CLARK HILL PLC
ATTORNEYS AT LAW

255 South Old Woodward Avenue
3rd Floor
Birmingham, MI 48009-6179
Tel. (248) 642-9692 ▪ Fax (248) 642-2174
www.clarkhill.com

Robert A. W. Strong
Phone: (248) 988-5861
E-Mail: rstrong@clarkhill.com

July 8, 2002

VIA ELECTRONIC MAIL and HAND DELIVERY

Ms. Dorothy Wideman
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
Lansing, Michigan 48909-7721

Re: MPSC Case No. U-13000

Dear Ms. Wideman:

Enclosed are an original and four (4) copies of the Replies to the Exceptions of the Association of Businesses Advocating Tariff Equity with a proof of service on the parties of record in the above docket.

Very truly yours,

CLARK HILL PLC

Robert A. W. Strong

RAWS/lat
Enclosures

cc: Parties of Record (w/Enclosures)

5078363v1
07411/087612

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of CONSUMERS ENERGY COMPANY for authority to increase its rates for the distribution of natural gas and for other relief.	)))))	Case No. U-13000

REPLIES TO THE EXCEPTIONS OF THE
ASSOCIATION OF BUSINESSES ADVOCATING TARIFF EQUITY

The Association of Businesses Advocating Tariff Equity ("ABATE") by its attorneys, Clark Hill PLC, file these Replies to Exceptions in accordance with the Rules of Practice and Procedure before the Michigan Public Service Commission ("Commission").

1. REPLY TO THE ATTORNEY GENERAL.

In her Exception No. 3, the Attorney General argues that rates in this case should not be set at cost-of-service levels. The Attorney General is the only party to take this particular position because the Michigan Public Service Commission Staff ("Staff"), Consumers Energy Company ("Consumers") and ABATE all filed extensive testimony indicating that it was finally time to set rates at cost-of-service levels. The Attorney General states that the principal justification for not moving rates at cost-of-service is the idea that rates should be gradually moved in the direction of cost-of-service. Attorney General's Exceptions, p. 15.

Inherent in the Attorney General's position is that:

- It is good public policy to require other rate classes to subsidize the residential class.

- It is good public policy to put in place rates which do not send the proper economic signals.
- The residential class deserves more protection from the Commission than the other customer classes.
- Subsidies are just and reasonable.

Gas transportation service began in the mid 1980's following the Federal Energy Regulatory Commission's Order 436 issued on October 9, 1985. Initially, local transportation rates were established on the basis of gross margins which required transportation customers to pay substantial subsidies. Between the advent of gas transportation and this current rate case, ABATE has constantly pointed out the fact that transportation customers were paying far above their cost-of-service levels. The Attorney General cannot dispute the fact that transportation customers under the current rates are paying far in excess of the average rate of return as demonstrated by all of the cost-of-service studies supplied by ABATE, Consumers and Staff (*e.g.*, 11 TR 1871; Exhibit I-141 and I-142; Exhibit A-110; and Exhibit S-147).

The Attorney General has put on blinders with respect to the policy implications of her position. In an era where customers are increasingly allowed to choose their energy suppliers, the Attorney General is advocating a policy that really binds residential customers to the monopoly supplier instead of allowing them to exercise choice. Competitors simply cannot compete with subsidized rates in a competitive market place thus effectively denying residential customers the ability to choose. In addition, the Attorney General's position, if adopted, would eliminate a mechanism which exerts downward pressure on the prices that the regulated utility can charge. If customers have a competitive option to regulated service, the competitive option establishes a ceiling on the price that may be charged by the monopoly utility. As a matter of sound public policy the Commission should set rates at cost-of-service levels in order to promote competitive markets in Michigan.

The Attorney General's position regarding gradualism is actually a position of denial. It denies the formation of a competitive market, it effectively forces residential customers to remain customers of the monopoly as opposed to being in a position to choose between the monopoly and other suppliers, and it denies that more than 15 years have passed since transportation customers became a separate rate class for purposes of setting rates. Even if gradualism were a legitimate principle, there certainly has been more than enough time to establish rates at cost-of-service levels since transportation first began.

In summary, good public policy requires that rates be set at cost-of-service levels in this proceeding and the Commission should reject the Attorney General's exception based upon the principle of gradualism. ABATE, the Staff and Consumers all have supported setting rates at cost-of-service levels and the only disagreement has been over which cost-of-service study to follow and what costs should be flowed through that study.

The Attorney General also takes exception with the Attorney Law Judge's ("ALJ") failure to allocate the benefits associated with the reclassification of natural gas between shareholders and customers. The Attorney General's evidence is unrebutted in that both shareholders and customers have and will benefit as a result of the reclassification of gas. ABATE supports the Attorney General's position that $105,982,000 should be removed from Consumers' average rate base to allocate the increased working capital costs in proportion to the way Consumers and its customers have shared the benefits. See Exhibit I-137.

ABATE also supports the Attorney General's contention that ALJ erred when he refused to remove the $150 million in equity infusion from the capital structure for ratemaking purposes.

2. REPLY TO METRO BUREAU GROUP SERVICES, INC.

ABATE is replying collectively to all of Metro Bureau Group Services, Inc.'s ("Metro") Exceptions because they are all directed at one issue: whether schools should be granted more favorable treatment vis a vis other transportation customers? The fundamental principle guiding ABATE's position in this case is that rates should be based on cost-of-service because they result in equitable rates for all customer classes and provide pricing signals to customers that best achieve all ratemaking goals. 11 TR 1885. Presumably, Metro also agrees with this principle. That being said, however, there is a requirement that a Commission order be based upon competent, material and substantial evidence on the whole record. MCL 24.306(1)(d) and MCL 24.285.

The traditional method to submit competent, material and substantial evidence to support cost allocations is a cost-of-service study. Cost-of-service studies were performed by ABATE, Consumers and the Staff which all showed that transportation customers were paying rates in excess of their cost-of-service. 11 TR 1882. As noted by the ALJ, ABATE's witness testified that Metro witness's beliefs were vague, unsubstantiated and unlikely to actually demonstrate any valid cost support for the stated recommendations. 11 TR 1884. Moreover, ABATE's witness testified that there was no valid demonstration that the customers represented by Metro were in an appropriate class or less costly to service than other transportation customers. Id.

Even though schools which transport natural gas will see a rate decrease as a result of this case because the rates will be set at cost-of-service, the schools apparently want further consideration without any empirical proof they are less costly to serve. There is a claim that they are less costly to serve than other transportation customers because they always pay their bills, but ABATE suspects that schools are no more creditworthy than other large transportation customers. Not only do the schools desire favorable preferences, but they also apparently want a relaxed legal standard to support that request. Unfortunately for the schools, the Commission cannot relax the legal standard that its orders must be based upon material, competent and substantial evidence on the whole record. Metro has not provided the necessary evidence and consequently Metro's Exceptions should be rejected.

3. <u>REPLY TO STAFF</u>.

In its first Exception, the Staff argues that Consumers should not be allowed to implement accounting changes which benefit Consumers and hurt customers five to six after its reengineering programs. ABATE agrees with the Staff's position.

In its second Exception, Staff is supporting a variance from a strict use of the Massachusetts Formula. The Staff noted that Consumers used a formula which omitted the revenue and wage components of certain affiliates but not the investment component, which skewed the results. The Staff then proposed alternatives which ABATE agrees are more reasonable under the circumstances than the results of Consumers' calculation.

In its third Exception, the Staff argues that the gas-in-kind percentage paid by transportation customers should be equivalent to the lost and unaccounted for gas percentage paid by bundled customers. ABATE agrees. As noted by ABATE in its Exceptions, the justifications to raise the transportation customers percentage all pertain to serving bundled customers and not transportation customers. ABATE believes it is unreasonable to discriminate against transportation customers.

In its fourth Exception, Staff takes exception to the fact that the ALJ adopted Consumers recommended adjustments to transportation volumes. ABATE agrees that the Staff's position that the Commission should discourage meaningless adjustments by rejecting Consumers' proposed volume changes.

In its fifth Exception, Staff argues that consistent methodology should be used to project expenses and that this methodology was not followed in connection with the calculation of pension costs and post retirement health care and insurance costs. ABATE agrees with the Staff's proposed adjustment.

In its seventh Exception, the Staff argues that for ratemaking purposes the Commission should not recognize the $150 million equity infusion. Again, ABATE agrees with the Staff for the reasons stated in Staff's Exceptions.

4. <u>REPLY TO CONSUMERS</u>.

Consumers takes exception to the ALJ's recommendation that the rate of return on common equity should be set at 11%. One of the arguments in support of its Exception was that Mr. Ballinger changed his DCF analysis such that new and higher numbers were generated due to the correction. Mr. Ballinger was asked whether he could explain a little bit more about his recommended range of 10.75% to 11.25%. His answer was:

> "The range was arrived at looking at the results of all my studies, which included the DCF and CAPM for both groups over the whole time period.
>
> After the revisions, which caused my DCF to go up some, I felt confident that the range that I had originally selected or found to be reasonable was still reasonable. So I didn't make a change as a result of the corrections that I made on page 24." 10 TR 1512.

According to the Staff witness, an 11% ROE was equivalent to a pretax rate of return of approximately 16% to 17%. 10 TR 1509-1510. This pretax rate of return was substantially higher than the money market yields or even the yield on a ten-year treasury, which according to

Mr. Ballinger ranged from a low of 2.5% to 5.06%. 10 TR 1510. One could easily conclude Mr. Ballinger's recommendation was generous.

He was also questioned about the relative degree of risk between a gas only utility and a gas and electric combination utility and opined that a gas only utility had lower risk and that was supported by his study. 10 TR 1521. To ABATE it appears that 11% is generous in a low interest rate environment. As Mr. Ballinger testified, the Fed reduced interest rates 11 times in year 2000 so interest rates have declined and the cost of equity has also declined. 10 TR 1547.

Consumers argues that a higher rate of return is needed to reflect the increased risk in the gas industry. Whatever risk there is appears to be of Consumers' or its affiliates or parent's own making. For example, the non-economic round trip gas trades made by an affiliate of Consumers forced that affiliate's CEO and CFO to resign as well as the chairman of CMS Energy. In another example, CMS Energy's own auditor refused to certify the financial statements for the years 2000 and 2001 which put a revolving credit facility in jeopardy. Now CMS Energy must agree to new terms which may include the reduction or elimination of the dividend in order to renew the revolver. Under the circumstances, 11% is more than adequate to attract capital.

Consumers also took exception with the ALJ's recommendation with respect to lost and unaccounted for gas. Consumers noted that the ALJ had recommended that the percentage for bundled sales customers be reduced to .82% whereas the percentage was increased to 1.72% for transportation customers. Consumers position is that both should be assessed the higher percentage. Again, ABATE would point out that all of the reasons for increasing the percentage for transportation customers apply only to service to bundled sales customers. These reasons certainly do not justify the increase and therefore ABATE requests the Commission to reject Consumers' exception.

The lost and unaccounted for gas represents a major financial issue for customers representing more than a one-third addition to the final revenue requirement recommended by the ALJ. The annual throughput on Consumers' system is approximately 320 million Mcf per year. Exhibit I-142, p. 5 of 5. Assuming a cost of gas of $4.00 per Mcf the annual cost of gas flowing through Consumers' system is approximately $1.28 billion. The differential between the Staff percentage of .82% and the proposed Consumers' percentage of 1.72% is .9%. When that is multiplied against the cost of the annual throughput, the annual revenue requirement associated with lost and unaccounted for gas increase is $11.5 million. As pointed out in ABATE's Exceptions, the data supporting this revenue increase are highly suspect which dictates that Consumers' rate increase related to this matter should be looked at with a great deal of skepticism.

Assuming for the moment that the Consumers' numbers are correct, Consumers should be directed to take steps to reduce this number if it is going to cost customers an additional $11.5 million per year. Moreover, this number should be factored into the analysis of whether Consumers is using its system in an appropriate fashion. All in all, the increased percentage when translated into dollars represents a huge rate increase for the customers of Consumers whether it is paid with gas in kind or through the loss factor and this rate increase is not supported by the record in this proceeding.

In another exception, Consumers challenges the ALJ's failure to adopt a proposed rule change related to transportation that would have required minimum deliveries during the months of January, February and March. This rule change should not be made for a variety of reasons. First, the rule change is premised on <u>speculation</u> that gas transportation customers will try to arbitrage their gas positions which in turn leads to the further <u>speculation</u> that this may put undue pressure on the system. There really is no proof that either of the speculative events have or will ever occur.

Second, most transportation is done for industrial customers which have very little temperature sensitive load. Industrial customers move transport gas for industrial processes relative evenly over 12 months of the year.

Third, as a matter of public policy, the Commission should not put restrictions on the use of private property unless it is absolutely required. In this instance, there is no showing that would justify any limitations.

Fourth, the rule change is flawed on its face. It utilizes a formula, which completely ignores reality. For example, a customer could reduce its gas usage by a percentage in excess of 3% of what it used in the prior January, February or March for a variety of reasons including conservation, production changes, etc. This rule would still <u>require</u> that customers go out and acquire 97% of the gas that they had delivered in the prior January, February and March and delivered into Consumers system even though the <u>customers did not need that gas</u>. This is a ludicrous result flowing from the ill-advised rule change.

5086977v1
07411/087612

II

RELIEF

WHEREFORE, ABATE respectfully requests the Commission to enter an order which is consistent with these Replies to Exceptions.

Respectfully submitted,

CLARK HILL PLC

By: Robert A W Strong

Robert A.W. Strong (P27724)
Thomas E. Maier (P34526)
Attorneys for the Association of Businesses
Advocating Tariff Equity
255 South Old Woodward Avenue
Third Floor
Birmingham, Michigan 48009
248/642-9692

Dated: July 8, 2002

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of CONSUMERS ENERGY COMPANY for authority to increase its rates for the distribution of natural gas and for other relief.	)))))	Case No. U-13000

PROOF OF SERVICE

STATE OF MICHIGAN)
)
COUNTY OF OAKLAND)

Lisa Ann Teets, being first duly sworn, deposes and says that she filed electronically Replies to the Exceptions of the Association of Businesses Advocating Tariff Equity in the above docket on the persons identified on the attached service list and by depositing the same on July 8, 2002, in the United States mail in the City of Birmingham, Michigan with first-class postage thereon fully paid.

Lisa Ann Teets

Lisa Ann Teets

Subscribed and sworn to before me
this 9th day of July, 2002.

Judith A. Haffner

Judith A. Haffner, Notary Public
Oakland, Michigan
My Commission Expires: July 11, 2004

5062047v1
07411/087612

SERVICE LIST
MPSC CASE NO. U-13000

Administrative Law Judge
Daniel E. Nickerson
Michigan Public Service Commission
6545 Mercantile Way
Suite 15
Lansing, Michigan 48909
Daniel.E.Nickerson@cis.state.mi.us

Attorneys Consumers Energy Company
Jon R. Robinson, Esq.
H. Richard Chambers, Esq.
Consumers Energy Company
212 West Michigan Avenue
Jackson, Michigan 49201-2211
jrrobinson@cmsenergy.com
hrchambers@cmsenergy.com

Mr. Carl L. English
President and CEO - Gas
Consumers Energy Company
Chairman of the Board and President
Michigan Gas Storage Company
212 West Michigan Avenue
Jackson, Michigan 49201
clenglish@cmsenergy.com

Attorneys for Michigan Public Service Commission Staff
Steven D. Hughey, Esq.
Larry G. Watterworth, Esq.
Assistant Attorneys General
Public Service Commission
6545 Mercantile Way
Suite 15
Lansing, Michigan 48911
hugheys@ag.state.mi.us
watterworthl@ag.state.mi.us
simss@ag.state.mi.us

Attorney for Attorney General
Donald E. Erickson, Esq.
Assistant Attorney General
6520 Mercantile Way
Suite 2
P.O. Box 30736
Lansing, Michigan 48909
ericksond@ag.state.mi.us

Attorney for National Energy Marketers Association
John M. Dempsey, Esq.
Dickinson Wright PLLC
215 South Washington Square
Suite 200
Lansing, Michigan 48933
jdempsey@dickinson-wright.com

Attorney for Midland Cogeneration Venture Limited Partnership
Michael J. Brown, Esq.
Howard & Howard
222 North Washington Square
Suite 500
Lansing, Michigan 48933-1817
mjbrown@howardandhoward.com

Mr. Gary B. Pasek
Vice President, General Counsel and Secretary
Midland Cogeneration Venture Limited Partnership
100 Progress Place
Midland, Michigan 48640

Attorneys for Metro Bureau Group Services, Inc.
Josh H. Fields, Esq.
Josh Fields & Associates
4700 South Hagadorn
Suite 195
East Lansing, Michigan 48823
jfoil98@aol.com

Thomas D. DeWard
25806 Glover Court
Farmington Hills, Michigan 48335-1236