STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of **Michigan Consolidated Gas Company** to terminate the suspension of its Gas Cost Recovery Clause and establish a cashout mechanism _______________________________________/	Case No. U-12762 (efile)

MICHIGAN PUBLIC SERVICE COMMISSION STAFF'S INITIAL BRIEF

I. Background and MichCon's Requested Relief

MichCon has requested authority to terminate the suspension of its GCR Clause, eliminate the currently effective fixed $2.95 per Mcf commodity rate component from its base rates, and to establish a natural gas commodity cashout mechanism for all its sales rate customers, including gas customer choice customers. With Commission approval, these changes would be implemented effective April 1, 2001. The elimination of the fixed $2.95 per Mcf commodity rate would coincide with the implementation of a $5.17 per Mcf GCR factor beginning on April 1, 2001. This increase of $2.22 per Mcf would be offset by cash-out profits and potential refunds as outlined on MichCon's Exhibit A-3.

MichCon's request in this case would end the three-year experimental gas customer choice program approved by the Commission in its Order dated April 28, 1998 in Case No. U-11682. That order also established the $2.95 per Mcf fixed gas commodity factor, and suspended MichCon's GCR Clause from January 1, 1999 to December 31, 2001. MichCon argues that the $2.95 per Mcf price cap would jeopardize customer choice in its service territory, since alternative suppliers cannot compete with such a low price. Furthermore, the current termination date of MichCon's experimental program is nine months later than Consumers Energy's experimental program ending date of March 31, 2001. MichCon argues that the simultaneous termination of MichCon's and Consumers' experimental programs would be beneficial by promoting greater uniformity in the customer choice programs, and more competition between the utilities and alternative suppliers. The new gas customer choice program prepared by MichCon is the subject of Case No. U-12761. MichCon has also requested GCR factors for the April 2001 - December 2001 period in Case No. U-12766. MichCon's application for authority to terminate the suspension of the GCR Clause in this Case No. U-12762 is supported by the prefiled testimony of Don M.. Stanczak, consisting of fifteen pages, and three exhibits.

II. Intervener's Positions

The Attorney General (AG) and the Residential Ratepayer Consortium (RRC) responded to MichCon's request by filing testimony. The AG witness, Ralph E. Miller and RRC witness, Frank J. Hollewa, testified that MichCon's application should be rejected. Mr. Miller testified that MichCon's proposal contains two principal defects, which the Commission should address if it decides to grant MichCon's application. First, customers would likely pay more than the promised price of $2.95 per Mcf for gas purchased from MichCon for the last nine months of 2001. 3 Tr 156-157. Mr. Miller would solve this problem by requiring MichCon to refund sufficient amounts to guarantee that customers ultimately would not pay more than $2.95 per Mcf for gas purchased from MichCon for the last nine months of 2001. 3 Tr 159-164 Second, MichCon's proposed crediting mechanism would result in high prices for April-December 2001, lower prices during most of 2002, and then higher prices for the remainder of 2002. 3 Tr 157. Mr. Miller would solve this problem by refunding all of the "cashout" profits during 2001, and refunding any additional gross margin amounts in January-March 2002. 3 Tr 167-170.

RRC witness Mr. Hollewa testified that if MichCon's application is granted, the Commission should not allow credits to be given to existing choice customers, because presumably these customers are already receiving a rate below $2.95 per Mcf. 3 Tr 115-116. Also, Mr. Hollewa discusses storage decrements, raises questions about the ability of MichCon to achieve additional storage decrements in 2001, and raises ownership issues about the gas cost savings from the storage decrement that occurred in 2000. 3 Tr 119-120.

Energy America presented the testimony of Al McDonald in support of MichCon's application. Mr. McDonald states that MichCon's proposals are reasonable and beneficial to gas customer choice. Mr. McDonald also believes that MichCon's proposals would help the Commission achieve its articulated goals as expressed in the August 4, 2000 and October 13, 2000 Orders, and would be beneficial to MichCon's customers. 3 Tr 77-80.

III. Statement of Blue Circle, Inc.

Blue Circle, Inc. is a cement plant operator in Detroit. Blue Circle relied on the fixed $2.95 per Mcf price for natural gas in its budgeting process, and set its product prices accordingly; these product prices are now fixed by contract and can't be revised upwards to recover additional costs. Blue Circle is concerned that a large, unanticipated gas price increase could force a loss of jobs at its plant. Blue Circle concludes its statement as follows: "It is ludicrous to even suggest that it is in the best interests of customers to eliminate the freeze so that customers will have more 'competition'. What customers would rather have is the fixed price per Mcf promised by MichCon."

IV. Staff's Response

Staff generally supports MichCon's request for the early termination of the suspension of the GCR factor, and a cashout mechanism to refund to customers the profits from the sale of low priced gas volumes currently under contract through December 2001, as long as MichCon is required to guarantee that customers will not pay more than the current fixed price of $2.95 per Mcf through December 2001. Staff is concerned that under MichCon's proposal, MichCon's sales customers (GCR customers) and gas customer choice customers (GCC customers) will almost surely pay more for gas than they would if MichCon's current three-year customer choice program is continued through December 2001. To the extent that MichCon's proposal fails to insure that MichCon customers will not pay more for gas volumes through December 2001, it should be rejected by the Commission.

Staff's Exhibit S-10 illustrates the differences between MichCon's proposal and Staff's proposal for determining MichCon's refund requirements, given the sales, purchases, prices, and storage withdrawals assumed by MichCon in its April-December 2001 GCR plan case. First, in the column entitled "Corrected MichCon Base Case", Staff has attempted to correct and update the "base case" numbers shown on MichCon's Exhibit A-3. Second, in the column entitled "Staff Base Case", Staff has illustrated how the refund calculation should be adjusted to ensure that customers do not pay more than $2.95 per Mcf for April - December 2001 billed volumes.

In the "Corrected MichCon Base Case" column of Exhibit S-10, Staff corrected lines 2 and 3 of Exhibit A-3 to reflect the gas sold volumes and the average GCR cost of gas for April-December 2001 as shown in MichCon's GCR case, Case No. U-12766. These changes would eliminate the $1 million potential refund that was shown on Exhibit A-3. Staff has also updated the Line 11 "January 1999 - March 2001 Gross Margin" to reflect the answer to RRC's First Discovery Request, Question 18a and to reflect the estimated gross margin for January-March 2001 derived by Staff from Case No. U-12766 information. Based on these sources, the "January 1999 - March 2001 Gross Margin" would be $66 million, rather than the $45 million shown on Exhibit A-3. However, these corrections still do not resolve the fundamental problem that Staff has with MichCon's calculation. MichCon's calculation is an "apples to oranges" comparison. MichCon compares the cost increase to <u>GCR customers only</u> with the cash-out amount that is refunded to <u>both GCR customers and GCC customers</u> to determine if an additional refund is necessary. If the total cash-out refund is equal to or higher than the increased cost to GCR customers, then MichCon would make no additional refund. The column entitled "Corrected MichCon Base Case" in Exhibit S-10 illustrates how this "apples to oranges" comparison results in higher costs to customers. Line 8 shows a gross cost increase to GCR customers of $176 million, offset by $181 million of cash-out refunds. However, only $148 million of the cash-out refund would go to GCR customers; the other $33 million would go to GCC customers. With only $148 million of refunds to offset $176 million of increased costs, MichCon's GCR customers would pay $28 million over the $2.95 per Mcf cost of gas.

Likewise, MichCon's approach completely ignores the higher prices that GCC customers will pay if MichCon's new program is approved.

Staff's calculation would resolve the deficiencies in MichCon's calculation by adding the GCC customer volume of 18 Bcf to the 82 Bcf of GCR customer volume, thereby providing an "apples to apples" comparison between increased customer costs and cash-out refunds. Staff's approach would result in a $33 million additional refund under MichCon's "base case" scenario. This would resolve the customer overpayment problem based upon MichCon's projections. However, under certain pricing and weather conditions, the additional refunding of MichCon's January 1999 - March 2001 gross margin on gas purchases might be insufficient to offset the higher gas costs incurred by GCR and GCC customers. MichCon's proposal to withdraw more inexpensive LIFO gas to cover a shortfall might not be possible if weather conditions are unfavorable, or if MichCon has overestimated the number of customers that will switch to alternative suppliers in April - December 2001. In Staff's view, the only way to ensure that GCR and GCC customers will not be stuck with higher gas bills is for MichCon to guarantee that GCR and GCC customers will not pay more than $2.95 per Mcf for their April - December billed gas volumes.

Staff's recommendation to require a $2.95 per Mcf guaranteed price is reasonable. Without MichCon's application in this matter, customers now have that guarantee with the current three-year customer choice program. A price guarantee would balance MichCon's profit potential with a counterbalancing loss potential, supplying a symmetry of risk and reward that would provide MichCon with incentives to keep gas costs as low as possible. Absent a price guarantee, MichCon could still profit from its participation in the current three-year customer choice program, without any downside risk since the worst that MichCon could do would be to break even. Under Staff's proposal, the $2.95 per Mcf price guarantee would be preserved, along with the benefits of MichCon's proposal to expand customer choice and eliminate a potentially large price spike in the middle of the winter of 2001-2002.

V. Conclusion

MichCon's application in this case should be approved, with the following modifications:

(1) The method of calculating required refunds of MichCon's gross margin on gas sales should be revised as recommended by Staff and illustrated on Exhibit S-10.

(2) MichCon should be required to guarantee that customers do not pay more than $2.95 per Mcf for gas purchased from April - December 2001, i.e., additional refunds should not be capped at the level of MichCon's gross margin on gas sales for the 27 month period of January 1999 - March 2001. The reasons for this are discussed by Staff Witness Mr. Aldrich at 3 Tr 202, and comprehensively by AG witness Mr. Miller at 3 Tr 159-164.

(3) To partially address the problem raised by Blue Circle, the AG's refunding recommendation as discussed at 3 Tr 167-170 should be adopted by the Commission. The AG's refunding proposal helps Blue Circle by reducing the net price paid by Blue Circle for gas purchases during its highest consumption period (summer and fall of 2001) from $4.26 per Mcf under MichCon's proposal, to $3.36 per Mcf under the AG's proposal (see Exhibit I-7).

Respectfully Submitted,

MICHIGAN PUBLIC SERVICE COMMISSION STAFF

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DATED: March 2, 2001

DMG/mrp

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Case No. U-12762 (efile)

PROOF OF SERVICE

STATE OF MICHIGAN)
) ss
COUNTY OF INGHAM)

Mishelle R. Pagels, being first duly sworn, deposes and says that on March 2, 2001, she served a copy of Michigan Public Service Commission Staff's Initial Brief upon the following parties via email and by depositing the same in a United States postal depository enclosed in an envelope bearing postage fully prepaid, plainly addressed as follows:

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Subscribed and sworn to before me
this 2nd day of March, 2001.

Pamela A. Walters, Notary Public
Ingham County, Michigan
My Commission Expires: 02-04-03