

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)
MICHIGAN CONSOLIDATED GAS COMPANY)
for approval of a gas cost recovery plan, five-year)
forecast, and monthly gas cost recovery factors for)
calendar year 2002.)
_____)

Case No. U-13060

At the March 12, 2003 meeting of the Michigan Public Service Commission in Lansing,
Michigan.

PRESENT: Hon. Laura Chappelle, Chairman
Hon. David A. Svanda, Commissioner
Hon. Robert B. Nelson, Commissioner

OPINION AND ORDER

History of Proceedings

On August 31, 2001, Michigan Consolidated Gas Company (Mich Con) filed an application, with prefiled testimony and exhibits, seeking approval of a gas cost recovery (GCR) plan and factors for 2002, pursuant to 1982 PA 304 (Act 304), MCL 460.6h et seq. Mich Con's application proposed implementation of a levelized GCR factor of up to \$4.54 per thousand cubic feet (Mcf) during 2002. The application also noted that the April 28, 1998 order in Case No. U-11682 suspended Mich Con's GCR clause from January 1, 1999 through December 31, 2001, and that Mich Con provided gas service to its GCR customers at a fixed rate of \$2.95 per Mcf during that period.

At a prehearing conference on October 8, 2001, Administrative Law Judge Daniel E. Nickerson, Jr., (ALJ) granted petitions for leave to intervene filed by the Residential Ratepayer Consortium (RRC), the Michigan Community Action Agency Association (MCAAA), and Attorney General Jennifer M. Granholm (Attorney General)¹. The Commission Staff (Staff) also participated in the proceedings. Additionally, the ALJ approved a procedural schedule that set the plan case for hearing in early February 2002.

On November 20, 2001, the Commission directed the ALJ to conduct a hearing pursuant to MCL 460.6h(8) to determine whether temporary GCR factors should be established. In so doing, the Commission noted that if Mich Con were to self-implement a GCR factor of \$4.54 per Mcf in January 2001, the abrupt transition from the fixed rate of \$2.95 per Mcf could pose a hardship for customers. The Commission ordered Mich Con to file a statement by November 27, 2001 identifying the GCR factor it proposed to implement in January 2002. In so doing, Mich Con reduced its proposed maximum monthly GCR factor from \$4.54 to \$4.38 per Mcf due to use of updated data.

On November 28, 2001, the ALJ held a second prehearing conference to establish a procedural schedule for the hearing on the temporary factor issue. On December 10 and 11, 2001, the ALJ conducted the hearing at which Mich Con, the Attorney General, the MCAAA, and the Staff presented witnesses for cross-examination. Thereafter, these parties submitted briefs and reply briefs. The ALJ did not issue a Proposal for Decision (PFD) because the Commission had indicated that it would read the record of the hearing.

On December 20, 2001, the Commission ordered Mich Con to charge a temporary GCR factor of up to \$3.62 during January 2002. For the remainder of 2002, Mich Con was permitted to

¹On January 1, 2003, Michael A. Cox was sworn in to succeed Ms. Granholm as Attorney General.

charge a GCR factor of up to \$4.38 per Mcf. A majority of the Commission² also authorized Mich Con to record a regulatory asset in an amount equal to Mich Con's December 2001 unbilled volumes multiplied by the difference between Mich Con's proposed annual GCR factor of \$4.38 per Mcf and the \$3.62 per Mcf factor reflected in the order, which the Commission stated would place Mich Con in the same position that it would have been absent the issuance of the temporary order.³

The evidentiary hearing devoted to the review of Mich Con's 2002 GCR plan and five-year forecast commenced March 5 and concluded March 8, 2002. The record of this matter includes 1,262 pages of testimony and argument in 9 volumes and 102 exhibits, 23 of which were admitted during the December 2001 hearings. The remaining 79 exhibits were admitted during the March 2002 hearings.

Subsequent to the close of the record, Mich Con, the Attorney General, the RRC, the MCAAA, and the Staff filed briefs and reply briefs.

On July 31, 2002, the ALJ issued a PFD. On August 14, 2002, Mich Con, the RRC, and the MCAAA filed exceptions to the PFD. On August 21, 2002, Mich Con, the RRC, the Attorney General, and the Staff filed replies to exceptions.

Background Information

On April 21, 1998, Mich Con filed an application in Case No. U-11682 for approval of a three-year pilot program to enhance gas customer choice (GCC). In an order issued on April 28, 1998, the Commission approved Mich Con's application. The pilot GCC program, which was in

²Commissioner Robert B. Nelson dissented from this determination.

³On July 16, 2002, the Commission granted rehearing of the December 20, 2001 order and directed that further proceedings be conducted with regard to two issues. That matter is currently pending before the ALJ. In so doing, the Commission allowed the temporary factors established by the December 20, 2001 order to remain in effect.

effect from January 1, 1999 until December 31, 2001, expanded a previous gas transportation program, adopted transportation standards of conduct, suspended Mich Con's GCR clause, froze the gas commodity charge at \$2.95 per Mcf, froze distribution service rates, established an earnings sharing mechanism, and implemented a transportation aggregation tariff.

A key to the success of the pilot program was a stable gas market, which was far from a certainty. Mich Con's April 21, 1998 application acknowledged that "[o]ver the last three years, the natural gas market has become increasingly volatile, often experiencing wide fluctuations in market prices with corresponding changes in Mich Con's market-sensitive GCR factor." Case No. U-11682 application, paragraph 19, page 12. Nevertheless, Mich Con promised both GCR customers and returning GCC customers the availability of gas at \$2.95 per Mcf without regard to market price increases. In so doing, Mich Con stated that it would "assume significant risks" and that portions of its gas supply costs "could be unrecoverable." In short, Mich Con represented that it would be "at risk" for the acquisition of gas supplies on the open market at rates in excess of the fixed \$2.95 per Mcf gas commodity rate. Case No. U-11682 application, paragraph 21, pages 13-14.

Mich Con apparently took such risks because the combination of suspending its GCR clause, fixing its gas commodity rate at \$2.95 per Mcf, and limiting participation in the GCC program meant that if Mich Con could keep its gas costs below \$2.95, it would recognize a profit on the difference between the \$2.95 per Mcf price and the actual cost of gas on all of its GCR sales, which is otherwise prohibited by Act 304.

These risks brought Mich Con significant rewards during the first two years of the pilot program. Exhibit A-48 demonstrates that during 1999 the difference between the \$2.95 per Mcf price and the actual cost of gas on all of its GCR sales amounted to \$45 million. During 2000, the

gross margin amounted to \$25 million. Pursuant to the information submitted by Mich Con in its filings in Cases Nos. U-12363 and U-12893, those earnings were not shared with its customers. However, gas prices began to rise precipitously during 2000. As shown on Exhibit A-26, New York Mercantile Exchange (NYMEX) natural gas 12-month strip⁴ settlement prices climbed above \$3.00 per dekatherm in April 2000, more than doubled by the end of December 2000, and remained high during the first three months of 2001.

On December 15, 2000, Mich Con filed applications requesting authority from the Commission to terminate its GCC pilot program and to implement a modified voluntary gas customer choice program for all customers within its service territory effective April 1, 2001 (Case No. U-12761) and to terminate the price freeze and reinstate its GCR clause (Case No. U-12762). However, on March 21, 2001, Mich Con asked the Commission to dismiss these cases, which was granted by order dated March 29, 2001.

Facing significant losses in 2001, Mich Con altered two aspects of its supply policy. First, Mich Con decided that it should incur significant storage decrements.⁵ Second, Mich Con switched from its market-based supply approach to a fixed-price approach. Even with these changes, Mich Con's 2001 gas costs exceeded revenues by \$28 million.

The \$28 million loss in 2001 was more than offset by the gains in 1999 and 2000. The cumulative gross margin realized by Mich Con on its GCR sales from 1999 to 2001 amounted to \$42 million. However, Mich Con insists that it was not the only beneficiary of the frozen GCR

⁴A strip is an option that allows for the simultaneous purchase of futures positions in consecutive months. The average of the prices for the futures contracts bought is the price level of the hedge. A six-month strip, for example, consists of an equal number of futures contracts for each of six consecutive contract months.

⁵A storage decrement occurs when more gas is removed from storage than is replaced during the year. A storage increment is recorded when less gas is removed than is placed into storage. Mich Con experienced sizable storage decrements in both 2000 and 2001.

factor. Mich Con maintains that its decision to freeze prices at \$2.95 per Mcf for 1999-2001 saved its GCR customers over \$500 million during that period.

Positions of the Parties

Mich Con

Mich Con projected a total requirement of 199.5 billion cubic feet (Bcf) of gas for 2002. As usual, most of its sales occur during the heating season.

Mich Con meets its winter supply requirements through a combination of flowing gas obtained from local producers and interstate pipelines and from gas withdrawn from its underground storage facilities. It is undisputed that storage gas constitutes the primary source of Mich Con's winter supply.

Traditionally, Mich Con's winter withdrawal season begins November 1 and ends March 31 of the next year. From April 1 through October 31, Mich Con replenishes its storage gas volumes for use during the next withdrawal season. However, as explained by Andrew M. Springstead, Mich Con's Gas Planning and Control Director, during 2001 Mich Con did not follow that pattern. Rather, Mich Con used storage gas to meet the needs of its sales customers instead of purchasing gas to replenish storage volumes. The record demonstrated that, as early as March 2001, Mich Con planned to decrement storage to meet the requirements of its customers for the remainder of 2001. At a meeting in the summer of 2001, Mich Con's upper management determined that the storage decrement target should be 17.5 Bcf. (Ultimately, the storage decrement actually amounted to 19 Bcf.) These decisions preordained that during 2002, Mich Con would need to rely on increased firm flowing winter supply as a replacement for storage gas.

To address the resulting 2002 supply shortfall, in April 2001 Mich Con began to acquire additional firm flowing supply for the first quarter of 2002 on a fixed price basis. Regarding the

reasonableness of this decision, George H. Chapel, Mich Con's Manager of Gas Supply, testified that factors such as the industry-wide lower than normal gas storage levels following the winter of 2000-2001 and historical NYMEX price trends suggested a possible price spike during the winter of 2001-2002.

Further support for altering Mich Con's existing supply acquisition strategy was presented by Don M. Stanczak, Mich Con's Director of Regulatory Policy and Operations. According to Mr. Stanczak, Mich Con had assumed that GCC participation would be at the maximum permitted by the Case No. U-11682 program. In fact, participation in the GCC program reached the maximum of 75,000 customers for 1999, but unexpectedly declined in 2000 and 2001 to 46,200 and 36,400, respectively. Therefore, Mich Con needed additional supplies when GCC participation levels declined. Mr. Stanczak stated that to meet such demand, Mich Con purchased additional gas at market prices that were higher than the fixed \$2.95 per Mcf rate and decided to rely on its relatively low cost gas in inventory, through an inventory decrement, to moderate the purchase of the incremental supply of relatively high priced gas.

Mr. Stanczak explained that the storage decrement moderated the purchase of the high cost gas because Mich Con uses a last-in-first-out (LIFO) methodology to account for gas in storage. According to him, Mich Con's existing LIFO layers are priced significantly below current market prices for natural gas. In fact, the existing LIFO layers are generally priced at less than \$0.40 per Mcf. Therefore, relying on storage gas priced below \$0.40 per Mcf rather than purchasing significantly more expensive gas at market prices reduced Mich Con's overall average cost of gas for 2001, which helped to mitigate Mich Con's 2001 losses.

Mich Con's decision to rely on a higher percentage of fixed price gas during 2002 was explained by Kevin M. McCrackin, Mich Con's Gas Supply Director. According to him, Mich

Con's 2002 gas supply strategy consisted of two discrete but complementary components. The first component was designed to ensure that GCR customers would not be subject to the full effect of any potential price run-up, should one occur, during the first quarter of 2002. The second component was intended to lock in relatively low future natural gas prices available during the summer of 2001.

Mr. McCrackin explained that both components of this strategy relied on fixed price natural gas supplies to mitigate volatility, which was a departure from prior GCR plan cases. In 1998, two-thirds of Mich Con's supply was met through acquisitions made at market-based prices with the remaining one-third based on fixed-based prices. Mr. McCrackin stated that Mich Con changed its natural gas supply acquisition strategy for 2002 after reviewing recent events relative to natural gas prices, namely the price run-ups experienced by NYMEX in 2000 and 2001, recent projections of future natural gas prices, and the parties' positions in Case No. U-12752, a recent GCR plan case filed by Consumers Energy Company (Consumers). In particular, Mr. McCrackin indicated that the pre-filed testimony⁶ of Joel A. Sharkey, Supervisor of the Competitive Services Section of the Commission's Gas Division, in Case No. U-12752 was instrumental in convincing Mich Con that relying too heavily on market-based pricing of purchases could subject its customers to both significantly increased gas costs and more volatile gas costs.

According to Mr. McCrackin, Mich Con fixed 40% of its first quarter 2002 supply requirements in April 2001, which amounted to 32 Bcf of gas,⁷ out of concern that prices could rise in the future. Mr. McCrackin testified that in April 2001 Mich Con was aware that prices had begun to

⁶Mr. Sharkey's testimony was filed April 9, 2001. Case No. U-12752 was resolved without a hearing through approval of a settlement agreement by order issued on July 25, 2001.

⁷Originally, Mich Con intended to purchase 50% of its first quarter 2002 supply requirements, or 40 Bcf of gas. However, the amount of its planned purchases was scaled back when prices began to fall.

rise and that national storage levels were near record low levels, which could exert upward pressure on prices.

For all but 30 Bcf of its remaining requirements for 2002, Mich Con intended to periodically lock in prices through use of a “hurdle pricing” mechanism. Mr. McCrackin stated that hurdle prices are historical prices for 12-month NYMEX strip future contracts that establish price points. These price points represent significant changes in price trends that have occurred in the recent past. According to Mr. McCrackin, the movement of gas prices across a hurdle price provides Mich Con with the signal to begin locking in the price of gas. Mich Con used the 12-month NYMEX strip prices from January 2000 through June 2001 to determine the hurdle prices. Finally, due to unknowns and variables, such as the weather and the number of participants in the GCC program, Mich Con determined that 30 Bcf of supply should be acquired at market-based rates.

Mich Con’s supply planning must accommodate abnormal weather conditions. As explained by Victor E. Borra, Mich Con’s Manager for Gas Supply and Planning, Mich Con retains a specific amount of gas in storage to meet the volumetric needs for colder-than-normal (CTN) weather over a prolonged period. According to Mr. Borra, Mich Con identifies this volume to ensure that it will have enough gas in storage to meet volumetric CTN weather requirements and maintain the minimum storage balance required for peak-day protection. For the 2002 GCR plan year, Mich Con’s CTN protection plan volume was set at 16.3 Bcf, as shown on Exhibit A-16.

Jennifer C. Schmidt, a Senior Project Manager within Mich Con’s Regulatory Policy and Operations Section, described a contingency mechanism designed to allow Mich Con to increase its base GCR factor under certain circumstances. According to her, the contingency mechanism is necessary because Mich Con planned to acquire 30 Bcf of supply at market-based rates.

Ms. Schmidt explained that the contingency mechanism would permit Mich Con to increase its GCR factor by 40% of the difference between increased future NYMEX prices and the NYMEX prices used to develop the base GCR factor. Such upward adjustments could occur on a quarterly basis.

Finally, as shown on Exhibit A-9T, Mich Con projected that its 2002 adjusted cost of gas would be \$724,742,000. Dividing the costs by Mich Con's projected 2002 GCR sales of 165,399,000 Mcf results in a 2002 GCR factor of \$4.38 per Mcf.

Staff

According to Mr. Sharkey and Robert G. Ozar, a Staff engineer, Mich Con's 2002 GCR plan is not reasonable or prudent because Mich Con's storage level at the beginning of the 2002 GCR plan year was unreasonably low. They argued that Mich Con's decision to decrement storage by 24.5 Bcf in 2000 and 19 Bcf in 2001 violated the spirit of the April 28, 1998 order in Case No. U-11682. In so doing, they stressed that Mich Con had indicated in its application in Case No. U-11682 that it would be at risk for all gas commodity costs during the GCC program. Indeed, they maintained that Mich Con's sale of \$0.40 per Mcf gas out of storage to customers at \$2.95 per Mcf during 2001 effectively abrogated the promise made in Case No. U-11682.

The Staff calculated a \$26,529,000 cost reduction by assuming that Mich Con should have been in position to withdraw an additional 19 Bcf of gas from storage during 2002. Accordingly, the Staff subtracted 19 Bcf of gas at the fixed price of \$5.50 per Mcf from 2002 purchases and substituted 19 Bcf of storage gas priced at 2001 and 2002 storage increment prices of \$3.69 per Mcf and \$4.25 per Mcf, respectively. The Staff maintained that Mich Con's 2002 GCR factor should be set at \$4.22 per Mcf, or \$0.16 per Mcf lower than Mich Con's proposed GCR factor.

Although the Staff also criticized Mich Con's decision to fix prices at or above historically high levels, the Staff did not propose a specific cost reduction for that practice in this proceeding. Rather, the Staff suggested that the Commission issue a warning pursuant to Section 6h(7) of Act 304, MCL 460.6h(7), which allows the Commission to comment on costs appearing in Mich Con's five-year forecast that the Commission may not permit the utility to recover in the future.

Attorney General

Ralph E. Miller, an independent consulting economist, supported cost reductions and adjustments totaling \$64.7 million related to Mich Con's storage operations and NYMEX price forecast. He recommended use of the January 2002 GCR factor of \$3.62 per Mcf approved in the December 20, 2001 order establishing temporary factors and a levelized GCR factor \$3.95 per Mcf for the remaining 11 months of the year.

In general, Mr. Miller agreed with the Staff's recommendation with regard to the removal of flowing gas supplies purchased for the first quarter of 2002 and the substitution of an equal amount of lower cost storage gas. However, the cost (\$6.0089 per Mcf) and volume (17 Bcf) supported by Mr. Miller differed from the cost (\$5.50 per Mcf) and volume (19.5 Bcf) supported by the Staff. Additionally, Mr. Miller did not agree with Mr. Ozar's assumption that Mich Con made a 7.9 Bcf storage increment in 2001. According to Mr. Miller, the appropriate amount of the cost reduction associated with reversal of Mich Con's storage decrement should be \$49,279,000, as shown on Exhibit I-55. However, in the event that his \$49,279,000 cost reduction is not adopted, Mr. Miller proposed an alternative \$33,000,000 cost reduction to adjust the scheduling of the fixed price purchases for the first three months of 2002, so that a much smaller quantity of gas was purchased in April 2001, with the deferred fixed price purchases rescheduled for later in the summer of 2001.

Mr. Miller also criticized Mich Con's updated NYMEX price forecast. He stated that the reductions in the forecasted prices made by Mich Con on November 27, 2001 were too small to reflect actual gas market conditions. Further, he objected to Mich Con's practice of adjusting the NYMEX price forecast. According to him, Mich Con's forecast should be based entirely on unadjusted NYMEX futures contract prices because Mich Con has not demonstrated that it possesses superior analytical techniques or has access to information unavailable to other market participants.

Mr. Miller opined that Mich Con's original NYMEX price forecast was a bit too high, but not grossly unreasonable. However, he believed that Mich Con's updated price forecast did not reasonably represent the 2002 futures contract prices prevailing at the time it was prepared. Therefore, Mr. Miller contended that Mich Con's GCR plan should be adjusted to reflect the average of the futures contract prices during the period from September 1 through November 21, 2001, which would further reduce Mich Con's 2002 GCR costs by \$15,371,185, as shown on Exhibit I-50.

Finally, Mr. Miller recommended two changes to Mich Con's proposed contingency mechanism. First, he suggested that the percentage of the adjustment should be reduced from 40% to 20% to reflect the fact that Mich Con locked in the price of additional volumes subsequent to the filing of this proceeding. Second, Mr. Miller stated that the contingency mechanism should operate in both directions, not just upward as proposed by Mich Con.

RRC

Frank J. Hollewa, an independent energy consultant, testified that Mich Con's decision to decrement storage was a matter of significant concern. He estimated that replacing 11 Bcf of the 2001 storage decrement in 2002 with \$4.37 per Mcf gas as planned by Mich Con would increase

gas costs for future GCR customers by \$44 million. Accordingly, he recommended that the Commission warn Mich Con that it would likely disallow all increased costs in 2003-2006 caused by the decision to decrement storage.

Mr. Hollewa also stated that Mich Con's decision to rely on new flowing supply during the first quarter of 2002 rather than on storage gas would result in Mich Con's GCR customers paying an additional \$54 million in gas costs during 2002. He believed that Mich Con's decision to fix the price of such gas in April of 2001 at \$6.00 per Mcf was driven primarily by the need to lock in new supply to replace gas that would normally be available from storage. He stressed that, had Mich Con chosen the alternative of refilling its storage facilities through purchases made during the summer of 2001 at a cost of \$4.00 per Mcf, the company would have reduced gas costs to its GCR customers by \$54 million during 2002. Based on Mr. Hollewa's testimony, the RRC urged the ALJ to reduce Mich Con's GCR factor by \$0.33 per Mcf.

MCAAA

The MCAAA presented two witnesses at the March 2002 hearing. Jerry E. Mendl, a registered professional engineer, and Geoffrey C. Crandall, a consultant knowledgeable in natural gas issues, agreed that Mich Con's 2002 GCR gas acquisition strategy was flawed. According to them, by purchasing so much gas well in advance of 2002, Mich Con obtained supply and price security by relinquishing flexibility that could have allowed the utility to reap the benefits of the price decreases that subsequently materialized. Further, they criticized Mich Con for locking up 80% of its 2002 GCR requirements by August 2001 by conducting a July 2001 "contracting spree." They also suggested that Mich Con should have followed the gas acquisition strategy of Consumers, which featured a more gradual commitment to fixed price contracts.

Through the testimony of these witnesses, the MCAAA expressed its opinion that low-income and residential GCR customers of Mich Con would suffer if subjected to a 48% increase in the GCR cost of gas. The MCAAA urged the Commission to either continue the \$2.95 per Mcf GCR factor for all of 2002, or, in the alternative, approve a GCR factor for 2002 that could not exceed \$3.40 per Mcf. In so doing, the MCAAA stressed that although Mich Con is required by Act 304 to demonstrate its attempts to hold down costs through regulatory and legal actions, no such information was forthcoming from Mich Con's witnesses. Moreover, it asserted that because Mich Con's customers paid for the injection of relatively inexpensive storage gas, the customers should have benefited more when such gas was accessed. Indeed, it contended that the Commission should investigate alternative accounting approaches to address this issue.

Because several of Mich Con's short-term supply contracts involve Vector Pipeline, which is partly owned by an affiliated company, the MCAAA also recommended that the Commission investigate the recent merger between Mich Con and The Detroit Edison Company (Detroit Edison). Finally, it insisted that the contingency mechanism proposed by Mich Con was flawed due to its unrealistically high percentage price adjustment and its one-direction operation.

Proposal for Decision

The ALJ recommended that the Commission calculate Mich Con's 2002 GCR factor by adding 19 Bcf of natural gas to Mich Con's January 1, 2002 storage level to nullify the effect of Mich Con's decision to decrement storage in 2001 by 19 Bcf. The effect of the ALJ's recommendation would reduce Mich Con's 2002 gas costs by \$26,529,000. The ALJ also recommended that the Commission reject both Mich Con's proposal to implement a contingent GCR factor mechanism and its CTN protection plan.

Exceptions

1. Retroactivity of Act 304

Mich Con asserts that the \$26,529,000 downward adjustment to its 2002 GCR plan is improperly based on the erroneous determination that the reasonableness and prudence test contained in Act 304 can be applied retroactively to any prior year decision that directly affects the volume, costs, or availability of gas in storage proposed in its 2002 GCR plan. According to Mich Con, the review of its 2002 GCR plan is expressly limited by the 2001 year-end gas storage balances. In other words, it is Mich Con's belief that the Commission lacks authority under Act 304 to review the reasonableness and prudence of Mich Con's gas storage actions during 2001.

Citing Franks v White Pine Copper Division, 422 Mich 636; 325 NW2d 715 (1985) and Hughes v Judges Retirement Bd, 407 Mich 75; 282 NW2d 160 (1979), Mich Con insists that the PFD advocates retroactive application of the Act 304 reasonableness and prudence standard to Mich Con's 2001 gas storage withdrawals, which were never intended to be subject to such scrutiny. Indeed, Mich Con argues that review of its 2001 gas storage withdrawals would impose a new obligation upon Mich Con that was not contemplated by the express terms of the April 28, 1998 order in Case No. U-11682.

Mich Con also maintains that the directive contained in MCL 460.6h(6) for the Commission to consider "the availability of gas in storage" limits the review in a subsequent GCR plan to consideration of the utility's 2002 actions based on the volume of gas in storage at the beginning of the plan year. Mich Con insists that the storage activity criticized by the ALJ occurred in 2001 as part of the GCC program and cannot now be scrutinized by the Commission.

Mich Con also argues that the ALJ's reliance on City of Detroit v Public Service Comm, 308 Mich 706; 14 NW2d 784 (1944), is misplaced. In so doing, Mich Con contends that Act 304 does

not authorize the Commission to apply the reasonableness and prudence test to storage actions that occurred during suspension of its GCR clause.

Mich Con also insists that the ALJ should not have compared details of the company's forecast for 2001 contained in Mich Con's 1998 five-year forecast to its actual performance in 2001. According to Mich Con, any such comparison is meaningless because the 1998 five-year forecast was made in 1997 before the three-year GCC program was ever contemplated.

Finally, Mich Con contends that the ALJ improperly determined that the 2001 year-end storage balance was unreasonable because the final four years of Mich Con's five-year forecast include storage balances that more closely approximate year-end storage balances of past GCR plans. Mich Con argues that this conclusion is just another form of retroactive application of Act 304 predicated on an assumption that Mich Con was required by Act 304 to manage its gas storage assets in 2001 for the benefit of GCR customers in 2002. In support of this conclusion, Mich Con maintains that the Staff acknowledged that the gas in Mich Con's storage fields belongs to Mich Con, not its GCR customers.

In response, the Staff contends that Mich Con's argument features a "crabbed" analysis of Act 304 that amounts to an avoidance of that law's most applicable provision. According to the Staff, the ALJ correctly observed that GCR plans are not completely independent. For example, the Staff stresses that Mich Con's 2001 year-end storage volumes not only determined the available storage gas at the beginning of 2002, but also directly affected the availability of storage gas throughout the balance of 2002. The Staff also insists that the ALJ correctly analyzed Mich Con's orchestration of the 2001 storage decrement and its \$26,529,000 adverse effect on Mich Con's 2002 GCR plan.

The Attorney General maintains that the ALJ rightly found that Section 6h(6) of Act 304 requires evaluation of the reasonableness and prudence of the decisions underlying the GCR plan, even if it means that the Commission reviews actions taken during the prior year. According to the Attorney General, Mich Con's activities during 2001 are subject to scrutiny under Act 304 in this proceeding to the extent that they affect the company's 2002 GCR plan and the cost of gas for 2002. The Attorney General insists that the GCR process is inherently retroactive because it requires looking back for purposes of establishing future rates rather than for purposes of correcting past "inequities." Moreover, the Attorney General states that the PFD's consideration of Mich Con's activities prior to the 2002 plan year was not motivated by a desire to change any rates in effect prior to 2002. Rather, the PFD's consideration of Mich Con's storage activities occurred in the context of determining whether Mich Con's 2002 GCR factor was reasonable and prudent. The Attorney General agrees with the ALJ that Mich Con's 2001 storage decrement clearly increased the company's planned gas purchases for the first quarter of 2002 and evidenced an unreasonable and imprudent use of its gas storage resources.

The RRC maintains that Mich Con's retroactivity argument is flawed because most, if not all, of Mich Con's 2002 GCR supply decisions were made in 2001. The RRC insists that the Commission must be able to review Mich Con's 2001 decisions because acceptance of Mich Con's position would lead to an absurd result. Moreover, the RRC stresses that in 2001, when Mich Con was making the decision to decrement storage, Mich Con was fully aware of the effect that the 2001 storage decrement would have on its 2002 GCR plan and factor. Viewed in this context, the RRC argues that Mich Con's protest against retroactive application of Act 304's reasonableness and prudence standards to its 2001 decision to buy high-priced gas to meet its 2002 GCR supply requirements instead of using available lower cost gas in storage is disingenuous.

The RRC also contends that the April 28, 1998 order in Case No. U-11682 does not legitimize Mich Con's 2001 decision to experience a storage decrement. The RRC argues that Mich Con's application in Case No. U-11682 acknowledged and accepted all of the risks associated with the three-year GCC program, including the risk of an increase in the cost of gas. According to the RRC, nothing in Mich Con's application or the Commission's order in Case No. U-11682 suggests an intent to insulate Mich Con from the consequences of a price run-up during the GCC program or that Mich Con would be free to mitigate the risks of market prices for natural gas by pulling cheap gas out of storage to mitigate its losses. On the contrary, the RRC states that a close reading of the averments contained in Mich Con's application in Case No. U-11682 shows that Mich Con committed to accept all risks associated with the price freeze without qualification.

Finally, the MCAAA echoes many of the same points stressed by the RRC. In so doing, the MCAAA insists that the retroactivity argument interjected by Mich Con has no merit. The MCAAA also contends that the Commission is the best judge of whether the April 28, 1998 order in Case No. U-11682 silently authorized Mich Con to shift the risk of cost increases from itself to its GCR customers. Accordingly, the MCAAA urges the Commission to reject Mich Con's arguments that the 2001 storage decrement relates wholly to 2001 and cannot be reviewed in this proceeding.

The Commission finds that Mich Con's exception regarding the alleged retroactive application of the reasonableness and prudence standard set forth in Act 304 to its 2001 decision to decrement its gas storage volumes by 19 Bcf is not well taken. To begin with, Act 304 is not being applied retroactively. Act 304 became law on October 13, 1982, well before the decision by Mich Con to

incur a storage decrement in 2001. Therefore, the Franks⁸ and Hughes⁹ decisions are distinguishable.

Next, although the Commission's April 28, 1998 order in Case No. U-11682 temporarily relieved Mich Con from adherence to the GCR process from January 1, 1999 to December 31, 2001, that order did not explicitly or implicitly indicate that Mich Con could avoid scrutiny of any management decision that would adversely affect Mich Con's 2002 GCR plan or factors. Indeed, Mich Con knew from April 28, 1998 that it would be required to file a GCR plan for 2002. Moreover, Act 304 requires Mich Con's 2002 GCR plan not only to completely describe its expected sources and volumes of gas, but also to offer an evaluation of the reasonableness and prudence of its decisions to obtain gas in the manner described in the plan. In this proceeding, the Commission is required to evaluate the reasonableness and prudence of all of the decisions underlying Mich Con's 2002 GCR plan. Such decisions are not exempt from review simply because they may have occurred prior to 2002. Indeed, because a GCR plan must be filed at least three months before the beginning of the plan year, of necessity all decisions described in a GCR plan will have occurred prior to commencement of the plan year.

In reviewing Mich Con's 2002 GCR plan, the Commission must consider the volume, cost, and reliability of the major gas supplies available to Mich Con, the cost of alternative fuels available to some or all of Mich Con's customers, the availability of gas in storage, the ability of Mich Con to reduce or to eliminate sales to out-of-state customers, whether Mich Con has taken all appropriate legal and regulatory actions to minimize the cost of purchased gas, and other

⁸Franks concerns application of a benefit coordination provision enacted in 1982 to the prospective coordination of worker compensation benefits payable for injuries incurred prior to its enactment.

⁹Hughes concerns application of a December 18, 1974 amendment regarding judicial pensions to prospective payments made to judges who had retired prior to passage of the amendment.

relevant factors. MCL 460.6h(6). Mich Con has not persuasively argued that the Commission abdicated its responsibility to fully comply with Act 304 or otherwise absolved Mich Con from any of the provisions of Act 304 in 2002 on the basis of an order issued in 1998 that pertains to 1999, 2000, and 2001.

Moreover, the Commission agrees with the ALJ that GCR plan years are not entirely discrete.

As observed by the ALJ:

The 2002 calendar year, like other calendar years, is not completely independent when considering potential influences that can impact the booked cost of gas sold by the utility. For example, the stored gas volume accumulated during the previous year will directly affect what the stored gas volume will be for the beginning of the subsequent year, which will directly affect the amount of stored gas volume that can be drawn upon in the subsequent year to supplement flowing gas purchased. The less flowing gas purchased will generally result in lower gas costs for the particular year.

PFD, p. 8.

The Commission also rejects Mich Con's contention that the phrase "the availability of gas in storage" that appears in MCL 460.6h(6) only allows the Commission to review in a subsequent GCR plan the utility's actions based on the volume of gas in storage at the beginning of that plan year. Mich Con's strained interpretation of MCL 460.6h(6) is not supported by case law or logic, and would effectively eliminate the Commission's ability to impose sanctions for a utility's unreasonable and imprudent manipulations of its storage volumes.

2. Retroactive Ratemaking

In its exceptions, Mich Con argues that the ALJ engaged in retroactive ratemaking by recommending that Mich Con's decision to incur a storage decrement in 2001 should result in a 2002 GCR disallowance. Citing Michigan Bell Telephone Co v Public Service Comm, 315 Mich 533; 24 NW2d 200 (1946), Mich Con contends that retroactive ratemaking occurs whenever the

Commission issues a lawful rate order and subsequently ignores its previous determination as to the reasonableness of the rate it prescribed.

According to Mich Con, the April 28, 1998 order in Case No. U-11682 fixed its gas commodity rate at \$2.95 per Mcf for 1999-2001, which was deemed reasonable and in the public interest. Thereafter, pursuant to the authority granted to it by the April 28 order, Mich Con determined that it would be appropriate to decrement its storage by 19 Bcf in 2001. Mich Con insists that the ALJ's recommendation that the Commission adjust its January 1, 2002 gas storage balance upward by 19 Bcf is improper because the Commission has no authority to declare the previous rate unreasonable. Simply stated, Mich Con believes that "declaring that the storage decrement in 2001 was unreasonable is a declaration that \$2.95 per Mcf is unreasonable." Mich Con's exceptions, p. 13. Moreover, citing Consumers Power Co v Public Service Comm, 460 Mich 148; 596 NW2d 126 (1999), Mich Con argues that the Commission has no statutory authority to require implementation of the GCC program. Therefore, Mich Con reasons that if the Commission could not order implementation of the GCC program, the Commission certainly lacks authority to implement changes to the GCC program on a retroactive basis under the guise of an Act 304 proceeding.

Further, Mich Con likens the recommended 2002 GCR cost disallowance to a refund. Mich Con asserts that because the ALJ recommends adjustment of a future rate based solely on a finding that past activity is now, upon subsequent review, unreasonable, the adjustment constitutes a refund that is prohibited not only by the April 28 order, but also by the rule against retroactive ratemaking. In any event, Mich Con contends that its 2001 gas storage withdrawals are already subject to Commission review for reasonableness in the context of the 2001 earnings sharing mechanism under review in Case No. U-13342, which was filed on March 28, 2001.

In response, the Staff contends that the ALJ's recommendation does not involve retroactive ratemaking because it will not affect the \$2.95 per Mcf rate in effect during 2001. Further, according to the Staff, Mich Con's decision to manipulate its gas storage levels manifestly underlies its unreasonable 2002 GCR plan and is therefore reviewable in this proceeding. Although acknowledging that the decision to decrement gas storage was a matter of management prerogative, citing Union Carbide v Public Service Comm, 431 Mich 135; 428 NW2d 322 (1988), the Staff insists that the Commission possesses sufficient ratemaking authority pursuant to Act 304 to deny Mich Con recovery of a GCR cost incurred as the result of an unreasonable or imprudent management decision.

The Attorney General argues that Mich Con's retroactive ratemaking argument is either a deliberate attempt at obfuscation or a misunderstanding of the concept of retroactive ratemaking. According to the Attorney General, Act 304 requires the Commission to take into account the decisions underlying Mich Con's GCR plan, including previously established appropriate beginning storage balances necessary to meet the needs of the GCR customers at a reasonable price. Such determinations must include scrutiny of Mich Con's prior year's activities to the extent that they constitute the foundation of the GCR plan. To that end, the Attorney General maintains that the GCR process is inherently retroactive.

The RRC contends that many of Mich Con's criticisms of the PFD are unfounded and misleading. For example, the RRC insists that the ALJ's recommendations involve neither a refund nor retroactive ratemaking. According to the RRC, while the Commission's review in an Act 304 GCR plan proceeding may result in a disallowance of costs in establishing the utility's annual GCR factor, there is no provision in Act 304 for a refund as the result of a plan proceeding. Additionally, the RRC stresses that the PFD does not advocate setting aside any findings made in

the April 28, 1998 order in Case No. U-11682. Indeed, the RRC asserts that the Mich Con should be required to live up to the representations made in its application in Case No. U-11682, wherein Mich Con repeatedly stated its intention to bear all of the risks of gas cost increases without even a hint that the utility might endeavor to minimize losses by decrementing gas storage.

Finally, the MCAA states that Mich Con's arguments about retroactive ratemaking are erroneous, unsupported, and inconsistent. Further, the MCAA points out that Mich Con has never provided a reference to any specific language contained either in its application in Case No. U-11682 or in the April 28, 1998 order that would support its claim that the Commission authorized Mich Con to decrement storage by 19 Bcf in 2001. The MCAA maintains that Mich Con simply panicked when the price of gas peaked in 2000-2001, and now is desperately trying to avoid the promises made to the Commission and its ratepayers in its Case No. U-11682 application. The MCAA urges the Commission to wield its unfettered authority under Act 304 to protect Mich Con's ratepayers from the utility's unreasonable management decisions.

The Commission finds that Mich Con's retroactive ratemaking and illegal refund arguments lack merit and should be rejected. The rate at issue in this proceeding is Mich Con's 2002 GCR factor. The \$26,529,000 downward adjustment to Mich Con's 2002 GCR costs recommended by the ALJ is an appropriate rate revision within the powers vested in the Commission by Act 304. For this reason, the Michigan Bell and Consumers Power cases cited by Mich Con are distinguishable.

Moreover, contrary to Mich Con's contentions, nothing in this case involves the reasonableness of the \$2.95 rate charged to Mich Con's customers during 2001 or a refund based on the difference between Mich Con's 2001 costs and revenues. As far as the Commission is concerned,

Mich Con's allegations regarding retroactive ratemaking and illegal refunds are "red herrings" that Mich Con has unsuccessfully raised in hopes of diverting attention away from the real issues.

Likewise, the Commission is not persuaded by Mich Con's arguments that the April 28, 1998 order in Case No. U-11682 lends any support to Mich Con's position. Mich Con's Case No. U-11682 application is laced with pledges to the effect that the utility will bear the risk of higher prices and that it will buy higher-priced gas to meet its supply needs. The Commission has not found (and Mich Con has failed to identify) any averment regarding a possibility that Mich Con would attempt to render all such promises illusory at the expense of its 2002 GCR customers.

Due to the combination of Mich Con's use of LIFO accounting, the relatively inexpensive gas buried in the older storage layers, and the very high-priced gas that Mich Con had to acquire to replace the 19 Bcf storage decrement, absent the adjustment recommended in the PFD, Mich Con's 2002 GCR customers will be required to bear the financial burden of the utility's imprudence. Act 304 was enacted to ensure that the utility, not its customers, is responsible for such ill-advised gas supply decisions.

Finally, the Commission finds that Mich Con's reference to Case No. U-13342 and the intimation that a decision in that proceeding regarding the storage decrement issue could unduly benefit its ratepayers is disingenuous. An examination of the application and subsequent pleadings filed in Case No. U-13342 fails to substantiate Mich Con's suggestion that the reasonableness and prudence of Mich Con's decision to decrement storage in 2001 is at issue in that proceeding or could involve Mich Con's customers receiving the value of the storage decrement a second time.

3. Additional Cost Reductions

In its exceptions, the RRC praises the ALJ's recommended \$26,529,000 cost reduction as a step in the right direction. However, the RRC believes that the appropriate cost reduction should

be much larger. According to the RRC, the Commission should reduce \$54 million from Mich Con's 2002 GCR plan to reflect all the cost consequences of the company's unreasonable and imprudent decision to meet its winter 2002 gas supply needs by purchasing flowing gas instead of relying on gas in storage.

In support of its position, the RRC argues that, reduced to its essence, Mich Con's testimony regarding the reasonableness and prudence of its 2002 gas acquisition strategy amounts to nothing more than one witness's proclamation that he merely executed the disputed purchases as directed by his superiors. On the other hand, the RRC maintains that Mr. Hollewa determined that Mich Con acted unreasonably and imprudently by fixing the price for 27 Bcf of Firm Primary Service (FPS) gas in April 2001 at an average of \$6.00 per Mcf for use in the first quarter of 2002. According to the RRC, had Mich Con waited until the summer of 2001 to fix the price of that gas, the utility could have saved \$2.00 per Mcf for the 27 Bcf of gas at issue, or \$54 million.

Mich Con responds by repeating its arguments regarding the retroactive application of Act 304, retroactive ratemaking, and illegal refunds, which have been rejected. It also repeats its contention that the April 28, 1998 order in Case No. U-11682 somehow immunized it from application of Act 304 during 2002 if the determination at issue involved the use of storage gas during 2001, which has also been rejected.

Mich Con states that the gas in storage belongs to it, not its ratepayers. Indeed, Mich Con cites Mr. Ozar's testimony that Mich Con was entitled to all of the gain on the gas sold during the price freeze, including gas withdrawn from storage for \$0.40 per Mcf. Further, Mich Con maintains that its decision to decrement storage must be viewed in light of the conditions at the time that the decision was made. According to Mich Con, in April 2001 it was eminently reasonable for Mich Con to decide to decrement storage in 2001 and to fix the price of flowing

supply for use in the first quarter of 2002. Citing market fundamentals and market prices in April 2001, Mich Con states the RRC's 20/20 hindsight and subsequent natural gas prices are simply not relevant to a determination of the reasonableness or prudence of its April 2001 decisions.

The Commission finds that the RRC's exception should not be granted. An examination of the PFD indicates that the ALJ did not fault Mich Con for its decision to fix the price of the 27 Bcf of FPS gas in April 2001 versus waiting until later that year to do so. Rather, the ALJ found that the basis for determining Mich Con's 2002 GCR plan to be unreasonable and imprudent was the utility's decision to incur an unusually significant storage decrement. Having made that determination, it was appropriate to fashion the remedy permitted under Act 304 by ignoring the decrement for the purpose of calculating Mich Con's 2002 GCR factor, which is precisely the approach presented by Staff witness Ozar.

Mr. Hollewa's methodology, which focuses on the difference between gas prices at different times in 2001, is inconsistent with Mr. Ozar's approach and, more importantly, ignores an abundance of case law that requires the Commission to evaluate the reasonableness and prudence of a utility's decision to buy gas on the basis of the information available at the time the decision was made, not through the use of hindsight.

4. Contingent factor adjustment mechanism

Mich Con's proposed GCR plan provided for a contingent factor adjustment mechanism, which would allow for upward adjustments under certain circumstances. The proposed contingent factor adjustment mechanism would authorize Mich Con to request implementation of a contingent factor reflecting the effect of the average NYMEX prices for the remaining 2002 GCR months. Such requests could be filed on December 15, 2001, March 15, 2002, June 15, 2002, and September 15, 2002. If average NYMEX prices for the corresponding period were greater than

the prices in the original GCR filing, Mich Con would be allowed to raise its maximum GCR factor by 40 % of the difference between the filed NYMEX prices and the more current average NYMEX prices. Mich Con represented that the proposed adjustment mechanism is similar to the methodology approved by the Commission in Mich Con's 1998 GCR plan proceeding, Case No. U-11455, but updated to reflect recent Commission-approved settlement agreements incorporating GCR contingency factors for Consumers and Michigan Gas Utilities Company (MGU) in Cases Nos. U-12752 and U-12617, respectively.

The ALJ rejected Mich Con's contingent factor adjustment mechanism. In so doing, he examined the Commission's order in Case No. U-11455 and determined that the contingent factor adjustment mechanism approved in that proceeding was symmetrical. Additionally, he was persuaded by that fact that in Case No. U-11455, the Commission had explicitly indicated that the adjustment mechanism approved for use by Mich Con during 1998 fulfilled the prerequisites of Section 6h(6) of Act 304, MCL 460.6h(6), because it "permit[s] a contingent factor that, on a quarterly basis, adjusts the authorized GCR factor upwards or downwards by 9.4¢ for every 10¢ change in the quarterly average NYMEX price from the level used in calculating the GCR factor in this case." April 14, 1998 order, Case No. U-11455, pp. 8-9. After carefully scrutinizing the adjustment mechanism approved in Case No. U-11455, the ALJ observed that the adjustment mechanism proposed by Mich Con in this proceeding did not incorporate symmetrical application of the contingent factor upwards and downwards:

The Commission in its approval of the contingent factor modified the application to apply symmetrically upwards or downwards. By not incorporating symmetry, MichCon's proposal is inconsistent with the Commission's prior modifications. Therefore, the ALJ recommends rejection of the proposed contingent factor or its modification to include downwards adjustments as already modified by the Commission.

PFD, p. 35.

Exceptions were submitted by Mich Con and the MCAAA. Mich Con argues that its proposed contingency factor methodology provides a reasonable and prudent solution to the problem of increased market prices. Mich Con also argues that mandatory downward adjustments are unnecessary because under the provisions of Act 304, Mich Con may unilaterally lower the GCR factor. Moreover, Mich Con stresses that because Section 6h(15) of Act 304, MCL 460.6h(15), requires the Commission to calculate interest on GCR overrecoveries at the higher of the utility's short-term borrowing rate or its rate of return on common equity, there is a built in disincentive for a utility to incur an overrecovery. In any event, Mich Con insists that its proposal is identical to the mechanism approved by the Commission's July 25, 2001 order in Case No. U-12752 for Consumers, which does not require symmetrical adjustments.

The MCAAA urges the Commission to broaden the overly limited and narrow rationale cited by the ALJ as support for his rejection of Mich Con's adjustment mechanism. According to the MCAAA, Mich Con's proposed upward contingent factor constitutes a quarterly automatic escalation clause that is unlawful, unreasonable, and unnecessary given the procedures and protections established in Act 304. The MCAAA insists that there is no statutory authority for the Commission to approve such a provision. Further, citing Attorney General Opinion 4844 of 1974, the MCAAA argues that the proposed adjustment mechanism violates the notice and hearing requirements set forth in Section 6a of 1939 PA 3, MCL 460.6a. The MCAAA also states that Mich Con's proposed adjustment mechanism is inconsistent with the spirit of Act 304 and unnecessary given the GCR reconciliation process. Finally, the MCAAA maintains that the Commission should determine as a matter of regulatory policy that the proposed adjustment mechanism should be rejected because it does not operate symmetrically.

Although Mich Con's request to implement its contingent factor adjustment mechanism is moot for the 2002 GCR year, the Commission finds that it should address one aspect of the issue at this time due to the likelihood that it will arise in a subsequent GCR proceeding. In so doing, the Commission notes that it recently approved settlement agreements incorporating GCR contingency adjustment mechanisms for Consumers and MGU in Cases Nos. U-12752 and U-12617, respectively. In both cases, the approved adjustment mechanisms do not require mandatory downward adjustments. Likewise, the Commission finds no requirement in Section 6h(6) of Act 304 mandating symmetry. Accordingly, if the issue arises in a subsequent proceeding, the Commission is persuaded that the lack of symmetrical application of an otherwise appropriate GCR contingency adjustment mechanism should not be considered an impediment to its approval. However, the Commission will require Mich Con to abide the same terms applicable to Consumers and MGU.

5. Colder-than-normal protection plan

The ALJ recommended that the Commission disapprove Mich Con's CTN protection plan that was described by Mr. Borra. In so doing, he stated:

After referring to MichCon's 2002 CTN Protection Plan, Exhibit No. A-17, the ALJ finds that MichCon's plan to meet CTN demand is to purchase a large portion of the required gas supply in the form of flowing gas. Since the purchase of this flowing gas will occur in the months of the first quarter of the year, the gas will be purchased at the historically most expensive time of the year. In contrast, if MichCon did not reduce their CTNP gas volumes by 3 Bcf, less than half of the gas volume would have to be purchased during the first quarter to meet MichCon's 2002 CTN protection plan. Furthermore, if the gas volume set aside for CTNP was purchased during the summer months, MichCon would be using gas volume purchased at a historically cheaper rate, which would relate to a lower booked cost of gas for the year. As RRC witness Mr. Hollewa testified, "he had never seen a futures price or a price opportunity to buy gas in January that was equal to or less than what you could buy gas for in June." Tr 8, p 1148, lines 1-3.

According to MichCon's 2002 CTN protection plan, CTN protection will be provided by purchasing 5 Bcf during the month of the CTN temperatures. MichCon, as provided in its CTN Protection Plan, will be still be [sic] required to purchase 2 Bcf of gas to meet CTN demand, even if MichCon did not reduce the CTNP in storage by 3 Bcf. Consequently, the ALJ finds that MichCon's proposed modification of its CTN supply plan should be rejected.

PFD, p. 38.

In its exceptions, Mich Con argues that the PFD's rejection of Mich Con's CTN protection plan is not based record evidence. According to Mich Con, the ALJ ignored the evidence presented by Mich Con's witnesses in favor of pure speculation.

Mich Con explains that CTN protection was developed based on the coldest December-March period during the last 30 years (1977-78). This data was applied to the 2002 GCR plan case heating factors to derive the incremental send out that would be required if such weather occurred. Mich Con then added an additional 3 Bcf for the possibility that CTN temperatures could exceed the 30-year low. Moreover, Mich Con explained that this methodology ultimately results in a reduction of CTN protection gas in storage of only 3 Bcf, i.e. 10 Bcf to 7 Bcf.

Mich Con asserts that its CTN protection plan is clearly reasonable. In so doing, it maintains that the speculation interjected into this proceeding by the intervenors and the Staff is predicated on historical storage balances that were not normalized for weather or other significant events. Further, Mich Con states that significant changes in regulation have caused significant changes in the industry's utilization of storage. For that reason, Mich Con argues that historical storage balances must be normalized in order to be meaningful. Therefore, according to Mich Con, the ALJ's recommendation is clearly erroneous because it is based upon flawed and misleading information.

The Commission finds that the issue of the reasonableness and prudence of Mich Con's CTN protection plan should be deferred to a future GCR proceeding. Although the ALJ recommended

rejection of Mich Con's 2002 CTN protection plan, he failed to identify the economic effect that such a determination could have on the company's 2002 GCR factor. An examination of the record and the pleadings filed by the Staff and intervenors does not disclose any useful information regarding this question. The merits of Mich Con's CTN protection plan were not addressed in the testimony of either of the Staff's witnesses. Additionally, although the Staff did comment on the issue in its brief, it appears that the Staff's primary concern involves the possibility that Mich Con could reduce the amount of storage capacity dedicated to serve GCR customers in order to expand storage service to third parties. Moreover, Mich Con points out that the position taken by the Staff on this issue is based primarily on stale data from a previous case rather than on record evidence in this proceeding. Therefore, the Commission is persuaded that its determination of this issue should be deferred to a future GCR proceeding.

6. Stricken testimony

A. Energy efficiency and conservation programs.

The MCAAA attempted to introduce testimony in support of its position that the Commission should require Mich Con to ameliorate high gas costs to residential and low-income customers by adopting effective energy efficiency and conservation programs. The ALJ ordered the bulk of such proposed testimony stricken from the record.

In its exceptions, the MCAAA objects to the ALJ's evidentiary ruling and urges the Commission to require Mich Con to lower its gas costs through implementation of effective energy efficiency and conservation measures.

In response, Mich Con states that the Commission has no authority under Act 304 to order Mich Con to conduct energy efficiency and conservation programs.

The Commission finds that the MCAAA's exception lacks merit. It is well established that the Commission has no authority to force a utility to engage in energy efficiency and conservation programs against its wishes. Ford Motor Co v Public Service Comm, 221 Mich App 370; 562 NW2d 224 (1997).

B. Merger investigation

The MCAAA also objects to the ALJ's failure to allow the MCAAA to pursue its position that the Commission should undertake an investigation into the merger between Detroit Edison and Mich Con. According to the MCAAA, the record is unbalanced because the ALJ allowed Mich Con's witnesses to make comments about the merger, while denying the MCAAA an opportunity to do so.

Mich Con responds that the Commission lacks authority under Act 304 to conduct the type of investigation sought by the MCAAA.

The Commission finds that the MCAAA's exception should be denied because it is not persuaded that an investigation into the effects of the Detroit Edison/Mich Con merger would be germane to this proceeding. However, the MCAAA is encouraged to pursue its concerns at such time that a more appropriate proceeding for investigating the Detroit Edison/Mich Con merger reaches the Commission.

7. Section 6h(7) warnings

Section 6h(7) of Act 304, MCL 460.6h(7), authorizes the Commission to issue warnings regarding aspects of a utility's five-year GCR forecast that, on the basis of present evidence, the Commission would be unlikely to permit the utility to recover from its customers in the future. The record reflects requests for the Commission to issue three such warnings.

First, in its testimony, the Staff recommended that the Commission issue a warning pursuant to Section 6h(7) to advise Mich Con that the Commission may not allow the utility to recover the costs associated with higher than market average prices if Mich Con continues to use the gas acquisition strategy described in the testimony of Mich Con witness McCrackin. In its brief, the RRC expressed support for the Staff's position.

The ALJ did not address the Staff's recommendation and the Staff chose not to submit an exception regarding the issue. However, the RRC did raise the issue in its exceptions.

According to the RRC, Mich Con's 2002 GCR plan was flawed because it was unreasonable for the utility to implement a hurdle pricing strategy during the 18-month period that could have been the most volatile price period in history. The RRC is also concerned that almost 50% of Mich Con's 2002 supply requirements was purchased through use of the hurdle pricing strategy within a 17-day timeframe.

The RRC asserts that Mich Con's hurdle pricing strategy must be revised. In the RRC's opinion, Mich Con should use two downward hurdles of \$2.50 and \$3.00 and two upward hurdles of \$3.50 and \$4.00, provided that there is a monthly cap on the volume of gas that may be purchased in any given month. Absent such a change, the RRC urges the Commission to issue a warning pursuant to Section 6h(7) to advise Mich Con that the Commission may not allow the utility to recover the costs associated with higher than market average prices.

Mich Con argues that its hurdle pricing mechanism was designed to ensure that GCR customers would not be subject to the full effect of any potential price run-up in the first quarter of 2002 and provided the utility with the opportunity to lock in relatively low future gas prices. Moreover, Mich Con states that its acquisition strategy reflects similar conclusions reached by other Michigan gas utilities and was supported by market indicators. Mich Con explains that its

hurdle pricing strategy uses a combination of historical price trends and the current NYMEX forward curve, which when plotted as a logarithmic trend analysis smoothes out market volatility. According to Mich Con, the RRC's criticisms are based on hindsight and current market conditions, which are not appropriate means to determine that Mich Con's reliance on the hurdle pricing mechanism was unreasonable.

The Commission finds that the warning supported by the RRC should be issued at this time. While Mr. Sharkey testified that the Staff generally supports different methods used by utilities to meet the requirements of Act 304 and that the price hurdle approach advocated by Mr. McCrackin was "innovative and very well thought out and appears to be a very viable method of meeting the requirements of the Act," he also testified that Mich Con had fixed the price for almost 100% of its anticipated sales balances for 2002 by the end of October 2001 while prices were still high as a result of a price spike in the winter of 2000-2001. 9 Tr. 1258. He argued that the execution of Mich Con's price hurdle approach warranted a warning that the utility might not be permitted to recover costs associated with higher than average prices. The Commission agrees.

Second, the RRC requested in its brief that Mich Con be warned that it may not be permitted to recover any increased gas costs that could be recognized during the out years of its five-year GCR forecast that are due to its 2001 decision to decrement storage.

The ALJ did not address this issue.

In its exceptions, the RRC maintains that Mich Con's 2002 efforts to replenish its storage fields could increase future gas costs. Indeed, citing the testimony of Frank J. Hollewa, its independent energy consultant, the RRC argues that the future increased gas costs could amount to over \$44 million.

Mich Con replies that its decision to decrement storage in 2001 cannot be reviewed in this proceeding and should not be the basis for an Act 304 disallowance.

The Commission is not persuaded that the warning requested by the RRC is appropriate at this time. Mr. Hollewa apparently calculated his future excess GCR costs by multiplying the 11.1 Bcf 2002 storage increment by the \$4.00 difference between the LIFO rate of \$4.37 for the newly created LIFO layer and the LIFO rate of \$0.37 associated with decremented storage levels. This approach seems to ignore the effects of the \$26,529,000 reduction in costs approved by this order. Further, it appears to involve assumptions about the LIFO rates of future storage increments and decrements that may not be accurate. Therefore, the Commission finds that the merits of this issue should be addressed on a case-by-case basis in Mich Con's future GCR proceedings.

Third, the RRC requested a warning pertaining to Mich Con's adjustment of published NYMEX prices. Citing the testimony of Mr. Chapel from the temporary order phase of the proceeding, the RRC stresses that Mich Con did not use an unaltered NYMEX strip price to project gas costs in this proceeding. Rather, the RRC asserts that Mr. Chapel admitted that Mich Con based its 2002 gas price projections on NYMEX strip prices that were adjusted through use of a mechanism that was not adequately explained on the record. According to the RRC, Mich Con provided no exhibits or work papers showing the historical data used by Mr. Chapel to adjust the NYMEX strip for November 21, 2001, nor did Mich Con provide the logarithmic regression that he used. For these reasons, the RRC insists that the Commission should warn Mich Con that, absent evidence that demonstrates the necessity for adjustments to the NYMEX strip prices, it is unlikely to approve the company's future GCR plans and requested GCR factors unless Mich Con uses the actual NYMEX strip as the basis for its price forecast.

In response, Mich Con maintains that the RRC criticism of its NYMEX forecast is not well taken. Mich Con insists that adjustment of its NYMEX forecast is appropriate to reflect the difference between NYMEX commodity only prices and the additional costs for transportation and fuel required to actually deliver the gas to Mich Con's city gate.

The Commission finds that the warning requested by the RRC should not be issued. The projection of a future price is not an exact science and may be accomplished in myriad ways. Pursuant to Act 304, Mich Con's NYMEX forecast must be reasonable, not infallible. Moreover, Mich Con's actual gas procurement decisions are subject to an after-the-fact reconciliation proceeding.

The Commission FINDS that:

- a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCL 462.2 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACCS, R 460.17101 et seq.
- b. Mich Con's 2002 GCR plan and monthly factors should be amended to reflect the determinations made in this order.
- c. Mich Con's projected 2002 GCR expenses should be reduced by \$26,529,000 for the purpose of establishing its 2002 GCR factor.
- d. Mich Con should be warned that the Commission may not permit it to recover the costs associated with higher than market average gas prices if the utility continues to use the gas acquisition strategy described in the testimony of Mr. McCrackin.

THEREFORE, IT IS ORDERED that:

A. The amended 2002 gas cost recovery plan and factors approved by this order shall be used to reconcile Michigan Consolidated Gas Company's 2002 gas cost recovery expenses and revenues.

B. Michigan Consolidated Gas Company's projected 2002 gas cost recovery expenses are reduced by \$26,529,000 for the purpose of calculating its 2002 gas cost recovery factor.

C. Michigan Consolidated Gas Company is placed on notice pursuant to Section 6h(7) of 1982 PA 304, MCL 460.6h(7), that the Commission may not permit it to recover the costs associated with higher than market average gas prices if the utility continues to use the gas acquisition strategy described in the testimony of Kevin M. McCrackin, its Gas Supply Director.

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.

MICHIGAN PUBLIC SERVICE COMMISSION

(S E A L)

/s/ Laura Chappelle
Chairman

By its action of March 12, 2003.

/s/ David A. Svanda
Commissioner

/s/ Dorothy Wideman
Its Executive Secretary

/s/ Robert B. Nelson
Commissioner

THEREFORE, IT IS ORDERED that:

A. The amended 2002 gas cost recovery plan and factors approved by this order shall be used to reconcile Michigan Consolidated Gas Company's 2002 gas cost recovery expenses and revenues.

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C. Michigan Consolidated Gas Company is placed on notice pursuant to Section 6h(7) of 1982 PA 304, MCL 460.6h(7), that the Commission may not permit it to recover the costs associated with higher than market average gas prices if the utility continues to use the gas acquisition strategy described in the testimony of Kevin M. McCrackin, its Gas Supply Director.

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.

MICHIGAN PUBLIC SERVICE COMMISSION

Chairman

By its action of March 12, 2003.

Commissioner

Its Executive Secretary

Commissioner

In the matter of the application of)
MICHIGAN CONSOLIDATED GAS COMPANY)
for approval of a gas cost recovery plan, five-year)
forecast, and monthly gas cost recovery factors for)
calendar year 2002.)
_____)

Case No. U-13060

Suggested Minute:

“Adopt and issue order dated March 12, 2003 approving an amended 2002 gas cost recovery plan and factors for Michigan Consolidated Gas Company, as set forth in the order.”