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March 9, 2001

Ms. Dorothy Wideman
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
P.O. Box 30221
Lansing, MI 48909

RE: Reply Brief of Michigan Consolidated Gas Company
MPSC Case Nos. U-12762 (e-file)

Dear Ms. Wideman:

Enclosed for filing in the referenced matter, please find the original and 5 copies of the Reply Brief of Michigan Consolidated Gas Company (MichCon).

Should you have any questions regarding this filing or require additional information, please do not hesitate to contact me. Your attention to this matter is appreciated.

Very truly yours,

David C. Champion

DCC

Enclosures

c: Counsel of Record

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 (e-file)

REPLY BRIEF OF
MICHIGAN CONSOLIDATED GAS COMPANY

Michigan Consolidated Gas Company ("MichCon") submits this Reply Brief pursuant to Rule 339(2), R 460.339(2) of the Rules of Practice and Procedure Before the Michigan Public Service Commission ("Commission" or "MPSC") and the procedural schedule established by the presiding Administrative Law Judge ("ALJ") in this case.

I. Introduction

This case concerns MichCon's application to terminate the suspension of its gas cost recovery ("GCR") clause and establish a mechanism to return the value of certain of the contracts in MichCon's 2001 gas supply portfolio to customers. MichCon's application also discussed the potential for refunding a portion, or all, of MichCon's gross natural gas sales margin earned during the first two years of its experimental gas customer choice ("GCC") program and implementation of GCR factors for the last nine months of 2001. MichCon's application was submitted in furtherance of MichCon's efforts to align various aspects its GCC program with the uniform terms and conditions for gas customer choice set forth in the Commission's decision in Case No. U-12550, Order dated October 13, 2000.

MichCon's application has met with near uniform opposition. All but one Intervenor urge the Commission to reject MichCon's proposal and continue the suspension of MichCon's GCR clause through December 2001. The essence of the opposition's arguments is that

Commission approval of MichCon's GCC program in 1998 amounted to a promise to provide customers a three-year, fixed price guaranty. The opposing parties contend that promise can not be broken in this case, and that MichCon must maintain the GCC program's fixed $2.95 per Mcf rate to ensure that customers pay no more than that amount through December 2001.

II. Summary of Initial Briefs

The Association of Businesses Advocating Tariff Equity ("ABATE"), the Attorney General ("AG"), and the Residential Ratepayer Consortium ("RRC") filed Initial Briefs opposing the sum and substance of MichCon's application. Blue Circle, Inc. ("Blue Circle") submitted a statement of opposing interest pursuant to Rule 207 of the Commission's Rules. R 460.17207. The Commission Staff ("Staff") recommended conditional approval of MichCon's application. MichCon and Energy America were the only parties to mention the many benefits of MichCon's proposal in this case.

ABATE urges denial of MichCon's application based on arguments about budgets and allocation of risks. On the budget side ABATE cites the Rule 207 statement of Blue Circle. Blue Circle said its budget was based on MichCon's promise of a fixed-price guaranty through December 2001 (TR 35) and that any change in MichCon's price would affect Blue Circle's cost structure and eat into its profits. (TR 36). Regarding risk allocation, ABATE points to the positions presented by the AG, the RRC and the Staff in support of the suggestion that MichCon effectively guaranteed its customers a fixed $2.95 per Mcf rate through December 2001 and any risk of loss resulting from that rate should be borne by MichCon. (ABATE Brief at 3-8). ABATE concludes its arguments with allegations that MichCon concealed the terms of GCC customer reenrollment from the parties (ABATE Brief at 8-9) and that MichCon's application fails to conform to applicable legal standards. (ABATE Brief at 9-10).

The AG echoes ABATE's risk allocation argument. The AG claims MichCon's proposal in this case is an attempt to transfer price risk to the Company's customers despite promises made by the Company to assume the risk of gas cost increases. (AG Brief at 3-7). The AG also argues that the evidence presented by the AG, the RRC and Staff proves that MichCon's proposal will result in customers paying more than the fixed $2.95 per Mcf rate established when MichCon's initial experimental GCC program was approved. (AG Brief at 8-11). The AG concludes her arguments with the claim that MichCon's proposal will not promote competition in MichCon's service territory. (AG Brief at 12-16).

Like ABATE and the AG, the RRC claims that MichCon's proposal breaks the fixed price promise MichCon made in Case No. U-11682 (RRC Brief at 10-11), and violates the terms of the Commission order approving MichCon's application in that case. (RRC Brief at 12-14). The RRC also claims that MichCon's proposal harms its customers (RRC Brief at 14-16), is unreasonable and contrary to the public interest (RRC Brief at 16-20), and that the only interests it serves are those of MichCon and the marketers participating in the GCC program. (RRC Brief at 23-24). Further, the RRC contends that MichCon's request to return to the GCR process effective April 1, 2001 must be rejected for MichCon's failure to comply with the provisions of MCL 460.6h, MSA 22.13 (6)(h) ("Act 304").

Unlike the other parties, the Commission Staff is willing to support MichCon's request to terminate its GCR clause suspension and return to the GCR process beginning April 1, though that support is not unconditional. Staff recommends approval of MichCon's application on the condition that MichCon agree to make all customers whole. Staff's proposal to accomplish that result requires MichCon to refund amounts sufficient to guaranty that both GCR and GCC program customers pay no more than the fixed $2.95 per Mcf rate currently charged by MichCon. (Staff Brief at 5).

Energy America, the only marketer to actively participate in this proceeding,[1] urges approval of MichCon's application. Energy America states that granting MichCon's request will aid the Commission in achieving the goal of greater uniformity among and between Michigan's gas customer choice programs. (Energy America Brief at 4). Energy America also explains how approval of MichCon's application will benefit all GCC program participants. Uniform start dates for MichCon's and Consumers Energy Company's permanent GCC programs[2] will eliminate customer confusion about program timing and terms. Further, terminating the fixed price component of MichCon's program in April, when customer consumption declines, will soften the effect on customer bills when transitioning from fixed to market prices. (Energy America Brief at 5). Moreover, the certainty accompanying approval of MichCon's application will allow marketers to make marketing strategy and gas pricing decisions now that will benefit customers through lower costs in the coming winter heating season. (Energy America Brief at 5). All these factors should attract marketers to Michigan, thereby stimulating competition.

III. Reply To Opposing Arguments

The arguments in opposition to MichCon's proposal presuppose an affirmative answer to four critical questions; (a) whether the terms and conditions of the experimental GCC program approved in Case No. U-11682 were to remain unchanged for three years, (b) whether customers will suffer economic harm if MichCon's application is approved, (c) whether denial of MichCon's application furthers Commission policy respecting gas competition, and, (d)

[1] The New Power Company was granted intervention but did not present evidence or argument in this case.

[2] Consumers' permanent GCC program begins April 1, 2001

whether approval of MichCon's proposal is precluded by law. Contrary to the opposing parties' claims, MichCon submits these questions should be answered in the negative, and MichCon's application approved, for the reasons discussed below.

A. The Terms And Conditions Of The GCC Program Are Subject To Change

MichCon's experimental GCC program was approved by order issued April 28, 1998 in Case No. U-11682. The Commission's order in that case did not provide that GCC program terms and conditions were "promises" or that they were "guaranteed". Nor did the Commission state that the program would remain unchanged through the end of 2001. The absence of such language in the order is understandable. The GCC program it approved was an experiment. The essence of experimentation is the testing of underlying assumptions with the goal of eliminating those that are unfounded or fail to produce intended results.

MichCon's actions in response to its GCC program experience reflect the program's experimental nature. As a result of the lessons learned in year one of the GCC program, MichCon sought to modify it in Case No. U-12050 to improve the customer solicitation process and to enhance customer protection features included in the program. Those program changes were not opposed and were ultimately approved by the Commission in an order dated August 17, 1999.

Similarly, MichCon recently proposed the many permanent GCC program modifications reflected in its pending application in Case No. U-12761. That application was submitted in response to the Commission's order in Case No. U-12550. Case No. U-12550 was initiated to consider development of more uniform GCC program terms and conditions based on the combined experience of utilities, customers and marketers participating in customer choice programs in Michigan and other states. In its order in Case No. U-12550, the Commission called for change in an effort to engender greater uniformity among and between GCC programs sponsored by Michigan's major natural gas utilities. MichCon's pending application in Case No. U-12761 reflects the GCC program changes called for by the Commission.

Were there a bias against change based on GCC program experience the Commission would not have approved the GCC program changes proposed in Case No. U-12050, or directed utilities to implement the further GCC program modifications described in its Order in Case No. U-12550. To claim that one (or more) of the provisions of MichCon's experimental GCC program were "promises" or "guarantees" or not subject to modification through December 2001 simply ignores the experimental nature of MichCon's GCC program and the history of actual and proposed GCC program changes during the past two years.

Further program change is necessary, now. As discussed in MichCon's Initial Brief (at 3), the results of the fixed price portion of the experimental GCC program are in. Fixed pricing fails to further competition in periods of rising prices. The recent increase in natural gas prices has prevented marketers from profitably competing for customers. As a result, marketers participating in MichCon's GCC program either enrolled fewer customers in year two of the program, or simply dropped out of the program altogether. In the four months since the solicitation process for GCC program year three began, MichCon has received no new customer enrollments. The sole reason for that result is the program's $2.95 per Mcf fixed price component. It frustrates competition for customers. The inability of marketers to compete for customers based on price frustrates customer choice and thus undermines a central objective of the GCC program.

The opposing parties claim MichCon's request to eliminate its $2.95 per Mcf fixed price is an attempt to shift the risk of increasing gas costs to customers. MichCon's proposal does not shift price risk to customers. To the contrary, MichCon's proposal protects against price risk by ensuring that customers receive the economic benefit of MichCon's fixed price gas contracts, as well as MichCon's gross margin on gas sales during the first two years of the GCC program. If additional protection is needed, MichCon is prepared to decrement storage as necessary to further reduce customer costs. MichCon submits that a fair assessment of its proposal leads to the conclusion that customers are not at risk. Rather, they reap nothing but rewards.

B. MichCon's Proposal Will Not Harm Its Customers

MichCon's GCC program has helped customers achieve significant savings. MichCon estimates its customers saved over $200 million during the first two years of the program. Customer savings in year three are estimated to exceed $400 million. (TR 43-44). These estimates are consistent with the Commission's independent analysis of customer savings under MichCon's GCC program. (TR 208).

Eliminating the $2.95 per Mcf fixed price component of MichCon's GCC program and allowing MichCon to implement GCR factors for the last nine months of 2001 will not adversely impact customer savings or cause financial harm to customers. MichCon's cash-out credit and gross margin refund proposals will in all likelihood result in customers paying no more than the current $2.95 per Mcf rate through the end of 2001. (TR 52).

The AG and the RRC suggest that customers will pay more than $2.95 per Mcf in 2001. The AG bases her claim on current NYMEX futures prices. (AG Brief at 10) The RRC recognizes the futility of predicting the future based on present prices. While acknowledging that attempts to accurately estimate precisely what customers will pay is virtually impossible (RRC Brief at 23) the RRC still claims customers will pay more than $2.95 per Mcf. The Staff is not so pessimistic. Staff suggests that customers might pay more than $2.95 per Mcf under certain pricing and weather conditions. (Brief at 5). However, even under Staff's proposal some, if not all, of MichCon's gross margin would be available for further customer refunds if the pricing and weather conditions referred to by Staff materialize, thereby necessitating return of additional monies to protect customers from paying more than $2.95 per Mcf. And, as noted in the preceding argument, MichCon is prepared to decrement storage if necessary to further mitigate costs.[3] In summary, the totality of the evidence overwhelmingly affirms MichCon's assertion that its proposal will cause no harm to customers.

C. MichCon's Proposal Promotes Competition

The AG claims MichCon's proposal will do nothing to promote competition. According to the AG, MichCon's proposal will cause customers to pay higher prices now, and will provide no benefits for competition in 2002 and beyond. (AG Brief at 12-13). The RRC approaches the issue from the opposite perspective. The RRC claims that MichCon's proposal benefits MichCon and marketers at the expense of the Company's customers. In the RRC's view, MichCon benefits by eliminating the alleged risk associated with its fixed $2.95 per Mcf rate. Marketers benefit through the opportunity to reenroll or attract new customers at higher rates. (RRC Brief at 23-24).[4]

From their arguments it is apparent that the AG and the RRC can't see the forest for the trees. This is understandable. The AG's witness has no marketing experience. (Exh. A-9). And what little experience he has with other customer choice programs was apparently gained in states known to be are far less advanced than Michigan. (TR 172). The RRC's witness is a

[3] The lone critic of MichCon's storage decrement proposal admitted that it would not adversely impact reliability. (TR 127).

[4] The claim that MichCon tried to hide (ABATE Brief at 8) the fact that approval of its proposal would result in termination of GCC contracts is baseless. GCC contract termination and reenrollment provisions are tariff requirements expressly approved by the Commission in Case No. U-12550. MichCon reflected these requirements in the tariffs submitted with its application in Case No. U-12761 for approval of a permanent GCC program.

former utility executive who now earns a living testifying on behalf of consumer interests. (TR 123). The consumer bias inherent in the testimony of these witnesses undercuts the credibility of their criticisms. Moreover, their focus on the need to maintain a gas cost rate that bears no relationship to the market cost for that commodity blurs their vision of the benefits of competition.

Competition should result in reduced prices. That result can not be achieved if prices bear no relationship to reality. Where, as here, marketers are forced to compete with an artificially low price, competition is effectively thwarted. If, on the other hand, MichCon is permitted to charge prices approximating a market price, competition should flourish.

Competition does not mean uniform pricing, as the AG seems to believe. (AG Brief at 15-16). Rather, competition involves alternatives. If MichCon is permitted to implement GCR factors approximating a market price, marketers can use that price as a basis upon which to establish alternative prices intended to induce customer choice of the alternative. If MichCon's application is denied, there will be no alternatives and thus, no competition.

MichCon's proposal will also assist in achieving the Commission's competitive goals. The Commission has expressed its desire for more uniformity among and between the GCC programs sponsored by natural gas utilities in Michigan. MichCon's proposal in this case accommodates that objective. Approval of MichCon's application will put MichCon's GCC program on the same timeline as the GCC program sponsored by Consumers. Further, simultaneous implementation of the MichCon and Consumers GCC programs should be attractive to marketers. Terminating MichCon's $2.95 per Mcf fixed commodity rate will allow marketers to profitably compete for customers based on price. It will also eliminate the need for marketers to incur additional advertising, marketing, consumer education and customer service costs. (TR 79). Most importantly, customers will obtain the long-term advantage of lower prices resulting from increased competition. (TR 72). MichCon submits that these benefits warrant rejection of the opposing parties' arguments and approval of MichCon's application in this case.

D. **MichCon's Proposal Is Lawful**

The RRC argues that MichCon's request to return to the GCR process effective April 1, 2001[5] must be rejected for MichCon's failure to comply with the provisions of MCL 460.6h, MSA 22.13 (6)(h). ("Act 304"). The RRC's arguments are based on the claim that Act 304 explicitly refers to a 12-month plan period and a 5-year forecast. According to the RRC, MichCon's proposed nine-month GCR Plan and related forecast do no meet the time periods identified in Act 304 and rejection is therefore required.

MichCon's application and testimony in this case address, among other things, MichCon's proposals to terminate the suspension of MichCon's GCR Clause and to return to the GCR process by implementing GCR factors for the nine-month period beginning April 1, 2001 and ending December 31, 2001. Thus, the issues before the Commission in this case include the question whether, if its GCR Clause suspension is terminated, MichCon should be permitted to implement GCR factors during the period April 1, 2001 through December 31, 2001 in order to make the transition away from its currently effective experimental rates and back to its calendar year GCR cycle.

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[5] Paragraph 7 of the Application filed in Case No. U-12762 states:

> "Coincident with its return to the GCR process effective April 1, 2001, MichCon proposes a one-time, nine-month GCR plan period starting April 1, 2001 and ending December 31, 2001. This "stub" plan period, and a corresponding nine-month GCR reconciliation, will permit MichCon to return to the calendar year GCR process in effect prior to the suspension of MichCon's GCR clause. MichCon proposes to submit an Act 304 filing no later than December 19, 2000, requesting that the Commission approve a new GCR factor for MichCon and specify April through December 2001 as the period to which MichCon's GCR factor will apply."

In *Attorney General v. Public Service Comm.*, 231 Mich.App.76, 310 NW2d, the Michigan Court of Appeals found that the Commission was empowered to specify procedures for suspension of the PSCR clause it implemented for Northern States Power ("Northern") under Act 304. Similarly, in *Attorney General v. Public Service Comm.*, Docket No. 207491, May 21, 1999 the Court upheld a subsequent Commission order reinstating Northern's PSCR clause and directing Northern to file a PSCR Plan. MichCon submits that these cases stand for the proposition that the Commission has the power to approve the nine-month GCR period necessary to return MichCon to the calendar year GCR cycle it used before its GCR clause was suspended.

The language of Act 304 provides further evidence of the Commission's authority. Section 3 of Act 304 expressly provides that a utility's GCR plan is to be filed pursuant to procedures " . . . established by the Commission . . .". Further, the factors requested by a utility are to be implemented during a future period " . . . specified by the commission . . . ". MichCon has requested authority to implement GCR factors over a future nine-month period. If, as the RRC claims, the Commission is constrained by Act 304 to specify a future 12-month period, the Commission can so conclude in this case.

Citing case law to the effect that judicial construction of an unambiguous statute is impermissible (Motion at 4), the RRC argues that the Commission must reach just such a conclusion based on the plain language of Act 304. MichCon disagrees. Were Act 304 as clear and unambiguous as the RRC claims the Commission simply would not have accepted this case. For instance, Act 304 contains no language authorizing the Commission to suspend or reinstate a gas cost recovery clause. Yet, as noted above, the Court of Appeals found such authority to exist by implication in Act 304. *Attorney General, supra*. Furthermore, it was the Commission's exercise of its implied authority under Act 304 that resulted in the GCR suspension MichCon seeks to terminate. Accordingly, here, as was the case in *Attorney General, supra,* the Commission will determine the extent of its authority under Act 304 and rule accordingly.

If, as the RRC suggests, the Commission must specify a 12-month period, then the Commission can, if it so chooses, grant MichCon's application in Case No. U-12762 and specify April 1, 2001 through March 31, 2002 as the period during which MichCon is authorized to charge a GCR factor.[6] The broad discretion granted the Commission with respect to the procedures applicable to GCR filings gives the Commission the authority necessary to take such action. Accordingly, the RRC's claim that the Commission is powerless to approve MichCon's request for a nine-month GCR plan period should be rejected.

ABATE's attempts at legal analogy should be ignored. (ABATE Brief at 9-10). The " . . . all legal and regulatory actions . . . " standard of Act 304 can not be applied to rates established under a suspended GCR clause. Similarly, MichCon's proposed nine-month GCR must be reviewed under Act 304, not the Railroad Act. Finally, as discussed at the outset of this Reply Brief, the GCC program is subject to continuing modification. The suggestion that MichCon waived any right to request GCC program changes is simply ludicrous.

IV. Conclusion

The initial briefs of the opposing parties ask the Commission to issue an order that will, as discussed here and in MichCon's Initial Brief, effectively incent customers to ignore gas customer choice. If the Commission adopts the opposing parties' arguments, it will not achieve the goal of extending the benefits of choice to all Michigan gas consumers in 2001. The Commission can only achieve that goal by an affirmative action in this case to promote

[6] If, in its order in Case No. U-12762, the Commission specifies a future 12-month period ending March 31, 2002, it should also specify that the reconciliation process be bifurcated to permit accurate accounting for those gas costs incurred during calendar year 2001, and those costs incurred during the first quarter of 2002.

competitive pricing of the gas sales commodity. MichCon's proposal accomplishes that result. The relevant evidence in this case demonstrates that terminating MichCon's $2.95 per Mcf rate should aid in retaining existing GCC program marketers, and attract new marketers to Michigan, thereby stimulating competition for GCC program customers. (TR 79-80). The evidence also shows that customers will benefit if MichCon's application is approved. There will be less customer confusion, more competition based on price, and a smoother transition from fixed to competitive pricing than would otherwise occur in 2002. (TR 78-79). Conversely, denial of MichCon's application will have an adverse effect on competition and the success of gas customer choice, thereby frustrating the Commission's goal of extending choice to all consumers in the State of Michigan. MichCon urges the Commission to promote competition, not preclude it. The Commission can ensure that result by granting MichCon's application in this case.

Respectfully submitted,

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Dated: March 9, 2001

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CERTIFICATE OF SERVICE

I hereby certify that I have caused copies of the Reply Brief of Michigan Consolidated Gas Company to be served upon all counsel of record in this case by electronic mail.

David C. Champion

Dated: March 9, 2001