S T A T E O F M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **AQUILA, INC.,** **d/b/a AQUILA NETWORKS – MGU,** for authority to implement a gas cost recovery plan and factors for the 12-month period ended March 31, 2005.	)))))	Case No. U-13990

At the May 17, 2005 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. J. Peter Lark, Chairman
Hon. Robert B. Nelson, Commissioner
Hon. Laura Chappelle, Commissioner

ORDER

I.

HISTORY OF PROCEEDINGS

On December 22, 2003, Aquila, Inc., d/b/a Aquila Networks – MGU (Aquila), filed an application for approval of its gas cost recovery (GCR) plan and factors for the 12-month period ended March 31, 2005, pursuant to 1982 PA 304, as amended, MCL 460.6h *et seq.* (Act 304). Prefiled testimony and exhibits supported a proposed factor of up to $6.3335 per thousand cubic feet (Mcf) of natural gas. Aquila also filed a motion requesting a temporary GCR factor of $6.3335 per Mcf and authority to implement a monthly (rather than quarterly) GCR price contingency adjustment mechanism. On April 20, 2004, Aquila filed an amended motion for

temporary relief requesting that it be authorized to continue application of its existing quarterly contingency mechanism[1] for the first calendar quarter of 2005 (January through March 2005).

Because Aquila is moving from a calendar year GCR planning period to a planning period running from April 1 to March 31, this plan case overlaps with Aquila's previous plan case by nine months. That previous case was resolved by entry of a settlement agreement, wherein the Commission authorized Aquila to charge a factor of up to $6.3335 per Mcf for the 2004 calendar year, subject to adjustment on a quarterly basis by a contingency mechanism based on changes in the New York Mercantile Exchange (NYMEX) prices (contingency mechanism). Case No. U-13900 (February 12, 2004). Aquila's current tariff requires that such a GCR factor change be filed with the Commission 15 days before the change is to take effect. The order in Case No. U-13900 further provided that this quarterly contingency mechanism would continue in effect until December 31, 2004, unless it was superseded by a Commission order in the instant case.

At a prehearing conference on April 14, 2004, Administrative Law Judge Sharon L. Feldman (ALJ) granted leave to intervene to Attorney General Michael A. Cox (Attorney General) and to the Residential Ratepayer Consortium (RRC), and approved a procedural schedule. The Commission Staff (Staff) also participated.

On August 19, 2004, an interim settlement agreement resolving Aquila's amended motion was filed in the instant case, establishing interim GCR factors for the remaining quarter of the GCR plan period (January 1, 2005 through March 31, 2005) that had not been addressed by the prior case. This settlement agreement was approved by Commission order on October 14, 2004 (Temporary Order). The settlement agreement retains the use of the NYMEX price change as the triggering event, and establishes a quarterly GCR factor ceiling of $7.5034 per Mcf, which is

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[1] This mechanism was authorized by the Commission in its February 12, 2004 order in Case No. U-13900.

based upon the quarterly factor in effect from October 1 through December 31, 2004. The Staff identified a minor correction to the gas cost estimates, and, with that correction, Aquila's updated plan calculated a GCR factor of $7.0348. Tr. 153.

On August 23, 2004, the ALJ held an evidentiary hearing. Testimony and exhibits were presented by Aquila, the Staff, and the Attorney General. All testimony and exhibits were bound into the record without cross-examination. The ALJ issued a Proposal for Decision (PFD) on November 19, 2004. Exceptions to the PFD were filed by the Staff, Aquila, and the Attorney General on January 7, 2005. No exceptions were filed by the RRC. Replies to the exceptions were filed by the Staff, Aquila, the Attorney General, and the RRC on January 25, 2005.

II.

POSITIONS OF THE PARTIES AND PROPOSAL FOR DECISION

The GCR process was created by the Legislature over 20 years ago to protect ratepayers from automatic adjustment clauses in tariffs, and to enable utilities to continue to recover their actual gas costs. The Commission is required to annually review a utility's GCR plan, and to conduct a second review after the conclusion of each plan year (a reconciliation) to verify the utility's entitlement to recovery of such costs. MCL 460.6h(3), (10), (12). The utility must demonstrate that its GCR costs are attributable to reasonable and prudent management decisions. MCL 460.6h(5), (13).

Because no party contested Aquila's plan, five-year forecast, or gas cost estimates (with the exception of the correction accepted by Aquila), the ALJ recommended that the plan, the five-year forecast, and the GCR base factor of $7.0348 be approved. The parties retain the right to support or to challenge the reasonableness and prudence of Aquila's actual gas supply costs in future proceedings in this case or in Aquila's reconciliation case. MCL 460.6h(5), (13).

In Aquila's last plan case, Case No. U-13900, the Commission approved a settlement agreement utilizing quarterly contingency factors that allowed the company to increase its GCR factor by the amount of the increase in average NYMEX prices relative to the NYMEX base estimate in the plan case cost calculation. Case Nos. U-13900 (February 12, 2004) and U-13550 (October 29, 2003). *See, also,* Exhibit 11. This is known as the quarterly contingency mechanism. Each party to this proceeding advocates a change in this approach as to how the GCR factor changes during the plan year. In addition, the Attorney General contends that this entire approach is unlawful because use of a NYMEX-price-based approach is outside the scope of the Commission's authority.

a. The Commission's Authority to Use a NYMEX-Based Price Contingency Factor

The Attorney General contends that the Commission is not authorized to use a NYMEX price change as the contingency that results in changing the GCR factor. The Commission is authorized by statute to include in GCR factors "specific amounts contingent on future events." MCL 460.6h(6). The revised factor may be put into effect on the occurrence of the contingency without further public notice or an additional contested hearing. MCL 460.6h(6). The Attorney General argues that this approach is unlawful because Act 304 further provides that the Commission may reopen a gas supply and cost review case, and that such a reopened case shall be "conducted as a contested case." MCL 460.6h(10). The Attorney General argues that if mechanisms such as price changes (which clearly occur on a regular basis) can be used to trigger contingencies, then the reopened contested case authority is surplusage in the statute, and this violates the fundamental principle of statutory construction that all words be given effect. The Attorney General argues that price changes, therefore, cannot constitute "events" for purposes of Section 6h(6).

The ALJ disagreed with the Attorney General's argument, opining that the language of Section 6h(10) appears to be broader than the language of Section 6h(6). The ALJ reasoned that the language of Section 6h(6) contemplated that factors could change in the event of the contingency without further contested hearings, and that nothing in that language foreclosed consideration of price changes *per se* as triggering events. The ALJ reasoned that, on the contrary, the language contemplates the use of price changes as triggering events, because it indicates that Federal Energy Regulatory Commission (FERC) proceedings may act as triggering events, and FERC proceedings often involve setting price changes. The ALJ thus rejected the Attorney General's argument that the Commission lacks authority to set GCR factors contingent on NYMEX price changes.

b. The Monthly Contingency Mechanism Proposal

As part of its application, Aquila requests that the Commission approve the replacement of the quarterly contingency mechanism with a monthly contingency mechanism, in order to better address the volatility of gas prices. This mechanism would operate in the same way that the quarterly contingency mechanism operates, in that it would be based on changes in the NYMEX gas futures prices. All other parties opposed Aquila's proposal for a monthly contingency mechanism, and all parties proposed at least one alternative to Aquila's present quarterly contingency mechanism for dealing with price changes that occur during the plan period.

Aquila's proposal would allow it to change the GCR factor for a month based on the average of the NYMEX prices for the concluding three trading days of the prior month. Adoption of this proposal would require elimination of the current tariff restriction requiring a 15-day advance filing of a GCR factor change. The company is requesting the change from quarterly to monthly in order to further mitigate the possibility of underrecoveries, and to continue to refine the process

of sending accurate price signals regarding the true cost of gas. Aquila argues that the Commission has adopted monthly adjustments before for SEMCO Energy Gas Company (SEMCO), in Case No. U-13622 (October 29, 2003), relying on the ability of monthly adjustments to better limit the occurrence of underrecoveries and overrecoveries.

The Attorney General argues that, when notice of a price switch occurs only a day or two before the beginning of the month in which it will be applied, customers do not have time to react in any meaningful way. Both the Staff and the Attorney General argue that, in the interests of predictability and stability, GCR factors should remain stable for as long as feasible, given the volatility of prices.

Under the present quarterly system, customers have 15 days advance notice that the new quarter will involve a price change. The ALJ recommended rejection of the switch to monthly adjustments, based upon the argument presented by the Attorney General that customers would not have time to meaningfully react to such a price change, as it comes literally days before the change takes effect. The ALJ recommended retention of the present quarterly time-frame.

c. The Mid-Year Review Proposal

The Attorney General proposed that the quarterly system be eliminated, and Aquila be limited to a single mid-year revision, which would occur as part of an expedited contested case hearing pursuant to Section 6h(10), which allows for the case to be reopened. MCL 460.6h(10). The Attorney General argues that such a system would provide customers with a more meaningful choice among competing suppliers because of the greater stability and predictability of prices that it would afford the consumer. The RRC supports this proposal as well.

In addition to adding another hearing to the process, the proposed procedure would do away with any contingency factors, and would require Aquila to, for example, set February's gas price

based upon the September NYMEX rate. The Staff presented evidence that September NYMEX rates are poor predictors of January to March NYMEX prices, and that a review that occurs only twice a year will be accurate for approximately only three months out of the twelve. Tr. 162. The Staff also presented evidence indicating that accommodating a doubling of contested hearings would overtax already-strained Commission resources. Tr. 161.

While noting that such a system would allow greater accuracy and stability in the price-setting process, the ALJ indicated that the Attorney General had failed to fully flesh out this proposal, in that he failed to show how the contested case proceeding could be compressed and yet yield the best possible result. Noting that the Staff is working on a comprehensive reform of the GCR process that will potentially better address underrecovery problems, the ALJ recommended rejection of the Attorney General's bi-annual contested case proposal.

d. The Hearing Update Proposal

As an alternative to the Attorney General's bi-annual contested case proposal, the Staff suggested that similar benefits could be obtained by requiring the company to update its plan during the initial contested case by updating the pricing information, which is the basis for the base rate and the contingency factors, during the proceeding. The contested cases routinely last long enough to allow for such a mechanism to essentially correspond to a bi-annual update. The Staff suggests that this update should take place one week prior to the filing date for motions to strike.

The ALJ opined that such an approach would prevent the parties from settling a case prior to that date, and may work to slow down the case even further where additional time is needed to analyze or contest the new information. The ALJ recommended that the parties to all GCR plan cases consider the timing of an updated price filing in setting the schedule for the case at a

prehearing conference, but that the Commission not require the filing of new price information at a particular stage of the case.

e. The Contingency Tariff Proposal

The Staff proposed that a contingency factor matrix tariff (contingency tariff) replace the contingency mechanism currently in place. This contingency tariff expressly provides, for each quarter remaining in the GCR plan period at the time it is calculated, a specific GCR factor for each 5 cent increase in a NYMEX average price when compared to the average price in the GCR base plan. Exhibit S-13. The starting point of the Staff's analysis is the uncontroverted GCR factor of $7.0348. Unlike the current contingency mechanism, which provides only a formula that requires further computations to implement, the contingency tariff contains specific GCR factors that are already computed for a given change in the NYMEX average prices. Tr. 153.

The new contingency tariff also caps the potential increase in the GCR factor to only those increases that result from an increase in the NYMEX average price of up to $1.50 per MMBtu. The cap limits the increase in the GCR factor to a maximum increase of 58 cents per Mcf in the third quarter of the plan year, and 52 cents per Mcf in the fourth quarter (if no increase occurred in the third quarter). Exhibit S-13. The Staff contends that the cap is appropriate to limit the increases ratepayers are subject to during the plan year, and it complies with the Commission's expressed preference for contingent factors that are stated as a specific amount contingent on a specific future event, rather than as a methodology or formula that uses variables that are determined at a later date and that sets no ceiling. Case No. 13990 (October 14, 2004 Temporary Order), p. 2. The new contingency tariff sets a ceiling on GCR adjustments in a fixed amount.

Based on the evidence presented, and because no party challenged the proposed cap, the ALJ recommended that the Commission adopt the Staff's proposed contingency tariff.

f. The Symmetry Proposal

The RRC argues that, if any contingency factor is adopted in this case, Aquila should be ordered to reduce its GCR contingency factor increases if NYMEX prices fall. The RRC argues that this is the only way to ensure symmetry in gas prices – the contingency factors should decrease, as well as increase, in response to the market prices. The RRC and the Attorney General argue that, in fairness, NYMEX price decreases should be mandatory triggering events that will require Aquila to respond by lowering the contingency factor.

The Staff and Aquila oppose this proposal largely based upon the fact that strong disincentives to overrecover already exist and act upon utilities such as Aquila to avoid pricing that is higher than warranted. The Staff points out that utilities have no incentive to overrecover gas costs, because of the obligation to pay interest on overrecoveries at the utility's authorized rate of return, which is significantly higher than the rate at which the utility can borrow money.
MCL 460.6h(15). The Staff contends that utilities have historically been given the flexibility to manage their GCR factors as long as they are at or below the established ceiling, and they already have the discretion to move them up or down.

The ALJ noted that the Commission has previously ruled that mandatory price decreases are not required by Section 6h(6). Case No. U-13060 (March 12, 2003), p. 29. However, based upon the fairness argument made by the RRC and the Attorney General, the ALJ recommended that the Commission direct Aquila to make some reduction in its GCR factor if NYMEX prices decline "significantly" from the levels used in establishing the factor.

g. The Return to Historical Rebilling Proposal

The Attorney General proposed a return to a modified form of historical rebilling or refunding of the difference between GCR collections and actual costs. Under the Attorney General's pro-

posal, refunds and surcharges resulting from a GCR reconciliation would be made on an historical basis for all amounts in excess of 10 cents per Mcf, and to all customers still receiving service through the same Aquila meter. (Amounts under 10 cents per Mcf would be rolled into the next plan period.) The Attorney General contends that this method of rebilling, as opposed to the current method of rolling the refund or surcharge into the next plan period, would provide less distortion of price signals and would give customers a better gauge by which to evaluate the Choice program.

Aquila argues that this proposal lacks detail with respect to several key aspects, such as whether the billing would be in a lump sum or installments, whether the billing would be linked to a particular historical month, how the greater costs associated with this type of billing would be handled, and how the inevitable complaints would be handled. Aquila points out that the Commission has previously rejected the historical rebilling approach, partially based upon the demonstrated high cost of running the historical rebilling system. Case No. U-10385 (June 30, 1994), p. 29. The Staff notes that it is in the process of a comprehensive revision of the GCR plan approval process, which will also address rebilling issues.

The ALJ noted that neither the Attorney General nor the RRC provided any meaningful information on either the startup costs or the annual costs of returning to the historical rebilling system. The ALJ rejected any changes at this time, but recommended that the Commission require the parties to address the issue of a return to historical rebilling again in the next plan case filed by Aquila.

III.

EXCEPTIONS AND REPLIES TO EXCEPTIONS

The Staff takes exception to the ALJ's recommendation regarding a mandatory reduction in the GCR factor when NYMEX prices decline. The Staff contends that Act 304 explicitly provides utilities with the discretion to set GCR factors at or below their authorized GCR price ceiling, and there is no floor set. The Staff points out that utilities already have the option to decrease a GCR factor if decreases occur in the NYMEX prices. The Staff contends that gas utilities, including Aquila, have no history of overrecovering their cost of gas, and there is no reason to think that they will begin to do so. The Staff points out that GCR factors are annualized, in that the base rate is a weighted average of costs relative to volume over the entire year. When NYMEX prices decrease, it is not necessarily prudent for the utility to decrease the GCR factor, if the utility needs to make up for an underrecovery earlier in the plan year. The Staff contends that it is important for utilities to have the flexibility to continue to bill an approved GCR ceiling factor when underrecoveries exist, even though the NYMEX price has declined, and that this is consistent with previous Commission and court decisions. *See,* Case No. U-13902 (June 3, 2004 temporary order), p. 7-8; *Attorney General* v *Public Service Comm,* 235 Mich App 308, 313; 597 NW2d 264 (1999) (holding that the Commission is authorized by statute to allow a GCR plan to roll a projected, prior period underrecovery into a GCR factor for a future period, where the GCR factor is subject to review initially in the GCR plan case proceeding and subsequently in the annual reconciliation proceeding). The Staff contends that the ALJ erred in recommending mandatory downward adjustments of Aquila's GCR factor.

In addition, the Staff does not support a return to historical rebilling at this time, and suggests the ALJ's recommendation on that topic be expanded, to require the parties to present comprehensive proposals aimed at mitigating underrecoveries.

Aquila takes exception to the ALJ's rejection of the proposed monthly mechanism. Aquila again argues that the SEMCO case provides relevant precedent. Aquila offers to change the three-day period selected for computing the price change from the last three days of the prior month to the first three days, thereby affording customers more time to react to the change than was afforded in the SEMCO case.

Aquila takes exception to the ALJ's rejection of the Staff's mid-hearing update proposal. Aquila contends that this is simply a good way to bring the relevant evidence up to date just before the hearing. Aquila contends that the ALJ has overreacted, in that this information should not trigger the need to file additional testimony or conduct additional discovery at this late stage in the proceeding, because the price information is available to everyone throughout the proceeding. Aquila also asserts that the parties may settle at any point in the case. Aquila argues that this update should be mandated in order to provide more accurate information at the time of the hearing.

Aquila takes exception to the ALJ's recommendation that GCR factor decreases should be mandated when the NYMEX price decreases. First, Aquila points out that this dispute over symmetry is a moot point with respect to the GCR plan year in issue, which ended on March 31, 2005. Aquila also points out that the RRC failed to present any evidence regarding the need for symmetry. Addressing the merits, Aquila states that the decision here is simply one of whether to attempt to deal with underrecoveries in the current plan year, or to put off dealing with them until well after the plan year is over. Aquila argues that it makes no sense to force the utility to reduce a GCR factor under the contingency factor approach when the NYMEX price drops, because the utility will have purchased the gas at a higher price.

Finally, Aquila takes exception to what it characterizes as the ALJ's refusal to address or recommend continuation of the quarterly contingency mechanism that is currently in place. Aquila asserts that it argued for the retention of this mechanism in the event that the proposed monthly mechanism was rejected, and that the ALJ erred in failing to address this argument. Aquila avers that the quarterly contingency mechanism has operated effectively, is a known quantity, and has reasonably addressed Aquila's underrecovery problems. While never stating that it opposes the contingency tariff, Aquila argues that the quarterly contingency mechanism should be retained.

The Attorney General takes exception to the ALJ's rejection of the argument that the Commission is not authorized to allow contingency factors to be based on changes in NYMEX prices. The Attorney General again argues that the Commission's use of NYMEX price triggers in setting GCR factors is contrary to proper statutory interpretation, because it renders part of Section 6h(10) to be surplusage, and because a change in a price cannot by definition be an "event" under Section 6h(6). The Attorney General argues for the reopened mid-year contested case as the only appropriate forum for adoption of an adjustment mechanism, contending that the reopened case is the only mechanism provided for under Section 6h. The Attorney General points to past Commission cases (citing Case Nos. U-13933, U-13989, and U-10173), in which an expedited process was implemented with apparently little or no burden. The Attorney General offers a general scenario in which the entire contested process could be completed in 30 days through the use of filed responses and testimony and an expedited hearing and briefing schedule.

Finally, the Attorney General again argues that the Commission should adopt a modified version of the historical rebilling method for allocating under- and overrecoveries. The Attorney General argues that the current roll-in procedure creates uncertainty as to when any underrecovery

will actually be recovered, and does not reflect actual prices at the time that the gas is being purchased by the consumer. While Aquila has indicated that it is not currently set up to process historical refunds, and that the costs of historical rebilling outweigh its benefits, the Attorney General suggests that Aquila's testimony on these points is not credible.

In its replies to exceptions, the RRC argues that the SEMCO case should not be considered a template for the instant case, because SEMCO is no longer using a monthly mechanism, but rather a quarterly mechanism such as the one that Aquila is currently using. The RRC avers that Aquila has not shown that the quarterly contingency mechanism is no longer working, and, in fact, has offered evidence to show that it is working, and therefore it should not be replaced with any other mechanism.

The RRC argues that the ALJ was correct to reject the Staff's mid-hearing update proposal, because, again, such information may lead to additional discovery and introduction of additional evidence. The RRC supports the ALJ's recommendation on contingency factor symmetry, and avers that, due to the lack of a symmetry requirement, SEMCO recorded an overrecovery in the 2003-2004 plan year of almost $3 million. The RRC also argues that any mandated downward adjustment would only affect the portion of the utility's gas supply portfolio that will be purchased in the remainder of the GCR period, and will not affect the utility's recovery of earlier higher costs, because the decreased factor will only be applied going forward.

The Attorney General filed replies to exceptions in support of the ALJ's recommendation regarding mandated decreases to the GCR factors, stating that symmetry should be at the heart of all rate considerations. The Attorney General supports the ALJ's recommendation to require the parties to address returning to historical rebilling. The Attorney General repeats the argument that the Commission is not authorized by law to approve monthly adjustments to GCR factors based

upon changes in NYMEX gas prices. Finally, he argues that the Commission should decide on a case-by-case basis whether or not updated evidence should be admitted in future GCR plan cases.

In its replies to exceptions, the Staff argues that changes in posted NYMEX natural gas futures prices are clearly an "event" within the accepted definition of that word and within the scope of MCL 460.6h(6), and that the Attorney General has failed to present any evidence to show otherwise. The Staff contends that an additional contested hearing is not necessary. The Staff opposes a return to historical rebilling, even with the proposed modifications.

In Aquila's replies to exceptions, Aquila supports the Staff's arguments against the proposal to mandate a decrease in the GCR factor. Aquila emphasizes the fact that the GCR process is annualized, while the RRC seems to focus on discrete price increases or decreases. Aquila again points out that, pursuant to MCL 460.6h(15), a utility must return to GCR customers any overrecovery with interest calculated at the greater of the average short-term borrowing rate available to the gas utility during the appropriate period, or the authorized rate of return on the common stock of the gas utility during that same period, significantly disincentivizing overrecoveries. Once the gas is purchased at a higher price, the higher-priced gas goes into storage and is drawn down at a later date, and billed to customers at a later date. The fact that the NYMEX has decreased or increased by that later date does not change the price at which the gas was purchased.

Aquila repeats its argument that a change in the NYMEX is an event, and characterizes the Attorney General's approach as 'head in the sand.' Aquila avers that the Attorney General's bi-annual review plan would result in huge under collections and tremendous volatility for all the major gas utilities. Aquila points out that Commission orders issued to Michigan Consolidated Gas Company (Mich Con), Case No. U-13902 (June 3, 2004 Temporary Order), Peninsular Gas Company, Case No. U-14260 (December 21, 2004), SEMCO, Case No. U-13960 (June 29, 2004),

and Consumers Energy Company (Consumers), Case No. U-13916 (June 29, 2004) all approved use of the quarterly contingency mechanism. Aquila contends that the Attorney General's proposal to drop use of the NYMEX-based contingency factor and to add another contested hearing each year adds only to the pockets of lawyers and consultants.

Aquila points out that two cases used by the Attorney General to illustrate the ability of the Commission to deal with an expedited GCR plan review had nothing to do with the GCR rate-making process. Case No. U-13933 concerned an application to implement a low-income energy assistance credit, and even though the Commission ordered the filing of an expedited report on the subject matter within thirty days, the Commission had to issue a follow-up order granting an extension. More to the point, as Aquila points out, it was simply the filing of a report, not a full-blown contested case. Case No. U-13989 was a contract case handled by the Commission on an *ex parte* basis. Aquila is correct in pointing out that neither of these examples lends any weight to the Attorney General's argument that the Commission could and should carry out a second expedited plan review case midway through the plan year.

IV.

DISCUSSION

The Commission is not bound by any single formula or method in determining utility rates and may make pragmatic adjustments when warranted by circumstances. *Ford Motor Co* v *Public Service Comm,* 221 Mich App 370; 562 NW2d 224 (1997). All parties herein have agreed that GCR factors should: (1) reflect a utility's gas supply costs, (2) provide appropriate price signals, and (3) be as stable as possible from month to month. Despite the goal of stability, and despite the evidence on the record showing that the current methodology is working fairly well for Aquila (Tr. 54-55, 63, 99), each party proposes a change to the methodology, presumably because

underrecoveries will continue to occur. Underrecoveries are a clear sign that the utility's actual gas supply costs are not reflected in the amounts the utility is charging customers, and those amounts are likewise not sending accurate price signals. Underrecoveries also interfere with the utility's cash flow, and impose interest costs on consumers at a date long after consumption of the gas. For these and other reasons, the Staff is working on a comprehensive reform of the GCR process. Tr. 164. In fact, the Staff's proposed comprehensive reform is before the Commission already, in Aquila's plan review case for its next plan year, Case No. U-14400, as well as in the plan review cases of Mich Con (Case No. U-14401), and Consumers (Case No. U-14403). All three of these companies' most recent plan year filings incorporate a request to use the new contingency tariff.

The Attorney General argues that the Commission lacks the legal authority to adopt NYMEX price changes as triggering events allowing for contingency factor changes, because such a contingency negates the language of Section 6h(10) regarding case reopening. Section 6h(10) authorizes the Commission to reopen a gas cost recovery case on its own motion for any reason, and allows a party to do so on a showing of good cause. MCL 460.6h(10). On the other hand, Section 6h(6) is specific to the issue of contingency factors and requires the naming of a specific event as the trigger, and the designation of a specific factor change which may occur as a result. It does not make any reference to reopening the case. MCL 460.6h(6). Indeed, reopening the case would seem to negate the point of the adoption of a contingency factor.

There is nothing in Section 6h(6) that constrains the type of 'future event' that may act as a trigger. *See, Attorney General* v *Public Service Comm,* 215 Mich App 356; 546 NW2d 266 (1996) (upholding Commission's authority to allow utility to include gains and losses it might incur from hedging in gas futures market in its gas cost recovery factors). The Commission finds that price

changes that affect virtually every natural gas sale in North America are events as that term is used in section 6h(6). The constraining factor is the requirement that the GCR plan be reasonable and prudent. Moreover, this finding does not render Section 6h(10) surplusage. There are myriad reasons to reopen a plan review case other than NYMEX price changes. The Commission is persuaded that Aquila's proposed plan is reasonable and prudent, and that NYMEX price changes may be used as contingent events triggering a GCR factor change.

The Commission thus concludes that the contingency factor mechanism, as modified by this order, is appropriate for purposes of this case. However, the Commission does share some of the reservations expressed regarding NYMEX-based escalators. Although Michigan has benefited from low, stable gas prices throughout much of the period since Act 304 became law, higher, more volatile pricing has recently become the norm, and many prognosticators see no cause for a quick return to cheap gas. At the same time, contractual pricing based on NYMEX indexing (with the volatility this implies) has become prevalent throughout the industry. The recent enactment of MCL 460.9, which affords customer access to alternative gas suppliers, has made the utility's GCR factor more significant from a competitive standpoint.

Turning to the remaining issues, the Commission is not persuaded that another contested case hearing is necessary in order to allow the GCR contingency to occur, because the scale of the change itself is already arrived at after a contested case proceeding. The contested hearing, such as this one, is the forum in which the contingent event triggering the use of the revised factor, and the amount and range of the factor itself, are selected. The instant case is a gas supply and cost review proceeding, for the purpose of evaluating the reasonableness and prudence of the plan, and for establishing the gas cost recovery factors to be incorporated in the rate schedule, and it must be conducted as a contested case. MCL 460.6h(5). Indeed, the Attorney General is contesting the

GCR factor in the instant proceeding. It is not necessary to afford the Attorney General or any other party another opportunity to present their objections to the GCR factors in another contested proceeding, as the plan proceeding is a sufficient forum.

Once the order from a plan proceeding is issued, the utility may incorporate in its rates for the period covered by the order any amounts up to the GCR factors permitted in the order. MCL 460.6h(9). If necessary, the utility may file a revised gas cost recovery plan after the first quarter of the plan year, or the Commission may reopen the gas supply and cost review case on its own motion, which also must be conducted as a contested case. MCL 460.6h(10). The reconciliation is also a contested case. MCL 460.6h(12). In the event of under- or overrecoveries, the Commission shall order refunds to be distributed or surcharges to be collected, utilizing procedures that the Commission determines to be reasonable, both of which are subject to interest. MCL 460.6h(13), (14), (15). These orders come out of the reconciliation case – again, a contested case proceeding.

The GCR plan filing, which must be done three months before the start of the GCR year, and the reconciliation filing, which must be done within three months of the end of the year, each require preparation of testimony and exhibits, published notice, discovery (which can be extensive), prehearings and evidentiary hearings, briefs, reply briefs, exceptions, and replies to exceptions. MCL 460.6h. The Attorney General asserts that this can be achieved in thirty days. The plan review (as well as a reopened review) is a contested hearing, and the procedural rights of a party to a contested hearing, including the right to a written decision from the administrative law judge and submission of exceptions and replies to exceptions, all apply. MCL 460.6h(2), (5), (10). These procedural requirements cannot be dispensed with unless all parties are willing to waive their rights under MCL 24.281. Aquila is unlikely to waive these rights in contested cases, as is

probably every other utility. In addition, this proposal would require the Commission to read the transcript and all other evidence in the record. The Commission is not persuaded that it should dispense with the Proposal for Decision and the additional briefing. Aquila states that the Attorney General's procedural suggestions regarding an additional contested case are unrealistic and unachievable. The Commission agrees and would add that they are unnecessary and not in the public interest.

Aquila requests a switch from a quarterly mechanism to a monthly mechanism, largely based upon Commission precedent in the SEMCO case. In the SEMCO case, the Commission adopted a monthly GCR factor contingency mechanism, whereby an adjustment was made to the GCR factor based on NYMEX prices for the last three trading days of the prior month. In light of the ALJ's concern about customers' ability to respond meaningfully to price changes that occur with so little notice, Aquila offers to change the pricing mechanism to base the monthly price on the first three days of the prior month. This would also obviate the need for any change to the tariff requirement that price changes be filed with the Commission fifteen days before they take effect.

The Commission acknowledges that gas prices are highly volatile and are likely to remain so. However, the Commission's decision in the SEMCO case occurred during a time of greater-than-usual price volatility, when the Commission felt that additional flexibility was needed, and was needed quickly. Prices have settled somewhat since that time, and the Staff now recommends the quarterly contingency tariff. The Commission favors greater stability and predictability whenever it is feasible, and is persuaded that the quarterly contingency tariff is preferable. In addition, the Staff's comprehensive reforms, including the contingency tariff adopted herein, have been incorporated into the latest plan year filings of Mich Con, Aquila, Consumers, and SEMCO.

Turning to the RRC and Attorney General's arguments for symmetry, the Commission is persuaded that symmetry is appropriate. Price fluctuation is the triggering event for contingency factors, not simply price increases. If NYMEX prices decline, the contingent portion of the GCR factor should be adjusted downwards as well.

Turning to the Attorney General's request for a return to historical rebilling, the Commission is not persuaded that any of the disadvantages to historical rebilling have ceased. The roll-in method calculates an end-of-the-year over- or underrecovery for all GCR customers, divides that amount by projected GCR year sales, and rolls-in the resulting amount as reduced or additional gas costs in the new year's GCR proceeding. The Attorney General has historically contested this approach. The Attorney General argues that the current roll-in procedure creates uncertainty as to when any over- or underrecovery will actually be recovered, and does not reflect actual prices at the time that the gas is purchased by the consumer.

The same criticism can be made of the historical rebilling method. The Commission ordered gas utilities to begin using the new method for providing refunds or adding surcharges in 1994. *See,* Case No. U-10385 (June 30, 1994) (Mich Con), Case No. U-10490 (September 27, 1994) (Consumers), and Case No. U-10747 (March 29, 1995) (Aquila). On July 31, 1997, in Case No. U-11192, the Commission authorized Aquila to roll in the prior period GCR over- or underrecovery into a future GCR factor. The Commission found that the historical rebilling method was costly and labor intensive, was not reliable with respect to locating all customers affected by an over- or under-charge, and was not flexible. *Id.,* pp. 28-30. The Commission found that the roll-in method would be less costly and more efficient while achieving a reasonable level of accuracy. *Id.*

The Commission's authority to exercise discretion in establishing how a refund is to be distributed or a surcharge is to be collected, as well as the roll-in method that the Attorney General objects to here, were upheld in *Attorney General* v *Public Service Comm,* 235 Mich App 308; 597 NW2d 264 (1999) and *Attorney General* v *Public Service Comm,* 215 Mich App 356; 546 NW2d 266 (1996). The Commission has also addressed this issue in some detail in its October 29, 2003 order in Case No. U-13622, where the Commission found that the Attorney General had offered no evidence that the benefits of a return to the historical rebilling approach would outweigh its costs. That finding is true in the instant case as well. The Commission continues to support the current roll-in approach.[2]

Turning to the Staff's proposal for a required update to pricing information one week prior to the deadline for motions to strike in the plan year review case, the Commission agrees with the Attorney General that the administrative law judge should be left to make this determination on a case-by-case basis, and may choose to build into the prehearing schedule a date by which price information must be updated. The Commission is reluctant to require the update in every case. There may be cases where the administrative law judge has reasons for preferring to go forward on the initial filings, or where the Staff wishes to propose a different formula for settlement that is not dependant upon the current price information, therefore, a degree of flexibility is called for. Indeed, any party can consult the NYMEX price at any given time, and factor that price into decisions regarding settlement. Because the NYMEX price information, in any case, is publicly available to all parties on a daily basis, the Commission prefers to leave the decision as to whether the price information must be updated at a particular stage of any case to the discretion of the administrative law judge.

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[2] The Attorney General, or any other party, is free to propose a return to historical rebilling in Aquila's next GCR plan case, as suggested by the ALJ.

Finally, the Commission finds that Aquila's complaint regarding the ALJ's alleged failure to address its request to retain its existing quarterly contingency mechanism is not well-founded. The ALJ addressed Aquila's request to change from a quarterly to a monthly basis, and addressed the Staff's request to change from the existing contingency mechanism to the contingency tariff. These issues resolved Aquila's request to retain its quarterly contingency mechanism in the absence of a switch to a monthly mechanism, and Aquila did not take exception to, or actively oppose, the adoption of the contingency tariff. The Commission finds that the ALJ adequately dealt with all the issues put before her.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 106, as amended, MCL 460.551 *et seq.*; 1919 PA 419, as amended, MCL 460.51 *et seq.*; 1939 PA 3, as amended, MCL 460.1 *et seq.*; 1982 PA 304, as amended, MCL 460.6h *et seq.*; 1969 PA 306, as amended, MCL 24.201 *et seq.*; and the Commission's Rules of Practice and Procedure, as amended, 1999 AC, R 460.17101 *et seq*.

b. Aquila'a GCR plan, contingency factors, and five-year forecast, as amended by this order, should be approved.

c. The use of the contingency tariff proposed in Staff Exhibit S-13 should be approved.

d. Aquila should be authorized to implement a GCR base factor for the 2004-2005 plan year of $7.0348 per Mcf, adjusted due to operation of the contingency tariff as proposed in Staff Exhibit S-13.

THEREFORE, IT IS ORDERED that:

A. Aquila, Inc., d/b/a Aquila Networks – MGU's 2004-2005 gas cost recovery plan, contingency factors, and five-year forecast, as amended by this order, are approved.

B. The contingency tariff proposed in Staff Exhibit S-13 is approved for use by Aquila, Inc., d/b/a Aquila Networks – MGU.

C. Aquila, Inc., d/b/a Aquila Networks – MGU, shall implement a gas cost recovery base factor for the 2004-2005 plan year of $7.0348 per thousand cubic feet, adjusted due to operation of the contingency tariff proposed in Staff Exhibit S-13.

D. Aquila, Inc., d/b/a Aquila Networks – MGU, shall file, within 30 days, tariff sheets consistent with this order.

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/ J. Peter Lark
Chairman

/s/ Robert B. Nelson
Commissioner

By its action of May 17, 2005.

/s/ Mary Jo Kunkle
Its Executive Secretary

/s/ Laura Chappelle
Commissioner

THEREFORE, IT IS ORDERED that:

A. Aquila, Inc., d/b/a Aquila Networks – MGU's 2004-2005 gas cost recovery plan, contingency factors, and five-year forecast, as amended by this order, are approved.

B. The contingency tariff proposed in Staff Exhibit S-13 is approved for use by Aquila, Inc., d/b/a Aquila Networks – MGU.

C. Aquila, Inc., d/b/a Aquila Networks – MGU, shall implement a gas cost recovery base factor for the 2004-2005 plan year of $7.0348 per thousand cubic feet, adjusted due to operation of the contingency tariff proposed in Staff Exhibit S-13.

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MICHIGAN PUBLIC SERVICE COMMISSION

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Chairman

By its action of May 17, 2005.

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Commissioner

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Its Executive Secretary

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Commissioner