

STATE OF MICHIGAN  
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of	)	
<b>SEMCO ENERGY GAS COMPANY</b> for a gas	)	
cost recovery reconciliation proceeding for the	)	Case No. U-13960-R
12-month period ended March 31, 2005.	)	
_____	)	

At the July 25, 2006 meeting of the Michigan Public Service Commission in Lansing,  
Michigan.

PRESENT: Hon. J. Peter Lark, Chairman  
Hon. Laura Chappelle, Commissioner  
Hon. Monica Martinez, Commissioner

**ORDER**

History of Proceedings

On June 16, 2005, SEMCO Energy Gas Company (SEMCO) filed an application for authorization to reconcile its gas cost recovery (GCR) revenues for the 12-month period ended March 31, 2005, pursuant to 1982 PA 304 (Act 304), as amended, MCL 460.6h *et seq.* SEMCO filed testimony and exhibits in support of its application.

Pursuant to due notice, a prehearing conference was held on August 23, 2005, at which time Administrative Law Judge Barbara A. Stump (ALJ) granted leave to intervene to Attorney General Michael A. Cox (Attorney General) and the Residential Ratepayers Consortium (RRC), and approved a procedural schedule. The Commission Staff (Staff) also participated.

On February 23, 2006, the ALJ held an evidentiary hearing. Testimony and exhibits were presented by SEMCO, the Staff, the RRC, and the Attorney General. The ALJ ruled on

evidentiary motions, and some parties withdrew portions of pre-filed testimony. All remaining testimony and exhibits were then bound into the record and witnesses were cross-examined. The record consists of 222 pages of transcript and 18 exhibits admitted into evidence.

The ALJ issued a Proposal for Decision (PFD) on April 25, 2006. Exceptions to the PFD were timely filed by the RRC and the Attorney General. SEMCO and the Staff did not file exceptions. Replies to exceptions were timely filed by SEMCO, the Staff, and the Attorney General.

#### Positions of the Parties and Proposal for Decision

Subsection 6h(12) of Act 304, MCL 460.6h(12), requires that, not less than once a year, and not later than 3 months after the end of the 12-month period covered by a gas utility's GCR plan, the Commission shall commence a gas cost reconciliation proceeding as a contested case for the purpose of reconciling the revenues recorded with pre-approved GCR factors. Actual expenses included in the cost of gas sold shall be reviewed for reasonableness and prudence.

SEMCO experienced an overall GCR underrecovery of \$90,495 for the 12-month period ended March 31, 2005. However, because interest payable to GCR customers on monthly in period overrecoveries exceeded interest collectible from customers for monthly underrecoveries by \$194,339, SEMCO's net GCR overrecovery refund obligation is \$103,844, which SEMCO proposed to roll into its 2005-2006 GCR plan costs. The Staff supports SEMCO's application.

The sole contested issue relates to SEMCO's decisions as to when to trigger its September dollar cost averaging (DCA) purchases. SEMCO's 2004-2005 GCR plan requires DCA purchases of approximately 40% of the company's winter flowing supply requirements. During each month from April through October, the company issued a Request for Proposal (RFP) to approximately 20 suppliers. The RFP, and the eventual winning bid, would contain only the basis price for the

supply. The remainder of the supply price is tied to the New York Mercantile Exchange (NYMEX) winter price strip. Hence, the remainder of the price is determined as of the date that SEMCO triggers the NYMEX component of the price, which may occur anytime prior to the date that the gas flows. 2 Tr 72. The monthly total quantities purchased were acquired in even layers of 1,057,000 dekatherms (Dth) per month. (The layer purchased in October was slightly smaller.)

Tamara L. Spencer, SEMCO's Manager of Gas Supply and Transportation, testified regarding the reasonableness and prudence of the gas purchase decisions made by the company during the 2004-2005 GCR period. Ms. Spencer testified that she tracked the daily NYMEX winter price strip in order to determine the best time to trigger the NYMEX price component. Ms. Spencer testified that she made the September DCA purchase (that is, locked-in the basis price only) on September 8, 2004. She testified that the NYMEX increased on September 9th and 13th, and this persuaded her not to trigger the NYMEX component of the price at that time. 2 Tr 73-74. She explained that she believed that these increases were largely due to the threat of Hurricane Ivan. She further testified that natural gas prices are typically lower in late September and early October than they are in early to mid-September. Thus, the company determined to wait for post-hurricane market corrections. After the hurricane, and despite high national natural gas storage levels and unseasonably warm weather, prices continued to rise. *Id.* Crude oil prices rose; natural gas prices rose. At this point, SEMCO decided to trigger the NYMEX component of the September DCA purchase in several installments, rather than all at once, to attempt to mitigate the continuing price rise. SEMCO triggered the NYMEX price component of the September 8 DCA purchase on October 15 and 27, November 24, and December 7, 2004. The prices that SEMCO paid on these dates were higher than the prices that SEMCO could have paid if it had triggered the NYMEX

price component on September 8 or 9, and higher than most of the prices paid during the April to August time period. Therein lies the RRC's opposition to SEMCO's application.

Exhibit RRC -1 shows that the NYMEX strip price during the April to August time period ranged from \$6.25 to \$6.89, and the NYMEX strip price triggered on four occasions as a result of the September 8 DCA purchase ranged between \$6.76 and \$7.97. 2 Tr 102-104. Relying on data in Exhibit RRC-2, the RRC argued in its initial brief that the prices available to SEMCO during the September 13-17 time period were almost \$0.02 lower than the lowest price SEMCO triggered in the previous five months. The RRC states that the NYMEX close winter strip price on September 8 was \$6.292. The RRC argues that the company must have known that this was lower than the price the company had triggered for its previous five DCA purchases. Hence, the RRC argues that the company should have known that these mid-September prices were favorable and should have triggered the NYMEX component of the price, rather than waiting for a price decrease in the late-September/early-October time period. The RRC argues that the decision to delay the trigger was unreasonable and imprudent. On the basis of a calculation of the average of the NYMEX close winter strip prices available to the company on and shortly after the September 8 DCA purchase date, the RRC urges the Commission to disallow \$1,275,004 in GCR costs.

The Attorney General supports the RRC's argument. Alternatively, the Attorney General argues that the Commission should disallow \$194,523. The Attorney General argues that SEMCO's approved GCR plan required fixed price purchases in even installments over a set period of time, and the company failed to follow this plan requirement for the October 27 and November 24 triggering dates by not fixing the prices on these two installments but rather allowing the price to default to the month-end NYMEX settlement price. The Attorney General contends that the prices on these two installments were the same prices the company would have

paid if it had waited until bid week and made a monthly spot purchase. Thus, the Attorney General argues, these were not true DCA purchases under the GCR plan.

The ALJ recommends rejection of the RRC's proposed disallowance. On the basis of the RRC's testimony indicating that September had the lowest available prices "of the year" (2 Tr. 213-214), the ALJ found that the RRC's conclusions were the result of hindsight. The ALJ also noted that the RRC's witness did not have any direct experience with making purchases in the NYMEX market. Applying the test for reasonableness and prudence in light of then-existing knowledge, the ALJ found that SEMCO could not have known until the end of the year that the September prices would turn out to have been the lowest of the year. The ALJ found that the company took reasonable steps to mitigate the price increases that it encountered by triggering the September 8 DCA purchases on four different dates for even amounts. The ALJ found that the company considered historical information and trends, the anticipated effects of the hurricane, Gulf production shut-in, oil price trends, natural gas storage levels, and the unseasonably warm weather in making its triggering decisions, and that this indicates that the company's decisions were reasonably and prudently made in light of existing conditions at the time. *See, Attorney General v Public Service Comm*, 161 Mich App 506, 517 (1987). The ALJ found that neither the Attorney General nor the RRC presented evidence that these considerations were unreasonable or imprudent.

The ALJ also recommends rejection of the Attorney General's proposed disallowance, because Ms. Spencer's testimony confirmed that the GCR plan does not preclude allowing the NYMEX component to be fixed at the month-end NYMEX settlement price.

#### Exceptions and Replies

The Staff and SEMCO did not file exceptions.

In his exceptions, the Attorney General again argues that the month-end settlement price is not the same as a fixed price and that SEMCO failed, on two trigger dates, to comply with its GCR plan by not setting a fixed price, costing ratepayers \$194,523 in excessive gas purchase costs. The Attorney General argues that any purchase that was not made at a fixed price is inconsistent with the GCR plan requirements.

In its exceptions, the RRC argues that its conclusions are not based on hindsight. The RRC argues that the ALJ erred in not seeing that the company could have at least triggered some purchases in September even if it believed that prices would decrease, because it could have taken advantage of any future decrease in October. The RRC also excepts to the ALJ's finding that SEMCO's witness was more credible on the issue of NYMEX purchases than the RRC's witness, arguing that the finding is arbitrary and capricious and an abuse of discretion because it is not based upon an explicit examination of how well that witness's evidence was supported by facts and sound reasoning. The RRC again argues that it was unreasonable and imprudent to ignore available prices, which were better than other recent prices, in favor of delay. The RRC points out that SEMCO provided no evidence as to how low prices would have had to go before the company would have triggered the September 8 DCA purchase. Finally, the RRC argues that SEMCO's evidence did not conclusively prove a historic downward trend in prices every year in late-September/early-October.

In his replies, the Attorney General indicates that the ALJ failed to apply the proper test for hindsight.

In its replies, the Staff reiterates that the company's actions with respect to the September 8 DCA purchase did not violate the GCR plan, and that the company had valid reasons for delaying the NYMEX component trigger.

In its replies, SEMCO argues that the ALJ correctly assessed the evidence and determined the weight to be accorded each witness's testimony based on the quality of the evidence presented. SEMCO further argues that the Attorney General presented no evidence to support his contention that the company violated its GCR plan.

### Discussion

It is often true that with the benefit of hindsight it is possible to show that money could have been saved. This is not the test that the Commission applies in determining the reasonableness and prudence of gas purchase decisions. Gas supply decisions are judged based on the known and reasonably foreseeable circumstances existing at the time that the decisions were made, and not on the results of the decisions. December 19, 1991 order in Case No. U-9173-R, p. 26; May 10, 1996 order in Case No. U-10444-R, p. 6; March 12, 2003 order in Case No. U-13060-R, p. 26. "Act 304 does not hold utilities to a standard of omniscience or perfect performance, but rather to a standard of reasonableness and prudence." February 5, 1997 order in Case No. U-10640-R, p. 10.

The RRC did not present any evidence to rebut Ms. Spencer's testimony regarding the company's decision-making process, the information that the company took into consideration at the time, or the rising NYMEX prices that the company confronted in September. At least one of the prices triggered as a result of the September 8 DCA purchase was lower than some of the previous five months' prices. The RRC argues that gas prices are volatile and weather is uncertain; but all parties agree that SEMCO was thinking about these very truths when it decided to delay triggering the NYMEX price component. SEMCO presented evidence showing that it was also considering historical trends in prices and natural gas supply, potential post-hurricane market corrections, and the information available from industry analysts. The Commission finds that SEMCO gathered and considered relevant information, and was reasonable and prudent in

light of existing knowledge and reasonably foreseeable circumstances in making its NYMEX triggering decisions resulting from the September 8 DCA purchase.

Additionally, SEMCO's 2004-2005 approved GCR plan contains no specific parameters as to when the NYMEX price component must be fixed. The Attorney General fails to cite any language in the GCR plan that precludes the company from allowing the price to be fixed at the month-end settlement price.

For these reasons, the Commission agrees with the ALJ and the Staff and rejects the disallowances proposed by the RRC and the Attorney General. SEMCO's application for reconciliation of its 2004-2005 GCR costs and revenues is granted, and the Commission approves the roll-in of a net overrecovery of \$103,844 into the company's 2005-2006 GCR plan.

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. SEMCO should be authorized to reconcile its 2004-2005 GCR costs and revenues as provided in this order and to roll its net overrecovery of \$103,844 into the company's 2005-2006 GCR plan.

THEREFORE, IT IS ORDERED that SEMCO Energy Gas is authorized to reconcile its 2004-2005 gas cost recovery costs and revenues as provided in this order and to roll its net overrecovery of \$103,844 into its 2005-2006 gas cost recovery plan.

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/ J. Peter Lark  
Chairman

( S E A L )

/s/ Laura Chappelle  
Commissioner

/s/ Monica Martinez  
Commissioner

By its action of July 25, 2006.

/s/ Mary Jo Kunkle  
Its Executive Secretary

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MICHIGAN PUBLIC SERVICE COMMISSION

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Chairman

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Commissioner

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Commissioner

By its action of July 25, 2006.

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Its Executive Secretary