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March 9, 2001

Ms. Dorothy Wideman
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
Lansing, MI 48911

***RE: Michigan Consolidated Gas Company, MPSC Case No. U-12762***

Dear Ms. Wideman:

Enclosed for filing in the above matter is the original and four copies of the **Attorney General's Reply Brief**, together with Proof of Service upon all parties.

Very truly yours,

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Encs.
c: Barbara Stump, ALJ
All Parties of Record
MPSC U-12762 Cover Letter

## PROOF OF SERVICE

*Michigan Consolidated Gas Company, MPSC Case No. U-12762*

The undersigned certifies that a copy of the **Attorney General's Reply Brief** was served upon the parties listed below by mailing the same to them at their respective addresses with first class postage fully prepaid thereon, or by State Interdepartmental mail as indicated, on the 9th day of March, 2001.

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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) |

# ATTORNEY GENERAL'S REPLY BRIEF


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**ATTORNEY GENERAL'S REPLY BRIEF**

## I. INTRODUCTION

Attorney General Jennifer M. Granholm submits this reply brief pursuant to the schedule established by the Administrative Law Judge ("ALJ") and the Michigan Public Service Commission ("MPSC" or "the Commission") in this case. The Attorney General is in receipt of the initial briefs filed by the Residential Ratepayer Consortium ("RRC"), Energy America, LLC ("Energy America"), the Association of Businesses Advocating Tariff Equity ("ABATE"), Michigan Consolidated Gas Company ("MichCon" or "the Company"), and the MPSC Staff. With the exception of MichCon and Energy America, the substantive positions of RRC, ABATE, and the MPSC Staff are similar to the Attorney General's position in this case. Therefore, this reply brief will primarily address the initial briefs filed by MichCon and Energy America.

## II. ARGUMENT

*Vice is often clothed in virtue's habit. Proverb.*

With its application, testimony and initial brief in this case, MichCon has vigorously sought to portray its proposal as somehow being beneficial to either the Commission or the ratepayer. However, the truth of the matter is that regardless of this herculean effort, MichCon's proposal is clearly designed to advance the parochial interest of the Company to the great detriment of its customers. Unfortunately, for purposes of achieving its objective, MichCon seeks to obtain the cooperation of the Commission which is an agency charged with a duty to protect the interests of MichCon's customers. In its deliberation on MichCon's application, the Attorney General believes that perhaps now more than ever, it is important for the MPSC to view circumstances from the perspective of the captive ratepayer regardless of how MichCon chooses to cloak its proposals in this case. Based on the overwhelming record in this case, MichCon's position is untenable and indeed the record brightly illuminates the Commission's path to rejecting MichCon's proposal.

At page 3 of its initial brief, MichCon argues that as a result of the Company's fixed price of $2.95 per Mcf, marketers were unable to "profitably compete," and that the "lack of competition frustrates the Commission's stated goals." The Attorney General submits that MichCon's argument misses the mark by a rather wide margin. Contrary to MichCon's apparent belief, the Commission's primary responsibility is to the ratepayers, not the marketers. Under the statutory and case law in Michigan, the Commission owes no duty to the marketers and it is not required to guarantee that the marketers are able to "profitably compete" in Michigan. Clearly, the Attorney General is strongly in favor of a vibrant and healthy competition in the natural gas market in Michigan. However, it is extremely illogical to sacrifice the real and practical interest of the ratepayer in a reasonable, reliable and affordably priced supply of natural gas in the name of "competition." In its effort to cloak its proposal with the garment of "pro-competition," MichCon asserts that "[s]imply put, fixed pricing stifles competition in periods of rising prices." (MichCon's Initial Brief, p 3). MichCon's assertion raises the question as to whether the Company was not aware of the effect of "fixed pricing" on "competition" when in 1998 it requested the fixed price of $2.98 per Mcf for a three year period. (3 Tr. 104-105). The Attorney General believes that MichCon's argument is disingenuous at best and at worst very cynical. The fact of the matter is that in 1998, during a period of declining prices MichCon requested and obtained approval to fix its prices at $2.95 per Mcf. As Mr. Miller testified, the $2.95 was designed to provide MichCon with an assured profit of many millions of dollars from its gas supply activities. Mr. Miller testified:

> In contrast, the fixed gas supply price of $2.95 per Mcf established in Case No. U-11682 is not and never was a cost-based rate. MichCon's application in Case No. U-11682 did not even claim that the proposed rate of $2.95 was based on MichCon's expected gas costs for the period 1999-2001, when the rate was to be in effect. The $2.95 rate was designed instead to provide MichCon with an assured profit of many millions of dollars from its gas supply activities. <u>It exceeded MichCon's own projections of its gas costs for the years 1999-2001 by $0.35 per Mcf, which translates into a margin of approximately $70 million per year</u>. And MichCon was able to lock in a large fraction of this planned gas supply profit margin by entering into fixed price gas purchase contracts for the approved three-year period of the GCR suspension.
>
> MichCon was able to institute this $2.95 rate in excess of its projected gas costs because it sought and received a suspension of its GCR clause at a time when natural gas prices were declining. The regulatory justification for this $2.95 rate was that it was not a rate increase, and it did not have to be cost-based because it

> was not higher than the rate then in effect. By obtaining a suspension of its GCR clause at a time when gas prices were declining, MichCon could keep the resultant gas cost savings for itself and it shareholders, instead of passing them on to its customers in the form of lower rates under the cost-based GCR procedure.
>
> (3 Tr. 144) (Emphasis added).

As the record in this case firmly establishes, fixed pricing at the level sought and obtained by MichCon, at a period of declining prices resulted in MichCon significantly overcharging its customers.

At page 10 of its initial brief, MichCon asserts that "the $2.95 per Mcf price guaranty recommended by the AG and Staff is patently unfair and wholly unjustified." The Attorney General disagrees with MichCon's assertion. Indeed, contrary to MichCon's assertion, what is "patently unfair and wholly unjustified" is to allow MichCon to pass on the risk of the current high gas prices to its customers after the Company pledged in unambiguous and unequivocal terms to fully bear that risk. (3 Tr 104-106). As the Attorney General indicated in her initial brief, it is highly improper to permit MichCon to terminate its GCR clause suspension and transfer all the risk to the customers. (3 Tr 164).

In furtherance of its request to prematurely terminate its GCR clause suspension, MichCon states as follows:

> The suggestion that MichCon guaranty a $2.95 per Mcf price through December 2001 also ignores a salient feature of the GCC program, the income sharing mechanism. Under MichCon's GCC program the Company is required to share with customers a portion of its gas sales income above certain target levels.
>
> (MichCon's Initial Brief, p 10).

Paradoxically, despite MichCon's strident efforts to break the deal it made when it obtained approval to fix its rates at $2.95 per Mcf, MichCon now argues that requiring it to abide by the deal would be a violation of the deal. MichCon's argument quite conveniently ignores the fact that from the perspective of the customer, the fixed rate of $2.95 per Mcf though December 2001, is not merely, <u>a</u> "salient feature" of the program, but is rather <u>the most</u> salient feature of the entire program. Moreover, for a party seeking to be relieved of its obligations under the approved program, MichCon is hardly in a position to argue that aspects of the program would be disregarded if the Attorney General's recommendation is adopted. Clearly, MichCon should not be allowed to "pick and choose" which provisions of the GCC program is should abide by and which ones it should totally disregard despite the significant adverse consequences of the Company's actions to the ratepayers. Notwithstanding MichCon's claim, one would be hard-pressed to envision how MichCon's' proposal demonstrates its "commitment to the customers' financial well being." (MichCon's Initial Brief, p 10). The focus of this case should be to ensure that the customers are not penalized for actions voluntarily taken by MichCon.

In its initial brief, MichCon argues that the GCC program has provided significant customer savings. At page 11 of its initial brief, the Company asserts that "[d]uring the first two years in which MichCon charged its fixed $2.95 per Mcf rate, customers saved in excess of $200 million over the cost they would have paid had MichCon's GCR remained in effect." (Footnote omitted). The Attorney General submits that MichCon's assertion is grossly inaccurate. As the footnote at the bottom of page 11 of the Company's Initial Brief clearly concedes, under the GCC program MichCon made $70 million in excess of its actual gas costs during the first two years of the program. Contrary to MichCon's assertion, if MichCon's GCR had remained in effect, the customers would have paid $70 million less than what they paid under the fixed $2.95

per Mcf rate. Under Act 304, MichCon is allowed to recover only the actual reasonable and prudent costs it incurs on behalf of its GCR customers. However, under MichCon's GCC program, the Company was placed in the advantageous position of charging its customers rates which far exceeded its actual costs regardless of the reasonableness and prudence of the costs. The Attorney General believes that it is a painful stretch of the imagination to consider the overcharging of customers as producing "significant" savings to the customers. Accordingly, MichCon's arguments in this regard should be rejected.

For support of its application for premature termination of its GCR clause suspension, MichCon points to the presentation of Energy America. At page 11 of its Initial Brief, MichCon states:

> A Commission order directing MichCon to continue its fixed $2.95 per Mcf price for the last nine months of 2001 will have a detrimental effect on competition. Energy America witness Mr. McDonald testified that in such circumstances marketers will be unable to compete with MichCon based on price and will either suspend further marketing efforts in MichCon's service territory or simply abandon the GCC program altogether
>
> (Tr 79-80).

MichCon's and Energy America's argument is clearly motivated by a desire to bring about an atmosphere in which their interests may be advanced regardless how adversely the end-users are impacted. One is reminded of the words of the Bard of Avon to the effect:

> Fair is foul, and foul is fair;
> Hover through the fog and filthy air.
>
> (William Shakespeare, Macbeth, I:1)

Simply put, in response to MichCon's proposal the MPSC should cry "foul." Contrary to MichCon's and Energy America's assertions, MichCon's proposal is not conducive to the welfare and financial well-being of the end-user. Clearly, to the extent MichCon succeeds in charging its customers more than $2.95 per Mcf for the last nine months of 2001, MichCon's proposal is unreasonable and not in the public interest.

As Mr. Miller's testimony demonstrates, there is a high likelihood that the available gross margins for purposes of refunds to the customers would be less than the amount projected by the Company. (3 Tr 182-184). Consequently, it is imperative that an inordinate amount of reliance is not placed on the availability of gross margins for purposes of making the customers whole. The Attorney General believes that the best way to ensure that MichCon's customers are not harmed, as a result of having to pay more than $2.95 per Mcf for gas for the last nine months of 2001, is to deny MichCon's application to prematurely terminate its GCR clause suspension. In the alternative, if the MPSC elects to approve the early termination of MichCon's GCR clause suspension, the MPSC should ensure that the customers are made whole by eliminating the cap that MichCon is proposing for the gross margin refunds. Mr. Miller clearly explained the importance of eliminating the cap on the gross margin refund. (3 Tr 159-164).

In its initial brief, RRC accurately points out that the MPSC has no authority to approve MichCon's request for a nine month GCR plan period. The Attorney General agrees with RRC that as a matter of law, MichCon's application is substantively defective. Based on the letter and the spirit of Act 304, the MPSC would be committing a reversible error if it grants MichCon's application to disregard the statutory requirement to file a GCR plan period covering 12 months rather than the Company's proposed nine month period. Accordingly, in addition to the factual practical and policy reasons presented in this case, the Commission has a solid legal basis for rejecting MichCon's application. The Attorney General submits that both law and equity demand the denial of MichCon's application.

## III. RELIEF

For all the reasons stated above as well as those contained in the Attorney General's initial brief, and testimony and exhibits, the Attorney General respectfully requests that the MPSC adopt her recommendations.

Respectfully submitted,

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