

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)	
MICHIGAN CONSOLIDATED GAS COMPANY)	
for approval of a gas cost recovery plan, 5-year)	Case No. U-15451
forecast, and monthly gas cost recovery factors)	
for the 12-month period ending March 31, 2009.)	
_____)	

At the April 16, 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

On December 28, 2007, Michigan Consolidated Gas Company (Mich Con) filed an application pursuant to 1982 PA 304 (Act 304), MCL 460.6h *et seq.*, for approval of a gas cost recovery (GCR) plan for the 12-month period ending March 31, 2009, and for approval of GCR factors for that period.

A prehearing conference was held on February 5, 2008 before Administrative Law Judge Daniel E. Nickerson, Jr. (ALJ). Mich Con, the Commission Staff (Staff), Attorney General Michael A. Cox, the Residential Ratepayer Consortium, and the Michigan Community Action Agency Association (MCAAA) participated in the proceeding. An evidentiary hearing was conducted on July 7, 2008.

Subsequently, the parties submitted a partial settlement agreement that resolved the majority of the issues in this case. On August 26, 2008, the Commission issued an order approving the

partial settlement agreement. The settlement agreement did not resolve certain issues raised by the MCAAA concerning the effects of Mich Con's accounting and gas storage methods on the cost of gas. After issuance of the August 26 order, Mich Con, the Staff, and the MCAAA submitted briefs and reply briefs on the issues raised by the MCAAA. The ALJ issued a Proposal for Decision (PFD) on September 12, 2008. On October 6, 2008, the MCAAA filed exceptions and on October 20, 2008, the Staff and Mich Con filed replies to exceptions.

Positions of the Parties

The MCAAA argued that the Commission should order an investigation of the effects of Mich Con's accounting methods and its gas storage practices on the volatility and cost of gas charged to ratepayers. The MCAAA observed that Mich Con uses a "last in first out" (LIFO) accounting method for calculating its booked cost of gas. According to the MCAAA, the LIFO method exacerbates both increases in the cost of gas when price spikes occur and the overall volatility of gas costs. The MCAAA pointed to a study performed by Mich Con in 2008 that it claims shows that Mich Con's LIFO accounting method "produces GCR rates that track the market more quickly, almost immediately in years when net increments [sic], than average cost storage accounting GCR rates. Average cost storage accounting smoothes market changes and lags increases and decreases in market prices." In addition, "GCR rates were higher [ranging from \$0.16 per thousand cubic feet (Mcf) to \$0.94 per Mcf] for every year under LIFO cost accounting than under average cost accounting." MCAAA initial brief, pp. 2-3.

The MCAAA argues that the LIFO accounting method along with Mich Con's gas storage practices have created a divergence in the cost of gas accounted for in storage, compared to the cost of gas that the company records when purchasing gas from the market as flowing gas. According to the MCAAA, the cost of Mich Con's gas in storage is far below market prices of gas,

which creates a “latent windfall” that exists in Mich Con’s storage fields. The MCAAA asserts that this “latent windfall” provides Mich Con with an incentive to sell excess gas at a significant profit. The MCAAA notes that in Case Nos. U-14800 and U-15042, the parties reached a settlement that provided for a sharing between ratepayers and shareholders in the gains from storage gas sales. According to the MCAAA, Mich Con recently filed an application in Case No. U-15628, again requesting to sell excess gas in storage to obtain a profit represented by the difference between the cost of gas in storage compared to the market price that can be obtained for sale of the gas in the open market.

The MCAAA further argued that Mich Con relied on a defective model to suggest that the net economic benefit of holding older reserves was negative. Specifically, the MCAAA claimed that the study used only four years of data, a time period that was too short. The MCAAA also argued that one of the primary purposes of Act 304 is to remove the volatility of gas prices while at the same time providing for reliable gas supplies. The MCAAA asserted that practices such as LIFO accounting, which intensifies gas price increases and volatility, should be discontinued.

The MCAAA proposed that the Commission order in this case, or in another upcoming proceeding, a detailed study of the effect of Mich Con’s LIFO accounting method and its gas storage practices on the volatility and cost of gas charged to ratepayers. The MCAAA also recommended that the Commission should consider requiring Mich Con to make changes to mitigate gas costs and reduce charges to ratepayers. The MCAAA proposed that the Commission separate a portion of Mich Con’s working gas inventory as a new category called “emergency base gas,” and that this gas should be priced at the oldest decrement of Mich Con storage gas. The MCAAA contended that upon the application of Mich Con or other parties, the Commission could authorize

Mich Con to mitigate the high cost of gas during a gas supply emergency through the use of “emergency base gas.”

The Staff argued that the study on which the MCAA relies is not part of the record in this case and that the Commission should disregard the MCAA’s arguments to the extent they depend on the study. The Staff further argued that the MCAA’s proposal would only be germane in the case where a GCR proceeding is reopened due to a spike in gas prices. As such, the Staff maintained that the MCAA’s proposal is outside the scope of this proceeding and, because adopting the MCAA’s proposal in a GCR reopener would have a significant effect on base rates, the proposal is properly addressed in a rate case.

Mich Con asserted that the MCAA’s proposal should be rejected because it is contrary to generally accepted accounting principles, does not differentiate between operational and calendar years, and does not reflect Mich Con’s operational storage cycling or differentiate between injected base gas and native base gas.

Mich Con argues that the MCAA’s proposal in this case is different from the sale of native base gas approved in Case Nos. U-14800 and U-15042. According to Mich Con, native base gas is gas that existed underground at the time the storage facility was developed. Native base gas is not included in Mich Con’s LIFO layers and is not part of the company’s LIFO accounting. Mich Con notes that the sale of native base gas was the result of improvements that changed how the company could operate its gas storage fields. These improvements allowed Mich Con to permanently access native base gas that was previously unavailable.

Mich Con further argues that the MCAA incorrectly states the volume of LIFO gas available for GCR supply. According to Mich Con, if it were to use injected LIFO gas, as the MCAA proposed, the company would not have sufficient gas to operate its system. In addition, Mich Con

asserts that adopting the MCAA's proposal would violate generally accepted accounting practices and the Commission's Uniform System of Accounts (USoA). Mich Con contends:

In any year an increment is created, the cost of the gas injected into storage is subtracted from the GCR cost of gas. Mich Con's shareholders pay for the gas that is injected into storage. Mich Con does not realize any revenue from selling Inventory Gas until it sells the gas to GCR customers. Additionally, gas injected into storage is priced at the average purchase rate of gas for the year.

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When Mich Con's non-gas rates are calculated in a general rate case, the low cost injected gas is reflected in the working capital requirement, which is a component of rate base. If Mich Con used a different type of storage accounting, its storage inventory would be priced considerably higher and its working capital requirement and thus base rates would be correspondingly higher. While Mich Con currently has approximately \$50.9 million of costs for injected storage gas in rate base, if that gas was priced at \$10.00 per Mcf, it would have \$760 million in rate base. Mich Con's use of LIFO accounting actually results in lower bills for its customers through lower base rates resulting from the low cost of LIFO inventory.

Mich Con's initial brief, pp. 6-7.

In its reply brief, the MCAA argued that the "problems" with its proposal that Mich Con points to are not actually problems. According to the MCAA, the Commission is not necessarily bound to any particular ratemaking formula, including generally accepted accounting principles or the Commission's USoA. The MCAA argued that its proposal is quite innovative and that the Commission could adopt its approach to even out low cost gas existing in Mich Con's storage facilities as a reserve to mitigate price spikes and to even out volatility in rate impacts to customers. The MCAA contended that the Commission could also require Mich Con to consider changing from its LIFO method of accounting to a system of accounting based on average costs, such as that used by Consumers Energy Company.

Proposal for Decision

The ALJ found the MCAA's request for an investigation of Mich Con's accounting and gas storage practices to be outside the scope of this proceeding, noting that the MCAA's request was

based on the sale of native base gas and was not supported by any legal authority. The ALJ found that while Act 304 does apply to the sale of injected storage gas, it does not extend to Mich Con's sale of excess native base gas.

The ALJ also found that the Staff's and Mich Con's concerns regarding the application of the MCAAA's proposal to the Commission's UsoA and generally accepted accounting practices were well taken.

The ALJ noted that the MCAAA claimed that Mich Con's economic model used for determining whether alternative storage capacity levels would reduce costs for customers was defective. The ALJ found that Mich Con successfully refuted this claim by showing that the length of the study was mandated in the settlement agreement and that the purported anomaly in the study was in fact a necessary adjustment to the data.

Finally, the ALJ found that, contrary to the MCAAA's assertion, there is nothing in Act 304 that prohibits the use of LIFO accounting and that the MCAAA failed to establish a logical connection between Mich Con's accounting and storage practices and the purposes of Act 304.

Exceptions

In its exceptions to the PFD, the MCAAA argues that the ALJ erred in rejecting its proposal for an exhaustive study of Mich Con's accounting methods. The MCAAA asserts that Mich Con is the only gas utility that uses LIFO accounting and that the others use an average accounting method. According to the MCAAA, this demonstrates that LIFO is not the only method for accounting for gas costs and that other methods are consistent with the UsoA and acceptable accounting practices. The MCAAA asserts that it is within the Commission's ratemaking authority and the purpose of Act 304 to order the investigation it proposed.

The MCAAA also takes exception to the ALJ's rejection of its claim that Mich Con's model was flawed for the reasons stated in its original brief.

In its replies to the MCAAA, Mich Con argues that the Commission should reject the MCAAA's arguments and proposals because they are not supported by the record. Mich Con reiterates that the MCAAA's proposals are contrary to generally accepted accounting principles; they do not differentiate between operational and calendar years; they do not properly reflect Mich Con's operational storage cycling; and they do not recognize the difference between native and injected base gas.

In its response, the Staff states that while it does not oppose the Commission undertaking an evaluation of whether or how Mich Con could change its LIFO accounting method in some future proceeding, the Staff nevertheless argues that the MCAAA made a number of factual errors in its claims in this case. The Staff contends that the MCAAA's assertion that a "windfall" exists is not supported by the evidence in this case, nor is it clear that the use of LIFO accounting is the cause of the purported windfall. The Staff further observes that Mich Con rebutted the MCAAA's claim that LIFO accounting harms ratepayers by showing the correlation between low-cost injected gas and Mich Con's lower working capital requirements that serve to decrease base rates for customers.

Discussion

The Commission agrees with the ALJ, Mich Con, and the Staff that the proposals advocated by the MCAAA are outside the scope of an Act 304 proceeding. As such, the MCAAA's supporting arguments are without merit. In addition, the Commission finds that the recommendation to undertake an extensive study of Mich Con's accounting and storage practices is unnecessary at this time. This is not the first time that the issue of LIFO accounting has been

raised in the context of a Mich Con GCR proceeding and the Staff has in the past requested information on how or whether the LIFO practice could be changed to conform to the average cost gas storage accounting used by other gas companies. As Mich Con and the Staff point out, a change to Mich Con's LIFO accounting, if it were possible, would have significant countervailing effects on Mich Con's rate base that would result in an overall increase in customer bills.

THEREFORE, IT IS ORDERED that the request by the Michigan Community Action Agency Association for an investigation into last in first out accounting methods used by Michigan Consolidated Gas Company is denied.

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

Orjiakor N. Isiogu, Chairman

Monica Martinez, Commissioner

Steven A. Transeth, Commissioner

By its action of April 16, 2009.

Mary Jo Kunkle, Executive Secretary