

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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| In the matter of the application of               | ) |                    |
| <b>MICHIGAN CONSOLIDATED GAS COMPANY</b>          | ) |                    |
| for a gas cost recovery reconciliation proceeding | ) | Case No. U-10640-R |
| for 1995.   | ) |                    |
| _____   | ) |                    |

At the February 5, 1997 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. John G. Strand, Chairman  
 Hon. John C. Shea, Commissioner  
 Hon. David A. Svanda, Commissioner

**OPINION AND ORDER**

**I.**

**HISTORY OF PROCEEDINGS**

On February 28, 1996, Michigan Consolidated Gas Company (Mich Con) initiated this gas cost recovery (GCR) proceeding under 1982 PA 304 (Act 304), MCL 460.6h et seq.; MSA 22.13(6h) et seq., by filing its application, prepared testimony, and proposed exhibits to support its reconciliation of GCR costs and revenues for 1995. According to the application, Mich Con's 1995 GCR costs (net of rolled-in refunds) exceeded its GCR revenues by \$531,961. After accounting for appropriate interest, Mich Con asserted that it had an underrecovery of \$26,821. Pursuant to the methodology approved by the Commission's June 30, 1994 order in Case No. U-10385, Mich Con's 1994 GCR plan case, Mich Con adjusted its January 1996 cost of gas to account for the underrecovery.

Pursuant to due notice, a prehearing conference was held before Administrative Law Judge Daniel E. Nickerson, Jr. (ALJ). At that time, the ALJ recognized the following parties to this case: Attorney General Frank J. Kelley (Attorney General), the Residential Ratepayer Consortium (RRC), the Michigan Community Action Agency Association (MCAAA), and the Association of Businesses Advocating Tariff Equity (ABATE). In addition, the ALJ granted limited intervenor status to ANR Pipeline Company (ANR). The Commission Staff (Staff) also participated in this case.

On September 24, 1996, an evidentiary hearing was held for cross-examination of witnesses. The record consists of 2 volumes of transcript totaling 243 pages and 53 exhibits that were admitted into evidence.

On October 14, 1996, Mich Con, the Attorney General, the MCAAA, and the RRC filed briefs. By October 28, 1996, those parties had filed reply briefs.

On November 25, 1996, the ALJ issued his Proposal for Decision (PFD) in which he recommended that the Commission approve Mich Con's GCR gas supply costs and the calculation of Mich Con's underrecovery proposed in the application. The ALJ issued a clarification on November 27, 1996.

On December 12, 1996, the RRC and the MCAAA filed exceptions to the PFD. On December 20, 1996, Mich Con filed a response.

## II.

### LEGAL FRAMEWORK

Act 304 provides the legal framework for the Commission's analysis of a proposed GCR plan and factor and requires that, at least annually, the Commission commence a gas cost reconciliation proceeding as a contested case. The statute requires the Commission to reconcile the revenues recorded pursuant to the GCR factor with amounts actually expensed and included in the cost of gas sold by the utility. Further, the Commission must 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 (GCR plan case).

Section 6h(14) of Act 304, MCL 460.6h(14); MSA 22.13(6h)(14), provides for authorizing a utility to recover from its customers any net amount determined to have been actually expensed that is in excess of the amount the utility recovered pursuant to the billed GCR factors, if the excess costs were incurred through reasonable and prudent actions not precluded by the Commission's order in the GCR plan case. If the excess costs were incurred by actions consistent with the GCR plan order, the Commission must allow recovery of those amounts if the utility demonstrates that the excess expenses were reasonable and prudent.

### **III.**

#### **DISCUSSION**

##### New York Mercantile Exchange (NYMEX) Triggers

Several of Mich Con's supply contracts include a provision allowing the company to fix future gas prices based on the future price projections of the NYMEX, when the company perceives that it would be to its advantage to do so. These provisions are commonly referred to as NYMEX triggers. In its GCR plan case, the company proposed to purchase 20% of its gas supply pursuant to fixed prices, but stated that actual purchases would depend on actual 1995 circumstances. Mich Con actually purchased only about 8% of its gas supply pursuant to fixed prices, because it chose not to exercise its right to pull NYMEX triggers.

The RRC challenged the reasonableness and prudence of Mich Con's decision to refrain from pulling NYMEX triggers, primarily because of the reasoning that led to that decision. The RRC asserted that Mich Con based its decision on its desire to avoid the risk of disallowance rather than a reasonable evaluation of market conditions. A discovery response, admitted as Exhibit I-18, indicates that Mich Con concluded that it

would likely gain full recovery of costs incurred if it purchased gas at market prices, but that exercising NYMEX trigger options might expose the company to the risk of disallowance.

Further, the RRC criticized Mich Con for failing to disclose in prefiled testimony that it had deviated from its GCR plan. In the RRC's view, Mich Con's refraining from exercising these options for 20% of its gas supply constituted a "major deviation from Mich Con's 1995 GCR plan." The RRC's brief, p. 1. Moreover, the RRC argued, Mich Con's failure to include this information in its filing disadvantaged the parties, because Mich Con should have produced evidence concerning 1995 market conditions as they related to NYMEX trigger options. Without that evidence, the RRC states, the Commission cannot determine whether Mich Con's decision to abandon the use of NYMEX triggers was reasonable and prudent.

The ALJ rejected the RRC's criticisms based on his determination that Mich Con had not significantly deviated from the approved GCR plan, because that plan included flexibility concerning whether the company would actually pull any NYMEX triggers on an estimated 20% of its gas supply. Moreover, the ALJ determined that Mich Con exercised the flexibility in a reasonable and prudent manner. He noted that Mich Con's decisions had resulted in gas supply costs that were lower than those projected in the GCR plan case and were "some of the lowest gas supply costs in the state." PFD, p. 12.

However, the ALJ further discussed and rejected Mich Con's concerns about the standard of review that would be applied to its trigger pulling decisions in GCR reconciliations. He agreed with the RRC that past challenges to Mich Con's trigger pulls should not preclude the company from appropriately using the flexibility that it negotiated into its gas supply contracts. In the ALJ's view, Mich Con should take reasonable and prudent actions independent of whether a party to the GCR proceeding might object.

In its exceptions, the RRC argues that Mich Con failed to provide sufficient information on this record for the Commission to make a reasoned determination concerning the reasonableness and prudence of the lack of NYMEX trigger pulls. The RRC further argues that the ALJ erroneously found that the difference

affected such a small portion of Mich Con's gas supply that it was not required to provide notice to the parties that it had followed a different course than the one approved in the plan case. Additionally, the RRC states, the ALJ ignored Mich Con's failure to provide sufficient evidence for the Commission to evaluate this issue. Thus, the RRC requests that the Commission require Mich Con to provide sufficient evidence in future GCR cases to allow meaningful evaluation of the reasonableness and prudence of decisions regarding whether to pull NYMEX triggers. Finally, the RRC requests that the Commission expressly adopt the ALJ's determination that challenges to Mich Con's trigger pulling in the past are not sufficient reason to abandon pulling triggers altogether.

First, Mich Con responds that the RRC has misinterpreted the ALJ's statement that the controversy involves a "small portion" of Mich Con's 1995 gas supply purchases. In Mich Con's view, the ALJ's statement refers to the fact that the proposed disallowance is less than 0.1% of the total costs of Mich Con's 1995 gas supply purchases. However, Mich Con states that, even if the phrase were intended to refer to 20% of Mich Con's purchases, there is no need to issue a warning or require Mich Con to produce more evidence than it did in this case.

Second, Mich Con argues, the RRC misstates Mich Con's position regarding the propriety of pulling NYMEX triggers in 1995. Mich Con asserts that its purchasing decisions were made based on a variety of considerations, including the flexibility inherent in Mich Con's GCR plan case, its perception of regulatory uncertainty surrounding the standard applicable to fixed price purchases, and the parties' challenges to Mich Con's prior trigger pulling activities.

Mich Con states that it does not presume that it will recover any costs without the Commission's review for reasonableness and prudence. However, Mich Con argues, the Commission should determine whether the company's decisions were reasonable and prudent given the circumstances at the time a challenged decision was made. In Mich Con's view, its 1995 gas purchasing decisions meet that standard.

The Commission is persuaded that Mich Con's failure to highlight its decision to refrain from pulling NYMEX triggers in its initial filing in this proceeding created no prejudice to the parties. The RRC, the Attorney General, and the MCAAA had sufficient awareness of the issue that they could, and did, question whether Mich Con acted reasonably and prudently when it decided not to use the NYMEX triggers. There is nothing on this record that persuades the Commission that Mich Con was unreasonable or imprudent because it failed to pull NYMEX triggers.

The Commission further finds that the fact that a party challenges a utility's practice, or proposes a particular standard for review, does not require the utility to cease that practice. However, the utility might reasonably scrutinize the challenged practice to assure itself that it is reasonable and prudent in the circumstances. By law, the standard by which gas supply decisions are judged is whether those decisions were reasonable and prudent. See MCL 460.6h (12); MSA 22.13(6h)(12). The Commission has consistently interpreted this section to mean that the utility's decisions must be reasonable and prudent based on the known and reasonably foreseeable circumstances at the time that those decisions were made. The Commission has refused requests to alter the standard provided by statute, but has noted that parties are free to argue that any given decision was not reasonable and prudent under the circumstances then existing.

#### Gas Purchasing Decisions

Through its witness, Jerry E. Mendl, the MCAAA charged that Mich Con had unreasonably purchased gas supplies at prices higher than necessary in three types of transactions. In total, the MCAAA proposed a \$351,000 disallowance for these purchases. The ALJ concluded that Mich Con's gas purchasing decisions were reasonable and prudent, and rejected the MCAAA's proposed disallowances. In its exceptions, the MCAAA argues that the ALJ erred by not adopting the disallowances that the MCAAA proposed.

First, the MCAAA argues that the record supports finding that Mich Con purchased more gas supplies under its contracts with Shell Gas Trading Company (Shell) and Amoco Energy Trading Company (Amoco) than required, although Mich Con could have purchased less expensive supplies on the spot market. The MCAAA insists that, under the contracts that Mich Con had with Amoco and Shell, the company could have reduced its purchases two or three days before nominating monthly transportation volumes with ANR. Additionally, the MCAAA argues, those contracts allowed Mich Con to increase or decrease the daily nominated quantity four times during the month. It asserts that there is no language in the contracts that restricts Mich Con from reducing takes based on price differentials. Accordingly, the MCAAA argues, Mich Con could have and should have reduced purchases from Shell and Amoco in January 1995 to obtain the best prices possible for GCR customers.

Second, the MCAAA argues, Mich Con purchased supplies on the spot market when it could have increased its takes under an interstate term contract with Coastal Gas Marketing (Coastal) at a lower price. Although William J. Wolter, Mich Con's Director of Gas Supply, testified that Mich Con must give Coastal notice of its daily nomination quantity two days prior to the monthly ANR transportation nomination, which is before the NYMEX contract settlement price for the month could be known, the MCAAA asserts that Mich Con could have altered its takes from Coastal upon 48-hours' notice. The MCAAA argues that, in December 1995, Mich Con could have purchased gas from Coastal at \$0.26 per decatherm (dth) less than Mich Con's most expensive spot market gas from the southeastern basin.

Third, the MCAAA argues that Mich Con failed to consider the gas cost savings available when it determined to release pipeline capacity. For example, the MCAAA states, in April 1995, the highest mid-continent spot market purchase price was \$0.26 per dth less than the highest price for spot market gas in the southeast. Further, prior to Mich Con's release of capacity, it had 185,585 dth of unused capacity on the mid-continent leg of the pipeline. Although under Mich Con's avowed policy, the MCAAA states, Mich Con

should not release capacity for less than \$0.26 per dth, the company released 300,000 dth of capacity on the mid-continent leg for \$0.13 per dth.

Mich Con responds that the ALJ correctly determined that the MCAAA's criticisms were based on a 20/20 hindsight comparison of historical data to Mich Con's purchasing activity. Mich Con states that the MCAAA's arguments ignore the record evidence that the company acted reasonably and prudently and could not have taken the steps proposed by the MCAAA. Mich Con urges the Commission to reject the MCAAA's arguments because they fail to address the actual facts and circumstances existing at the time that the alleged imprudence occurred.

The Commission finds that the MCAAA's exceptions should be rejected. The Commission is persuaded that Mr. Wolter's testimony adequately answers the questions raised by the MCAAA. For example, Mr. Wolter testified that Mich Con had set the price and volumes for supplies taken from Amoco and Shell before it could have known the actual price of spot market gas. As to Mich Con's ability to change the volumes taken, Mr. Wolter testified:

Mich Con had fixed the prices of the Amoco and [Shell] contracts for January 1, 1995. Because of this, Mich Con had no ability to flex downward on those contracts for that month. Secondly, Mr. Mendl's analysis seems to assume that the contracts could have been flexed at any time during a month. A reading of the contracts indicates that this is not the case. The Amoco and Associated contracts obligate Mich Con to commit to purchase volumes 7-8 days prior to the start of the operating month. However, those same contracts are priced at a first of the month index price. This means that Mich Con had to commit to purchase supplies at least 7-8 days before knowing what the price would be. For operating purposes, we assumed that the index prices would ultimately turn out to be the same as the spot prices we were purchasing. This, however, does not always occur. The fact that it does not always occur does not mean that Mich Con's assumption was imprudent or unreasonable.

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The contracts were negotiated as essentially 100% take agreements with the right to flex downward for operating reasons such as warmer-than-normal conditions or the requirements of storage cycling. They were not negotiated, as suggested by Mr. Mendl, as 80% take agreements with the right to flex up in the event of favorable prices. The sellers were willing to assume the risk that operating conditions would alter their sale. Prices are far more volatile than operating conditions. . . . My

concern is that if the Commission adopts Mr. Mendl's contract flexing recommendations as a general policy, Mich Con will either lose much of its ability to obtain valuable operating flexibility or such flexibility will begin to cost a premium. To date, this flexibility has been provided at no additional cost.

2 Tr. 108.

Act 304 does not hold utilities to a standard of omniscience or perfect performance, but rather to a standard of reasonableness and prudence. The Commission is not persuaded that Mich Con's purchases pursuant to its term contracts were either unreasonable or imprudent. Rather, the Commission finds that Mich Con reasonably fixed the volumes and prices for the Amoco and Shell contracts, which then precluded it from altering the purchase amount in January 1995. Accordingly, the Commission rejects the MCAAA's proposed disallowance for January 1995 purchases from Shell and Amoco.

Similarly, the contract with Coastal requires Mich Con to order its daily nominations prior to knowing the NYMEX settlement price or the price required by the Coastal contract. Once that nomination is made, Mr. Wolter testified, changes may be made for operational needs, but not for mere price differences. Evidence that Mich Con's purchasing decisions regarding Coastal supplies increased the cost of gas depends on a hindsight analysis and on a reading of the contract that is not supported by the record. Thus, the Commission rejects the challenge to Mich Con's purchases from Coastal.

The Commission also rejects the MCAAA's argument that Mich Con unreasonably purchased more expensive supplies from the southeast basin at a time when lower cost mid-continent basin supplies were available to it. Mr. Wolter testified that Mich Con actually saved its GCR customers substantial amounts by minimizing the effective price of gas through capacity releases during the challenged time period. Mr. Mendl's analysis ignores this consideration.

For all of these reasons, the Commission adopts the ALJ's recommendation to approve as reasonable Mich Con's calculation of a net underrecovery of \$26,821.

The Commission FINDS that:

- a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCL 462.2 et seq.; MSA 22.21 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; MSA 22.1 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; MSA 22.13(1) et seq.; 1982 PA 304, as amended, MCL 460.6h et seq.; MSA 22.13(6h) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq.; and the Commission's Rules of Practice and Procedure, 1992 AACRS, R 460.17101 et seq.
- b. Mich Con reasonably and prudently incurred \$471,215,655 for the 1995 GCR cost of gas.
- c. When the recorded revenues are reconciled with the cost of gas and related interest and refunds, Mich Con experienced a net underrecovery of \$26,821, which the company properly accounted for pursuant to the Commission's June 30, 1994 order in Case No. U-10385.

THEREFORE, IT IS ORDERED that Michigan Consolidated Gas Company's gas cost reconciliation is approved as filed by the company.

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; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

John G. Strand  
Chairman

(SEAL)

John C. Shea  
Commissioner

David A. Svanda  
Commissioner

By its action of February 5, 1997.

Dorothy Wideman  
Executive Secretary

c. When the recorded revenues are reconciled with the cost of gas and related interest and refunds, Michigan Consolidated Gas Company experienced a net underrecovery of \$26,821, which the company properly accounted for pursuant to the Commission's June 30, 1994 order in Case No. U-10385.

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MICHIGAN PUBLIC SERVICE COMMISSION

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Chairman

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Commissioner

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\_\_\_\_\_  
Executive Secretary

In the matter of the application of )  
**MICHIGAN CONSOLIDATED GAS COMPANY** )  
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\_\_\_\_\_ )

Case No. U-10640-R

Suggested Minute:

“Adopt and issue order dated February 5, 1997 reconciling 1995 gas cost recovery revenues and expenses for Michigan Consolidated Gas Company, as set forth in the order.”