

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of joint application of )  
**PRESQUE ISLE ELECTRIC & GAS CO-OP** )  
and **THE TOWNSHIP OF ALLIS** to fix and determine ) Case No. U-15342  
rates and charges for the retail sale of natural gas in )  
the township. )  
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At the August 25, 2009 meeting of the Michigan Public Service Commission in Lansing,  
Michigan.

PRESENT: Hon. Orjiakor N. Isiogu, Chairman  
Hon. Monica Martinez, Commissioner  
Hon. Steven A. Transeth, Commissioner

**ORDER**

History of Proceedings

This case was initiated by a joint application by Presque Isle Electric & Gas Co-op (Presque Isle) and the Township of Allis (Allis) that was filed on August 3, 2007. The application was filed pursuant to the Commission's authority under 1919 PA 419, MCL 460.54. A prehearing conference was held before Administrative Law Judge Sharon L. Feldman (ALJ) on September 27, 2007, at which Presque Isle and Allis appeared. The Commission Staff (Staff) also participated in the proceedings.

Combined evidentiary hearings were held on January 30 and 31, 2008 for this case and Case No. U-15331.<sup>1</sup> The parties filed briefs on February 22, 2008 and reply briefs on March 14, 2008. On April 23, 2008, the ALJ issued her Proposal for Decision (PFD). Presque Isle and Allis filed exceptions on June 18, 2008 and Presque Isle, Allis, and the Staff filed replies to exceptions on July 2, 2008.

On July 10, 2008, pursuant to 1999 AC, R 460.17401 (Rule 401) Presque Isle filed a motion to reopen the proceedings. On July 18, 2008, Presque Isle filed a supplement to its motion to reopen the proceedings, and on July 31, 2008, the Staff and Allis filed responses to Presque Isle's motion. On December 23, 2008, the Commission issued an order in which it remanded the case for further development of the record:

[T]he Commission finds that the recent volatility in the gas market and the fact that the gas prices reflected in the evidence presented in the case were updated to March 2008 only, present a sufficient change in fact that requires reopening for the development of a complete record. Presque Isle's motion to reopen the proceedings should be granted and additional evidence presented should be limited to updated estimates of gas commodity costs and to corrections of sales estimates and corresponding recalculation of distribution rates.

Order, December 23, 2008, p. 5.

A prehearing conference for the reopened case was held on January 12, 2009 and an evidentiary hearing was held on March 20, 2009. The parties filed initial briefs on April 21, 2009 and reply briefs on May 7, 2009. The ALJ issued her second PFD on May 13, 2009. Allis filed exceptions on May 29, 2009 and Presque Isle and the Staff filed replies to exceptions on June 5, 2009.

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<sup>1</sup>Case No. U-15331 involved a similar application filed by Presque Isle and the Village of Hillman (Hillman). The application in Case No. U-15331 was dismissed on September 23, 2008 after the Michigan Court of Appeals reversed the Montmorency Circuit Court, finding that Hillman could not be compelled to join an application requesting that the Commission determine rates for service by Presque Isle.

## Positions of the Parties

Presque Isle requested that the Commission settle a dispute between the cooperative and Allis over gas distribution rates and commodity costs and requested that the Commission approve mechanisms for adjusting rates in the future. Presque Isle noted that since it started providing gas service, its rates for gas and distribution have been linked to the rates of Michigan Consolidated Gas Company (Mich Con). According to Presque Isle, the use of a proxy for setting rates has often led to an overrecovery of costs and could in theory lead to a significant underrecovery that would jeopardize the cooperative financially.

Instead of continuing to use a proxy approach to rate setting, Presque Isle proposed a times interest earned ratio (TIER) mechanism for setting distribution rates and a gas cost recovery (GCR) mechanism for recovery of gas costs. Presque Isle asserted that its proposed TIER mechanism will operate the same way in Allis as it does in the other 34 municipalities where Presque Isle provides gas service and that it is substantially similar to the TIER mechanism that the cooperative uses for electric service. Presque Isle proposed setting initial rates using a TIER of 1.6 (with a target TIER of 1.8 in the future) with automatic rate adjustments made only if the TIER falls below 1.6 or rises above 2.2. TIER rate adjustments would not exceed 10% unless Presque Isle submits a cost of service study and notice to all customers to permit consideration of all elements necessary to establish just and reasonable rates. If there is a dispute over proposed rates, the dispute will be submitted to the Commission.

Presque Isle contends that its proposed GCR mechanism will function the same way in Allis that it does in the other 34 municipalities where the cooperative has franchises to provide gas service. Presque Isle stated that it will annually project gas costs and sales volumes and roll in the previous year's over or underrecovery to calculate an annual GCR factor.

Presque Isle originally calculated a gas cost of \$0.9492 per hundred cubic feet (Ccf) for costs between April 1, 2007 and March 31, 2008. *See*, Exhibit P-2. Presque Isle's TIER calculation resulted in a distribution rate of \$0.3184 per Ccf. The GCR factor and TIER resulted in a combined natural gas cost of \$1.2676 per Ccf. Presque Isle pointed out that the difference between its total gas cost and the Staff's calculation was only \$0.01761 per Ccf.

In the reopened proceedings, Presque Isle calculated a gas commodity cost of \$9.4919 per thousand cubic feet (Mcf) to \$9.726 per Mcf if the Commission adopts the cooperative's proposed GCR mechanism. If no mechanism is approved, Presque Isle requests a gas cost of \$11.26 per Mcf to \$13.00 per Mcf to protect the cooperative from underrecovery.

Presque Isle also updated its sales estimates in the reopened proceeding to 7,100,239 Ccf or about 900,000 Ccf lower than included in the company's initial filing. The resulting distribution rate calculation changed Presque Isle's residential/commercial distribution charge to \$0.36134 per Ccf, based on the revised sales estimate, a difference of approximately \$0.043 per Ccf.

According to Presque Isle, under its current franchise, Allis can refuse to agree to increased rates, even when a rate increase is just and reasonable. Presque Isle added that customers in Allis are currently paying less than customers in the other 34 municipalities served by the cooperative, with the result that Presque Isle's other customers are providing a subsidy to Allis. Presque Isle contends that there is little difference in the rates supported by the cooperative and those supported by the Staff. Presque Isle claimed, however, that its proposal for annual TIER ratemaking and GCR processes will eliminate the problems with annual, costly litigation over gas rates. Presque Isle asserted that the Staff does not object to the TIER and GCR processes that the cooperative described; the Staff simply prefers that the annual rate setting process not occur with the involvement of the Commission.

Presque Isle claims that MCL 460.54 and its franchise agreement with Allis allow the Commission to operate as a “referee” to decide rates and ratemaking processes for the cooperative and Allis. Presque Isle adds that in this case, the Commission “must step into the shoes of the . . . Allis governing bod[y] and determine the just and reasonable method/process by which rates are implemented and adjusted.” Presque Isle’s initial brief, p. 7.

Presque Isle asserted that because it is not a regulated gas utility, the Commission is not required to comply with any particular statutory process in establishing reasonable rates and rate adjustment processes. Presque Isle cites *City of Detroit v Public Utilities Commission*, 288 Mich 267, 284; 286 NW 368, 373 (1939) in support of its argument that the Commission has authority to approve its GCR and TIER mechanisms because “‘rate’ is more than a simple number-stated and, in fact, can include a price paid for a commodity or service based upon a specified standard.” Presque Isle’s reply brief, p. 10.

Alternatively, Presque Isle argued that the Commission could use its authority to set rate caps using a higher TIER to assure full cost recovery. Presque Isle asserts that if the Commission does not adopt Presque Isle’s TIER and GCR proposals, the Commission should approve a rate cap approach. According to Presque Isle, MCL 460.54 specifically speaks to fixing and establishing “reasonable maximum rates and charges.” Instead of the \$1.25 or \$1.26 per Ccf recommended in the Staff’s or Presque Isle’s cases, the cooperative asserted that the Commission could approve a price cap rate of \$2.00 per Ccf or some higher amount – calculated on a TIER target of 2.6 or higher as a “maximum rate” that Presque Isle could charge.

The Staff also used a TIER formula on a projected basis to derive a pro forma revenue requirement but supported a TIER of 1.8. The Staff also made several adjustments to Presque Isle’s historical test year including a reduction to Presque Isle’s gas operations interest allocation

of \$331,056 to take into account Presque Isle's abandoned area expansion program (AEP). According to the Staff, Presque Isle collected only \$1,101,808 of \$6,989,213 in fees from customers in the expansion area before discontinuing the fees and transferring the remaining plant costs to plant in service. The difference between the original cost and the fees collected from these customers is \$5,887,405 and represents the capital costs of the AEP for which Presque Isle will receive no further reimbursement from the customers for whom the plant was built. The plant built represents distribution facilities outside of Allis's service territory. The Staff imputed interest costs associated with this plant and removed them from interest expense on long term debt. In the future, the Staff recommended that Presque Isle recover all of its AEP costs from those customers that incur the costs. The Staff recommended that the Commission require Presque Isle to set into place a system where new customers who cause construction expenditures pay for these expenditures through contributions in aid of construction or through monthly area expansion rates that cover the installation charges of the mains and services to serve those new customers.

The Staff's recommendation for gas commodity cost was derived from Presque Isle's projected natural gas needs, natural gas already under contract, remaining volumes needed to be purchased, associated costs, and the total commodity cost of gas. The Staff's recommendation of \$9.4082 per Mcf was based on the cost of gas for Presque Isle's entire service area, not just Allis.

The Staff claimed that Presque Isle's proposed TIER mechanism does not provide Allis with the authority to disallow unreasonable or imprudent expenditures. Similarly, the Staff maintained that Presque Isle wants the Commission to set a GCR factor that is subject to adjustments for fluctuations in the cost of purchased gas without submitting those costs to the Commission for a reasonableness and prudence review. Thus, the Staff recommended that the Commission reject both of Presque Isle's ratemaking proposals.

The Staff notes that under MCL 460.6h, the Commission conducts a contested case proceeding to determine whether the GCR plan is reasonable and prudent and then either approves, disapproves, or amends the plan accordingly. Not less than once a year, the Commission conducts another contested case, a gas cost reconciliation proceeding, to consider whether the costs charged customers were reasonably and prudently incurred. The Staff observed that Presque Isle's proposal did not contain either of these customer protections.

The Staff asserted that it is reasonable to set rates on a system-wide basis rather on the basis of the cost to serve Allis only. The Staff cited *City of Mount Pleasant v Public Service Commission*, 342 Mich 310, 325-326; 69 NW2d 837 (1955) (*Mount Pleasant II*) in which the Court found that the Commission could set just and reasonable rates for a municipality on a district-wide basis.

Allis argued that the Commission's authority to set rates under MCL 460.54 is limited by the terms of the franchise, citing *City of Mount Pleasant v Michigan Consolidated Gas Co*, 325 Mich 501; 39 NW2d 49 (1949) (*Mount Pleasant I*). Allis further claimed that because the franchise does not authorize Presque Isle to charge system-wide cost-of-service rates, the cooperative must continue to base its rates on Mich Con's residential rates. Allis pointed to language in the franchise that provides that rates may be adjusted to reflect any fees or taxes that are not incorporated into Mich Con's rates and asserts that the method for determining rates, with reference to Mich Con's residential rates, cannot be altered by the Commission.

Allis claimed that Presque Isle failed to provide any evidence supporting its contention that it could not provide a cost of service study for the township only and that the use of system-wide costs would violate Allis's home rule authority. Allis argued that the Commission should find that the rates proposed by Presque Isle are not just and reasonable and that the case should therefore be dismissed.

Alternatively, if the Commission finds that system-wide costs may be used for establishing rates in Allis, Allis argued that the Commission should disapprove Presque Isle's proposed TIER mechanism on grounds that it violates the franchise by providing only a limited opportunity for the township to object to and negotiate rates. Allis contended that Presque Isle should set rates in accordance with the township's proposed interest coverage approach using a TIER of 1.4. Allis further argued that Presque Isle should not be permitted to increase rates more often than once every three years. In addition, Allis recommended that rate increase proposals must include a cost of service study for the community under consideration and certification that Presque Isle's accounts reflect generally accepted accounting practices and that rates and terms of service be filed with, and approved by, the Commission and by each municipality. Allis recommended that any GCR factor adopted in this case should recover only costs incurred subsequent to appropriate authorization in a GCR proceeding and no retroactive cost recovery should be permitted.

Allis agreed with the Staff that customers in Allis should not be charged for Presque Isle's AEP costs and that a lower TIER should be set to reflect the cooperative's imprudent construction activities. In addition, Allis recommended that the Commission approve a system expansion tariff to assure that customers who cause costs are required to pay those costs.

Finally, Allis noted that 35% of Presque Isle's customers are seasonal and that these customers purchase less than half the gas purchased by full-time customers. Because delivery charges are collected on a volumetric basis, Allis maintained that seasonal customers pay less than their share of distribution costs. To address this disparity, Allis recommended that seasonal customers be charged a higher distribution rate than full-time customers and recommended approval of a tariff that addresses the issue of seasonal customers terminating and reconnecting service to avoid customer charges.

## Proposals for Decision

In her first PFD issued on April 23, 2008, the ALJ found that any rates set by the Commission must conform to the requirements of the franchise between Allis and Presque Isle. The ALJ further determined that there was nothing in the franchise language that expressly precludes Presque Isle from setting rates on the basis of system-wide costs rather than on the basis of costs for Allis only. The ALJ rejected Allis's argument that the Commission must set rates using Mich Con rates as a proxy, noting that any rate can be expressed with reference to Mich Con's rates.

The ALJ observed that the TIER and GCR ratemaking mechanisms described by Presque Isle are the same that the cooperative uses in its other franchise agreements. The ALJ then identified four key issues that need to be resolved before approving the mechanisms:

- 1) When the Commission is acting on a joint application from a municipality and its franchisee utility, does the Commission's rate setting authority under MCL 460.54 include the authority to establish ratemaking mechanisms?
- 2) When the Commission is acting on a joint application under MCL 460.54, is the Commission constrained by restrictions on ratemaking contained in Act 3 or Act 304?
- 3) Does either municipality's franchise preclude the Commission from approving the ratemaking mechanisms requested by Presque Isle?
- And 4) Do the applications in either case preclude the Commission from approving the ratemaking mechanisms requested by Presque Isle?

April 23, 2008 PFD, p. 23.

The ALJ found Presque Isle's argument based on *City of Detroit* unpersuasive, noting that the court in *City of Detroit* relied on language from *Lenawee County Gas & Electric Co v City of Adrian*, 209 Mich 52, 58; 176 NW 590 (1920). The ALJ found that neither of these cases provided authority for the Commission to establish ratemaking mechanisms under MCL 460.54. The ALJ observed that in *City of Detroit*, "[the] definition of 'rate', the phrase 'measured by a specified unit or standard', does not refer to the price but to the commodity the price is applied to. The phrase thus modifies the immediately preceding phrase as follows: 'some commodity or

service of general need or utility supplied to the public, measured by a specified unit or standard'. 'Price' is presumptively measured in dollars. Thus, a 'rate' is a price for a specified unit of a commodity, e.g. dollars per cubic feet of gas or kilowatt hours of electricity."

Nor did the ALJ find persuasive Presque Isle's claim that MCL 460.54 permits the Commission to establish ratemaking mechanisms as long as these mechanisms are "just and reasonable." The ALJ determined that this language did not expand the Commission's authority beyond setting maximum rates and charges and that if it did, the word "maximum" would effectively be read out of the statute. The ALJ concluded that MCL 460.54 does not allow the Commission to authorize TIER or GCR mechanisms to set future rates, but instead requires the Commission to determine reasonable "maximum rates and charges."

In the event that the Commission does find that MCL 460.54 permits the Commission to establish ratemaking mechanisms, the ALJ recommended that the Commission reject the TIER and GCR mechanisms proposed by Presque Isle on grounds that they are neither reasonable nor prudent because of a lack of Commission oversight in the planning and reconciliation processes. The ALJ added that the ability of Presque Isle to automatically raise its rates and burdens Allis with the need to bring a case before the Commission for review. The ALJ noted that, in contrast to the proposal here, the TIER mechanisms used by the regulated electrical cooperatives do provide for regular filings and an opportunity for a hearing in cases where a rate increase is requested.

Similarly, the ALJ found that Presque Isle's proposed GCR mechanism was not reasonable and prudent. The ALJ cited the Staff's testimony noting the key differences between the GCR process at the Commission and Presque Isle's proposal. Specifically, under Presque Isle's proposal, annual filings are not submitted to the Commission; the planning process required by MCL 460.6h is omitted; and Presque Isle reserves the right to increase the factor in the middle of

the plan year with no specified protections for the municipalities. The ALJ noted that there is no opportunity for Allis to review the reasonableness and prudence of Presque Isle's gas purchase plan and no opportunity to challenge the reasonableness of Presque Isle's expenditures.

The ALJ determined that there was no merit to Presque Isle's claim that in addition to possessing authority to establish ratemaking mechanisms under MCL 460.54, the Commission was not constrained by the requirements of 1939 PA 3, (Act 3) MCL 460.1 *et seq.* or 1982 PA 304, (Act 304) MCL 460.6a *et seq.* Specifically, the ALJ found that even if the Commission did have authority to approve ratemaking mechanisms under MCL 460.54, any mechanism would have to conform to the planning and review requirements of Act 3 and Act 304.

The ALJ found that the Commission's authority to approve ratemaking mechanisms and procedures was also limited by the franchise agreement between Allis and Presque Isle. The ALJ observed that the franchise agreement only authorized the Commission to establish maximum rates and charges in the event of disagreement over proposed rates. The TIER and GCR mechanisms proposed by Presque Isle would take effect without the agreement of Allis or approval by the Commission. Finally, the ALJ found that the joint application filed by Allis and Presque Isle did not request that the Commission set any rate adjustment mechanisms, rather, the application asks the Commission to "determine and fix the rate and charges for natural gas in Allis Township."

In establishing Presque Isle's revenue requirements, the ALJ determined that there were three areas of dispute: 1) the Staff's proposed adjustment to interest on long-term debt to exclude interest costs attributable to plant expansion that occurred under Presque Isle's abandoned AEP; 2) the choice of a TIER; and 3) the cost of gas. The ALJ found that no party objected to the Staff's historical 2006 operating results, and that the Staff's Exhibit S-2 provided a reasonable framework for determining the company's revenue requirements.

The ALJ found that the Staff's adjustment to interest on long-term debt to exclude costs attributable to the cooperative's abandoned AEP was correct, noting that it was not appropriate to assign costs to Allis from an expansion program that was initiated without an analysis of the costs to the company and its ratepayers. The ALJ observed that although the intention was to collect the AEP costs from the customers causing those costs, the program was discontinued without further analysis, and at least in part in response to pressure from the new customers paying the higher rates. The ALJ also observed that the fact that AEP costs are shared among other ratepayers in the areas that Presque Isle serves is not relevant to this proceeding because these other municipalities have agreed to include those costs whereas Allis has not.

Regarding the TIER proposals, the ALJ found that the Staff's proposed TIER of 1.8 was most reasonable for setting rates and recommended that the Commission reject Presque Isle's proposal that the Commission set a rate cap in excess of current revenue requirements. The ALJ recommended adoption of a revenue requirement of \$10,795,704 and maximum rates as shown in Exhibit S-3.

The ALJ rejected Presque Isle's proposal that, in lieu of authorizing TIER and GCR mechanisms, the Commission establish maximum rate caps. The ALJ noted that Presque Isle's rate cap proposal was not clear and that it was impossible to determine what recourse Allis would have in the event that Presque Isle established unreasonable rates, even if the rates were below the cap.

In response to miscellaneous relief requested by Allis, the ALJ agreed that the Commission has the authority to require Presque Isle to file its tariffs with the municipalities, noting that the franchise agreements require such filings. In response to Allis's other requests, the ALJ agreed with Presque Isle and found the requests to be outside the scope of the proceeding.

In a second PFD issued on May 13, 2009, the ALJ noted that the establishment of gas commodity costs was a highly contentious issue in the proceeding and that updated gas cost rate recommendations ranged from \$6.18 to \$13.00 per Mcf. The ALJ highlighted the following disagreements among the parties: 1) whether the revised gas cost calculations should be prospective or based on past time periods; 2) if a forward-looking time period is used, whether the calculation should reflect gas costs Presque Isle has already incurred for that time period; 3) issues regarding how New York Mercantile Exchange (NYMEX) futures prices should be used; 4) whether transportation costs should be updated; 5) how should lost and unaccounted for gas costs be reflected; and 6) the extent to which the Commission should use a higher gas cost rate to protect Presque Isle from potential underrecoveries.

The ALJ agreed with the Staff and Allis that it was most appropriate to determine a gas commodity rate on the basis of projected gas costs. The ALJ noted that a key difference between Allis's rate and the Staff's rate was that Allis's cost of \$6.180 per Mcf was based only on NYMEX futures prices for April 2009 to March 2010. The Staff's cost of \$9.152 per Mcf took into account that some of the gas for that time period had already been purchased at a much higher cost. The Staff also used NYMEX futures prices for a three-year period to determine prices for the remaining volumes because Presque Isle often contracts for gas several years in advance. The ALJ found that this approach was a sound means of incorporating a broader array of market price estimates into the gas commodity rate.

The ALJ also found that it was reasonable to update gas transportation costs as part of this proceeding. However, the ALJ found that the Staff's proposal to reevaluate Presque Isle's loss factor of 2.95% was outside the scope of the reopened proceeding but recommended that the Commission caution Presque Isle that in any future proceeding, the cooperative would have to

substantiate its loss factor. Likewise, the ALJ determined that Presque Isle's recommendation to set a gas commodity cost cap of up to \$13.00 per Mcf, and the Staff's recommendation to set the gas commodity rate at \$9.4082 per Mcf to provide the cooperative some flexibility, went beyond the limited purpose for reopening the proceeding. The ALJ recommend that the Commission approve a gas commodity rate of \$9.152 per Mcf as shown in Exhibit S-5.

The ALJ noted that there was no dispute over the corrected sales numbers and that the Staff appropriately updated its distribution rate calculation to consider revised sales estimates of 710,024 Mcf. Consistent with the earlier PFD, the ALJ recommended that the Commission establish a distribution rate of \$0.35058 per Ccf for Presque Isle's residential and commercial customers, with a monthly customer charge of \$8.50; and a distribution rate of \$0.17500 per Ccf for industrial customers, with a monthly customer charge of \$188.00.

#### Exceptions and Replies to the Proposals for Decision

In its exceptions, Presque Isle argues that the rejection of its proposed TIER and GCR mechanisms was improper. According to Presque Isle, the ALJ erred in finding that MCL 460.54 permits only the establishment of a certain amount as a rate, rather than a standard for determining that amount, as the cooperative has proposed. Presque Isle adds that its position on the appropriateness of a TIER mechanism is supported by the fact that the parties in the case used a cost of service TIER calculation in making their recommendations for distribution rates. Presque Isle reiterates that the language in *City of Detroit* referencing "a specified unit or standard" for defining a rate also supports its proposals for ratemaking mechanisms. Presque Isle adds that the ALJ erred in finding that any GCR process approved under MCL 460.54 had to conform to the requirements of Act 3 and Act 304 and that the proposed mechanisms violated the franchise agreement or the application.

Presque Isle recommends alternatives to its original TIER and GCR proposals that it claimed would address the ALJ's concerns. These alternatives require the cooperative to submit its proposed rates annually to the Commission, in addition to the township. In the event that the township objects, the parties would submit a joint application to the Commission and rates would not be increased before the Commission issues an order.

Presque Isle takes exception to the adjustment of interest costs to remove the interest cost of the cooperative's AEP from Allis's rates. Presque Isle argues that while the ALJ agreed that it was appropriate to use system-wide costs to establish rates for Allis, the ALJ arbitrarily removed the system-wide costs for the AEP from Allis's rates. Presque Isle argues that the ALJ did not find the AEP unreasonable or imprudent but nevertheless determined that these costs should not be assigned to Allis.

Finally, Presque Isle notes that the difference in proposed total rates between its presentation and that of the Staff was less than \$.02 per Ccf. Presque Isle adds, however, that its calculation assumes that the Commission will approve some form of annual TIER ratemaking mechanism; and, if this mechanism is not approved, a rate based upon a higher TIER would be required. Likewise, if no GCR mechanism is adopted, Presque Isle asserts that the Commission must adopt a sufficiently high cost of gas to protect the cooperative from financial loss.

Allis takes exception to the ALJ's finding that system-wide costs should be used to establish rates. According to Allis, its franchise does not authorize cost of service based rates; it requires rates to be set based on Mich Con's rates. Allis maintains that if the Commission does change the basis for ratemaking, it should approve rates based on the cost to serve Allis only. Allis asserts that it is unjust to require Allis to pay costs for customers outside the geographic boundaries of the township.

Allis argues that the ALJ erred in setting the initial TIER at 1.8 and that a TIER of 1.4 is more appropriate. Allis points to the fact that the record supports a finding that Presque Isle engaged in an imprudent expansion of its system, which provides justification for reducing the initial TIER. Finally, Allis argues that the ALJ erred in failing to recommend seasonal rates or make a recommendation that Presque Isle adopt a construction and expansion policy to assure cost recovery from the customers who benefit from expansion activities.

In its exceptions to the second PFD, Allis argues that the ALJ improperly recommended a 2009-2010 gas commodity cost using 2009-2012 data because long-term price estimates are too speculative to incorporate into the current gas commodity rate. Allis asserts that the Commission should calculate a gas cost commodity price using gas pricing in existence after the December 23, 2008 date of the Commission's order reopening this docket, resulting in a \$6.18 per Mcf commodity rate. Alternatively, Allis argues that the Commission should use the cost of approximately 85% of gas already contracted by Presque Isle for April 2009 through March 2010, then price at current NYMEX rates the 15% of gas yet to be contracted, which results in a cost of \$8.8155 per Mcf.

Allis also argues that the ALJ erred in determining that adjusting Presque Isle's loss factor was outside the reopened proceeding. Allis claims that this determination is inconsistent with the ALJ's decision to use 2010-2012 price projections for gas cost.

## Findings of Fact and Conclusions of Law

With one exception, the Commission finds the PFDs lawful, well reasoned, and supported by the record. The Commission agrees that its authority under MCL 460.54 does not extend to the authorization of ratemaking mechanisms such as the TIER and GCR processes presented by Presque Isle and that the use of rate caps in lieu of a TIER and GCR suffers from the same lack of oversight that Presque Isle's proposed TIER and GCR mechanisms do. While Presque Isle proposed some adjustments to its GCR and TIER processes to address the ALJ's concerns, the Commission finds that these refinements are outside the record and cannot be adopted without an opportunity for the other parties to respond.

The Commission agrees with the ALJ, Presque Isle, and the Staff that system-wide costs may be used for establishing cost of service based rates in Allis and that this finding is fully supported by *City of Mount Pleasant v Michigan Consolidated Gas Co*, 325 Mich 501; 39 NW2d 49 (1949). However, the Commission finds that disallowance of interest costs for Presque Isle's AEP was error. The Commission notes that the issue of whether the AEP and cost recovery methods were reasonable and prudent was not central to the case and finds that there is insufficient record evidence to disallow the AEP interest costs as part of the system-wide costs. The Commission nevertheless observes that the ALJ is correct in finding that the costs of system expansion should, as a general rule, be borne by the customers who caused those costs.

The Commission agrees that seasonal rates, as proposed by Allis, should not be implemented at this time and that the Staff's calculation of a gas commodity rate for 2009-2010 was reasonable.

THEREFORE, IT IS ORDERED that:

A. A gas commodity rate of \$9.152 per thousand cubic feet of gas for gas service from April 2009 through March 2010 for the Township of Allis is approved.

B. Distribution rates, as adjusted by this order, are approved for the Township of Allis for April 2009 through March 2010.

C. Within 30 days of the date of this order, Presque Isle Electric and Gas Co-op shall submit to the Commission a document reflecting final rates for the Township of Allis, substantially similar to Exhibit S-6 and tariff sheets reflecting final rates.

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, under MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

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Orjiakor N. Isiogu, Chairman

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Monica Martinez, Commissioner

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Steven A. Transeth, Commissioner

By its action of August 25, 2009.

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Mary Jo Kunkle, Executive Secretary