbons); and the costs of obtaining its own patent, such as attorney's fees expended in making and perfecting a patent application. The term does not include expenditures for efficiency surveys; studies of management, management techniques and organization; consumer surveys,

³ The issue, as raised by ABATE at page 8 of its brief, as to whether utilities should "spend resources" and make contributions would more appropriately be addressed in individual utility rate cases.

advertising, promotions, or items of a like nature. (USOA – page 5, emphasis added.)

Q. Does the GTI and the R&D work it performs fall within the definition of R&D as provided for in paragraph 31.B of the General Instructions in the Commission's USOA?

A. Yes, the definition specifically provides for R&D work furnished by research institutes. According to its web-site and information obtained in this proceeding, GTI is the leading research, development, and demonstration (RD&D) organization serving the natural gas industry. GTI has more than sixty years of experience in technology development and training. GTI [sic] role includes RD&D needs assessment, program development, research and development efforts, and implementation of technologies and effective issue resolution. The type of R&D work performed by the GTI is fully explained in the testimony of Ronald Edelstein.

Q. Please identify some of the accounts that are provided for by the Commission's USOA in which gas utilities may record R&D expenses as defined in paragraph 31.B of the General Instructions.

A. The USOA provides that R&D expenditures can be [sic] recording in two Balance Sheet Accounts:

Account 107. Construction Work in Progress – Gas.

C. Expenditures on research and development projects for construction of utility facilities are to be included in a separate subdivision in this account. Records must be maintained to show separately each project along with complete detail of the nature and purpose of the research and development project together with the related costs. (Page 45)

Account 185. Research, Development and Demonstration Expenditures

A. This account shall include the cost of all expenditures coming within the meaning of Definition 31.B of the Uniform System of Accounts, except those properly includible in Account 107, Construction work in progress – Gas.

B. Cost that are minor or of a general or recurring nature shall be transferred from this account to the appropriate operating expense function or if such costs are common to the overall operations or cannot be feasibly allocate to the various operating accounts, then such costs shall be recorded in Account 930, Miscellaneous general expenses.

C. In certain instances a company may incur large and significant research expenditures which are nonrecurring and which would distort the annual research and development charges for the period. In such a case the portion of such amounts that cause the distortion may be amortized to the appropriate operating expense account over a period not to exceed five years unless otherwise authorized by the Commission.

- D. The entries in this account must be so maintained as to show separately each project along with complete detail of the nature and purpose of the research and development project together with the related costs. (Pages 73 and 74)

The USOA further provides for R&D operating expense accounts as follows:

Account 703 – Miscellaneous Steam Expenses. (page 187)

Account 735 – Miscellaneous Production Expenses (page 200)

Account 759 – Other Expenses (page 209)

Account 776 - Operation Supplies and Expenses (page 214)

Account 834 – Other Expenses (page 231)

Account 841 – Operation Labor and Expenses (page 234)

Account 859 – Other Expenses (page 251)

Account 930.2 – Miscellaneous General Expenses (page 283):

Item 4. For major companies, research and development expenses not charged to other operation and maintenance expense accounts on a functional basis. For non-major companies, experimental and general research work for the industry.” (3 Tr 166-169)

Clearly, the Commission is authorized to allow gas utilities to recover their voluntary contributions to GTI or other third-party organizations, if the Commission finds the contributions reasonable and prudent. Furthermore, once reflected in base rates, a customer does not have the choice to be excluded from that portion of the rates simply because that customer does not believe that it directly benefits from the contribution. To allow otherwise, would lead to chaos and confusion, in that customers, not the Commission, would be setting customized rates for natural gas services.

Finally, reliance on the recent Court of Appeals decision in Attorney General v Public Service Comm, 269 Mich App 473 (2006) to support ABATE’s assertions is misplaced. The facts in 269 Mich 473 are easily distinguishable from the instant proceeding: The court’s findings were limited to its interpretation of the Customer Choice and Electricity Reliability Act, MCL 460.10 et seq and the Commission’s authority pursuant thereto to establish mandatory customer surcharges to fund green

power programs. The Court specifically found that the “Legislature clearly intended consumer participation in green power programs to be voluntary” thereby giving utility customers the choice to pay the rates supporting the programs. The findings in 269 Mich 473 are therefore inapplicable to whether the Commission possesses the necessary jurisdiction to reflect voluntary contributions made by gas utilities to GTI in rates recoverable from all ratepayers.

II. The Natural Gas Companies Are Not Bound By the FERC Settlement Agreement.

At page 3-7 of its initial brief, ABATE asserts that the settlement agreement approved by Federal Energy Regulatory Commission (“FERC”), which abolished mandatory funding of GTI through interstate pipeline charges, precludes this Commission from authorizing rate recovery of voluntary contributions made by natural gas utilities to GTI, and/or exempts ABATE’s members from any rate recovery in “that they can only be voluntary contributors to the financing of GTI.” (p 6 of ABATE’s brief). These assertions are meritless.

As discussed supra, once voluntary utility contributions are determined by the Commission to be reasonable and prudent and recoverable in rates, customers cannot pick and choose which parts of the Commission approved rates they will pay. Moreover, as previously determined by the Commission, the FERC-approved settlement agreement does not limit Commission action in this proceeding.

“This proceeding does not involve interstate pipelines, over which the Commission has no rate setting authority. It involves Commission-jurisdictional natural gas distribution companies. Thus, the Commission finds ABATE’s reliance on the FERC settlement agreement to be misplaced. While it is true that the FERC settlement agreement places limitations on the forms of funding available to the GTI after January 1, 2005, those limitations apply to the interstate pipelines that were parties to

the FERC settlement agreement, and whose cost recovery processes are governed by FERC. The Commission is not a party to the FERC settlement agreement, and the Commission's options with respect to voluntary or mandatory funding of GTI by LDCs are not limited by the terms of the FERC settlement agreement, because the LDCs are not interstate pipelines. 83 FERC ¶ 61,093 at *61,454. Neither of the post-January 1, 2005 funding alternatives laid out in the FERC settlement agreement affects the ability of a state commission to investigate potential funding mechanisms for GTI's RD&D programs, nor the ability of an LDC to choose to support GTI and to apply to the state commission for recovery of those amounts in rates." October 18, 2005 Order, Case No. U-14561

Finally, the non-signatories to the FERC agreement are not bound by its terms.

See generally American Mutual Liability Insurance Co. v Michigan Mutual Liability Co., 64 Mich App 315; 235 NW2d 769 (1975) ABATE's assertions regarding the applicability of the FERC settlement agreement should therefore be rejected.

III. Relief

WHEREFORE, natural gas utilities should be allowed to recover in their base rates as operating expenses voluntary funding contributions to GTI research projects as selected by the utilities and determined by the utilities and the Commission in future rate case proceedings to be beneficial to their ratepayers.

Respectfully submitted,
SEMCO ENERGY GAS COMPANY, MICHIGAN GAS
UTILITIES CORPORATION, WISCONSIN PUBLIC
SERVICE CORPORATION, AND NORTHERN
STATES POWER COMPANY, A WISCONSIN
CORPORATION

Sherri Wellman

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Dated: July 10, 2006

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