STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **MICHIGAN GAS UTILITIES** for authority to increase its rates for natural gas service and for other relief.	)))))	Case No. U-10960

At the March 27, 1997 meeting of the Michigan Public Service Commission in Lansing, Michigan.

PRESENT: Hon. John G. Strand, Chairman
Hon. John C. Shea, Commissioner
Hon. David A. Svanda, Commissioner

OPINION AND ORDER

I.

HISTORY OF PROCEEDINGS

Michigan Gas Utilities (MGU), a division of UtiliCorp United Inc. (UtiliCorp), is a public utility engaged in the sale, distribution, and transportation of natural gas, and serves approximately 138,000 customers in more than 50 cities and villages and 93 townships located in the southern and western portions of the lower peninsula of Michigan.

UtiliCorp, which is based in Kansas City, Missouri, has eight operating divisions and provides gas or electric service in eight states, British Columbia, and New Zealand. UtiliCorp also holds numerous subsidiaries that operate pipeline systems and provide gas brokering, appliance repair, and a variety of other services.

On October 31, 1995, MGU filed an application, testimony, and supporting exhibits, requesting authority to increase its rates for natural gas service by $10,547,752, which was later reduced to $6,377,000[1], and finally reduced to $5,229,000[2].

Pursuant to due notice, a prehearing conference was held before Administrative Law Judge Robert E. Hollenshead (ALJ) on December 11, 1995. At that time, the ALJ recognized the Association of Businesses Advocating Tariff Equity (ABATE), North Star Steel Company (North Star), Alchem Aluminum, Inc., (Alchem)[3], Attorney General Frank J. Kelley (Attorney General), and the Commission Staff (Staff), in addition to MGU, as parties to this case.

The parties filed direct, supplemental, rebuttal, and surrebuttal testimony. Evidentiary hearings commenced on March 25, 1996 and concluded on June 21, 1996. The record consists of 16 volumes totaling 2,666 pages and 119 exhibits that were admitted into evidence.[4]

The parties submitted briefs and reply briefs on July 15 and 30, 1996, respectively. On August 29, 1996, the ALJ issued his Proposal for Decision (PFD), in which he recommended that the Commission authorize a rate increase of $2,077,000.

On September 16, 1996, MGU, ABATE, and the Staff filed exceptions to the PFD. On September 30, 1996, MGU, ABATE, the Attorney General, and the Staff filed replies to exceptions.

II.

TEST YEAR

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[1]MGU's reply brief, p. 35.

[2]MGU's exceptions, p. 39.

[3]These first three parties presented a unified position and were represented by the same counsel. This order will refer to these parties as ABATE, unless otherwise noted.

[4]The ALJ rejected Exhibit S-17 because it was incorporated in total within another exhibit. See 4 Tr. 349.

In each rate proceeding, the Commission must identify an appropriate test year as a basis for evaluating the utility's rate base, capital costs, revenues, and expenses to determine whether existing rates should be altered. This methodology begins with booked amounts for an historical period, which are then adjusted for known and measurable changes that are reasonably expected to occur prior to and during the projected test year.

MGU proposed the 12-month period ended May 31, 1995 as its historical period. Its projected test year is the 12-month period ending May 31, 1997. None of the parties objected. The Commission accepts MGU's proposed test year.

III.

RATE BASE

A utility's rate base is the investment upon which a utility is given an opportunity to earn its authorized rate of return. It is equal to the capital invested in plant, less accumulated depreciation, plus working capital.

In its revised testimony and exhibits, MGU proposed a net utility plant (capital invested less depreciation) of $118,092,000 and working capital of $21,552,000, for a total rate base of $139,643,000.[5] The Staff's proposal reduced net plant to $116,799,000 and working capital to $16,002,000, for a total proposed rate base of $132,801,000.[6]

The ALJ recommended that the Commission adopt most of the Staff's adjustments and use a rate base of $132,915,000 for this proceeding.

Net Utility Plant

[5] See Exhibit A-8, Schedule B-1.

[6] See Exhibit S-77, Schedule B-1.

The ALJ noted that the Staff proposed three adjustments to MGU's gross plant and related accumulated depreciation amounts. The only adjustment that MGU contests is the proposed removal from rate base of $1,317,227 related to MGU's Area Expansion Program (AEP).

The Commission first approved MGU's AEP in the March 11, 1986 order in Case No. U-8335 to provide MGU with an optional method of financing main extensions. This program provided new customers with the option to pay for main extensions (including carrying costs) over a three- to five-year period through a surcharge on gas usage, rather than requiring construction costs to be paid before gas service commenced.

The Staff's audit for this case reflected that MGU implemented AEP surcharges based on its projection of the number of customers that would take service from the extension rather than the number of customers that had actually signed a contract to do so. The Staff argued that MGU's failure to follow Rule B7.3 of its standard rules in its tariffs led to substantial understatements of the appropriate surcharge to new customers and to subsequent undercollections of contributions in aid of construction. Roger A. Lamb of the Commission's Gas Division testified that some of the AEP accounts showed an increase over the amount that was originally recorded, which meant that those accounts were not even recovering enough to cover the carrying charges.

The Staff took the position that the AEP was not intended to shift the costs of constructing new mains to ratepayers in general, but was intended to provide customers seeking new service an alternative financing mechanism. The Staff argued that ratepayers should not be required to compensate the company for undercollections resulting from its failure to follow the AEP rules.

MGU took the position that projections and estimates of the number of customers and their usage are inherent in the AEP rules. It asserted that the Commission has previously approved the use of estimates to calculate surcharges. MGU asserted that the Staff's proposed adjustment disallows costs associated with used

and useful plant that was reasonably and prudently constructed, and is premature for AEPs that are not yet terminated.

The ALJ concluded that the costs associated with MGU's new customer additions under its AEP rules should not be borne by ratepayers in general. Thus, he recommended that the Commission remove the unrecovered costs of extending service under MGU's AEP by adopting the Staff's proposed adjustment to net plant.

In its exceptions, MGU argues that the ALJ's interpretation of the AEP rules is flawed and his conclusion should be rejected. MGU explains that when an AEP area is established, the total amount of customer contribution for construction is calculated and booked as a debit to accounts receivable with an equal credit to the plant account. MGU states that, had it followed the Staff's suggestion to calculate the surcharge based on actual signed contracts, the debit to accounts receivable and the corresponding credit might or might not be larger. Thus, MGU argues, the Staff's position that plant balances are overstated is not correct.

Further, MGU argues, the ALJ's interpretation of the AEP rules is not consistent with industry practice, which uses customer projections for implementing AEPs. It points out that the Commission's order authorizing the AEP does not expressly require that the surcharge be calculated using the actual number of customers signing contracts. Moreover, MGU argues, the recently approved customer attachment program, which replaced the AEP, uses projections for determining customer contributions.

MGU further argues that the adjustment is premature because, of the 40 AEP areas completed by MGU, 30 terminated early because MGU projected correctly or took steps to improve performance. MGU states that the AEP rules allow the company to adjust the surcharge, add new customers to an AEP area, or target an AEP area to increase sales. According to MGU, the adjustment recommended by the PFD is for areas for which MGU has not yet taken these steps. It "has not sought to include in base rates unrecovered costs because it remains to be determined what, if any, costs are unrecovered." MGU's exceptions, p. 11.

Moreover, MGU argues, requiring shareholders to bear the costs of undercollected AEP areas is not symmetrical, because overcollected amounts from AEPs are subject to refund.

According to MGU, the Commission's finding that an ex parte order was appropriate in Case No. U-8335, because approving the AEP would not increase current customers' rates, reflected a finding concerning the immediate impact on rates. MGU argues that the Commission's finding does not preclude a later determination that these costs may be recovered through base rates.

Moreover, MGU argues, adopting the Staff's position requires the company to know how many customers will sign a contract before it can calculate the charges for which customers will be asked to contract. MGU says that actual number of customers and costs are interdependent; customers will not sign contracts until they know what they will be required to pay. MGU argues that because the AEP rules expressly call for projections for costs of the extension and the annual customer consumption, both of which will vary from the actual data, it is also reasonable to project the number of customers. In the company's view, ratepayers may reasonably be asked to pay for the benefit of spreading the cost of service over a larger volume of sales.

The Staff responds that the ALJ reasonably adjusted net plant to reflect contributions in aid of construction that should have been collected from new customers attaching to MGU's system. In answer to MGU's argument that its recently approved new customer attachment program supports its position, the Staff states that the new program has its own rules, which are different than those at issue here.

The Staff argues that the Commission's recognition that all customers would benefit from new customer additions does not shift the responsibility for payment away from new customers. The Staff further argues that the March 11, 1986 ex parte order in Case No. U-8335 did not obviate MGU's responsibility to collect contributions for new construction from AEP participants. Finally, the Staff argues, MGU made no effort to quantify any benefits to ratepayers in general from the AEP projects.

The Commission finds that the costs associated with MGU's AEP should not be borne by ratepayers in general. In the March 11, 1986 order in Case No. U-8335, the Commission noted:

> MGU represents that its proposal is consistent with the current Rule 14 in that no costs are shifted between new and old customers. Instead, as appropriate, new customers are given the option of paying their main extension charges (plus carrying costs) over a three- to five-year period based upon their actual consumption of natural gas rather than pay those charges prior to receiving gas service.

Order, pp. 3-4. The AEP was not intended to alter the amount of construction costs recovered from newly connecting customers. In this light, MGU's argument concerning (unquantified) benefits to ratepayers from AEPs is irrelevant.

The Commission further rejects MGU's argument that it must know the exact surcharge amount before it can expect to obtain new customers. MGU should be able to estimate the surcharge based on a prior survey of likely participants in the area. That estimate can then be shared with potential customers before they sign a contract with the understanding that the actual surcharge may be more or less.

Finally, the Commission finds that the provision for estimating customers pursuant to MGU's new customer attachment rules does not support the company's position. Those rules are not at issue here. Moreover, the Commission's order approving the new customer attachment rules notes that they constitute a significant change from the then current practice. See June 5, 1995 order in Case No. U-10745.

For all of these reasons, the Commission concludes that the ALJ properly adopted the Staff's adjustments to net plant.

Working Capital

Working capital is commonly defined as current assets less current liabilities. Current assets include cash, accounts receivable, and gas inventory in storage, among other things. Current liabilities include accounts payable, dividends payable, accrued taxes, and accrued interest, among other things. For ratemaking

purposes, deferred debits and credits are also reflected in working capital. Generally, working capital is the amount of investment necessary to bridge the gap between the payment of a utility's expenses and receipt of revenues from the utility's customers.

Using the Commission-approved balance sheet method, MGU calculated its working capital component of rate base to be $21,552,000. The Staff made several adjustments to MGU's proposal to arrive at working capital of $16,002,000. The ALJ concluded that all of the Staff's adjustments should be adopted. MGU excepts to the ALJ's conclusions regarding the treatment of AEP related accounts, material and supply costs attributed to MG Ventures (an MGU affiliate), and manufactured gas plant cleanup costs.

1. AEP Accounts

In its exceptions, MGU argues that the ALJ erred when he determined that $4,317,000 in accounts receivable related to the AEP should be removed from working capital because those accounts bear interest and inclusion would allow double recovery of interest on the same capital. MGU also excepts to the ALJ's determination that $784,000 should be removed from the liabilities portion of working capital for deferred interest on the AEP.

MGU argues that the record demonstrates that these accounts are not interest bearing because MGU has ceased recording interest income on them. Therefore, MGU argues, the accounts should not be excluded from working capital. However, if the Commission determines otherwise, MGU argues, a corresponding adjustment to the company's rate of return should also be made.

In its replies to exceptions, the Staff argues that the ALJ properly excluded the interest-bearing AEP accounts receivable from working capital. The Staff agrees that ceasing to record interest on these accounts is probably appropriate given the "fictitious customer accounts MGU created under its erroneous interpretation of the AEP rules." Staff's replies to exceptions, p. 6. However, the Staff insists that MGU's decision with

regard to those accounts does not render the remaining AEP accounts receivable no longer interest bearing, because AEP customers are required to pay interest in accordance with the AEP rules.

Additionally, the Staff states that its removal of deferred interest accounts is consistent with, and balances, the exclusion of AEP accounts receivable from working capital. The Staff concludes that its adjustment to working capital related to the AEP accounts is reasonable.

The Commission finds that MGU's exception should be rejected. The portion of the accounts for which MGU has ceased recording interest should be excluded from rates, consistent with the exclusion of the AEP accounts from rate base.

2. <u>MG Ventures Materials and Supplies</u>

The ALJ included $114,000 for materials and supplies related to operations of MG Ventures. MGU agrees that whether this addition to working capital is appropriate turns on whether revenues from MG Ventures are included in net operating income. MGU takes the position that the Commission should include both or neither. For reasons more fully discussed in the net operating income section of this order, the Commission concludes that the $114,000 should remain in working capital.

3. <u>Manufactured Gas Plant Cleanup</u>

MGU argues that the ALJ improperly disallowed from working capital $1,345,000 related to cleanup costs for manufactured gas plant sites. MGU states that the costs are reasonable and highly likely to be incurred. MGU agrees that the resolution of the manufactured gas site costs will determine the outcome of this issue. For the reasons discussed in the net operating income section of this order, the Commission finds that the ALJ's determination on this issue is correct.

Conclusion

Consistent with the discussion above, the Commission concludes that the ALJ's recommended rate base of $132,915,000 should be adopted.

IV.

RATE OF RETURN

To calculate MGU's revenue requirement, it is necessary to determine the rate of return to be applied to the utility's rate base. The rate of return is computed as the weighted average cost of the utility's capital, which requires a determination of the percentage of its capital structure attributable to each source of capital, as well as the cost of each source.

Capital Structure

The ALJ determined that, for purposes of this rate case, the Commission should employ the capital structure of MGU as a stand alone division, rather than the capital structure of UtiliCorp as a whole, although he recognized that, as the Staff posited, UtiliCorp has the ability to create or alter MGU's capital structure to suit its needs. The ALJ noted that the other divisions of UtiliCorp are involved in various businesses other than local gas distribution and, therefore, have differing capital structure requirements. He further noted that rating agencies consider MGU's divisional capital structure. The ALJ stated that use of the divisional capital structure recognizes an association between the division's financing and its rate base and holds the company's cost of debt and equity to a level related to the division's activities rather than the corporate activities of UtiliCorp as a whole. Finally, the ALJ stated, the divisional capital structure has been accepted in several other states.

In its exceptions, the Staff argues that the Commission should adopt the consolidated capital structure of UtiliCorp for purposes of this rate case. In the Staff's view, the consolidated capital structure is more appropriate because that is the structure upon which financing decisions are actually made and is less subject to manipulation than the divisional capital structure, which UtiliCorp assigns to MGU. In the Staff's view, the actual capital structure should be used unless a party demonstrates that the actual structure is unreasonable.

The Staff points out that the ALJ acknowledged UtiliCorp's ability to alter MGU's capital structure at will. In the Staff's view, the potential for abuse inherent in the divisional capital structure approach is an overwhelming reason to adopt the consolidated structure. The Staff states that the reasons proffered by the ALJ for adopting the divisional capital structure assigned by UtiliCorp to MGU are neither sufficient to support adopting the divisional capital structure nor supported by the record. The Staff asserts that MGU did not establish a relationship between the assigned divisional capital structure and the actual cost of debt and equity for MGU's business or that such a structure would minimize the cost of capital for MGU.

The Staff argues that UtiliCorp's other business activities support using a consolidated rather than divisional capital structure in order to avoid cross-subsidization from the utility to those other enterprises. The Staff further argues that there is no "tangible" proof that investors and rating agencies are aware of MGU's capital structure except the assertions to that effect by MGU's witness John C. Dunn. Moreover, the Staff argues, investors and rating agencies would have little incentive to challenge a capital structure designed to inflate a rate increase requested from a regulatory agency, because those parties are primarily concerned with the overall rate of return to UtiliCorp, the financing entity.

The Staff urges the Commission to find unpersuasive the decisions of other state utility commissions on this issue. First, the Staff argues, MGU has not shown by evidence, other than Mr. Dunn's assertions, that the named states have actually adopted the divisional capital structure of a utility division for ratemaking

purposes. The Staff asserts that closer examination of the Missouri decision that Mr. Dunn cited reveals that the case was remanded to the state commission by a reviewing court and a final determination is still pending. Moreover, the Staff argues that decisions from other states presumably would be based on the same testimony offered by Mr. Dunn, without benefit of the Staff's analysis presented by Brian L. Ballinger.

In its reply to exceptions, MGU asserts that the ALJ's conclusion is founded on extensive and compelling testimony, which demonstrates the reasonableness of using a divisional capital structure. MGU underscores the Staff's admission that the impact on rates will be minimal if the ALJ's resolution, adoption of the divisional capital structure with adjustments offered by the Staff, is adopted rather than the Staff's proposed capital structure.

Although the Staff registered its concern that MGU could manipulate the capital structure for purposes of rate cases, MGU states that the Staff did not point to any such abuse in this case, nor did the Staff point out in what manner the divisional capital structure was unreasonable or imprudent. MGU asserts that its designated capital structure is based on the financial requirements of the business and change only when those requirements change.

Further, MGU challenges the Staff's contention that MGU failed to demonstrate that cross-subsidization will not result from adoption of the divisional capital structure. MGU asserts that once UtiliCorp assigns a capital structure to a division, that structure remains with that division. According to MGU, UtiliCorp cannot merely reallocate capital items at the conclusion of this proceeding. Further, MGU states, there is no evidence to suggest that any cross-subsidy has occurred or will occur in the future. MGU argues that the fact that UtiliCorp guarantees all of MGU's debt says nothing about the actual capital requirements of MGU as a regulated utility.

MGU criticizes the Staff's position that the divisional capital structure should be rejected because it does not minimize the cost of capital to ratepayers. According to MGU, the appropriate capital structure is one that best reflects the facts as they exist, not necessarily the one providing the least cost to ratepayers.

The most significant difference between the capital structure that UtiliCorp assigned to MGU and that proposed by the Staff is the percentage of equity. The divisional structure assigns 49% of capital to equity. The consolidated capital structure has about 38.84% equity. The five-year history of common equity listed on Exhibit S-79, Schedule D-5, p. 2, shows that MGU's common equity has decreased slightly since 1991. Also, the equity percentage assigned to the divisional structure falls slightly below the average of the pure play companies analyzed by the Staff. See Exhibit S-79, Schedule D-5, p.1. The consolidated capital structure's percentage of equity is less than that of any of the other "pure play" companies on that exhibit.[7]

The Commission is persuaded that the ALJ's recommendation to accept MGU's divisional capital structure with the adjustments proposed by the Staff is reasonable and should be adopted. Mr. Dunn testified that UtiliCorp assigns a capital structure to each of its divisions based on the known capital structure of comparable, publicly traded companies. Mr. Dunn stated that UtiliCorp's highest priority is to assign a capital structure that is appropriate to the business of that division. To accomplish that purpose, UtiliCorp uses a pure play analysis. The Commission notes that the results of the methodology chosen today are nearly the same as those that would have arisen from adoption of the Staff's proposed methodology. Additionally, although the Commission has, on this record, adopted the stand alone capital structure for MGU, that finding should not be taken as a general conclusion that corporate-assigned capital structures should be adopted for ratemaking purposes.

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[7]For a pure play analysis, a group of companies in a single line of business is analyzed to determine the operational and financial characteristics necessary for that business. These pure play characteristics are then used to establish the requirements and performance of each of the different lines of business within a single, multiple function company.

Cost of Common Equity

The ALJ found that, based on his capital structure recommendation, the Commission should adopt a cost of common equity for MGU rather than UtiliCorp as a whole. He further found that the Staff proposed a more reasonable rate of return on common equity for the MGU division than MGU's witness proposed. Moreover, the ALJ determined that Mr. Ballinger's proposed rate of return fell within a range of returns authorized by the Commission in recent rate cases and within the average rate of return authorized in gas rate cases reported in the October 1, 1994 "Public Utilities Fortnightly," which was 11.35% for the 12 months ended August 31, 1994.

The ALJ further determined that the business risk for MGU is lower than it is for UtiliCorp as a whole because of the extensive nonregulated business interests of the latter. He determined that the appropriate difference in return between MGU and UtiliCorp would be 25 basis points, resulting in a recommended authorized rate of return on common equity of 11%.

In its exceptions, the Staff argues that the Commission should adopt its proposed rate of return of 10.75%, which is the midpoint of the range established by the Staff of 10.5% to 11%.

MGU argues in its exceptions that the ALJ's adoption of the Staff's proposed return on equity for MGU is supported by only one paragraph of testimony from Mr. Ballinger. The remainder of Mr. Ballinger's testimony, says MGU, focuses on the appropriate rate of return on equity for UtiliCorp as a whole. In contrast, states MGU, Mr. Dunn used the discounted cash flow (DCF) model and a risk premium analysis to calculate a recommended rate of return on equity for MGU of 13%.

MGU argues that the ALJ accepted the Staff's criticisms of Mr. Dunn's analysis, which in the company's view, largely involved differences of opinion. MGU states that differences of opinion are not sufficient to reject Mr. Dunn's position entirely. However, if the Commission accepts Mr. Ballinger's adjustments to Mr. Dunn's analysis, MGU claims the result should be a recommended return on equity of 11.8%, which would

comport with evidence that MGU is riskier than the pure play group that has an average rate of return on equity of 11.35%, as found in the October 1, 1994, "Public Utility Fortnightly" and would include a factor for the costs associated with issuing stock.

The Staff responds that the ALJ reasonably rejected MGU's request for a higher rate of return. The Staff argues that MGU's reduction in its request from 13% to 11.8%, results from recognition of the methodological flaws in Mr. Dunn's analysis. However, the Staff states, MGU's claims that Mr. Ballinger's recommendations are not applicable to MGU and that correcting for the deficiencies in Mr. Dunn's analysis would result in a rate of return on common equity of 11.8% are both erroneous. Further, the Staff states that the PFD correctly rejected a flotation cost adjustment because there was no evidence that the company intends to issue stock.

The Attorney General accepts the ALJ's determination that the rate of return on common equity should be set at 11%, although he would prefer that the Commission adopt the Staff's recommended return of 10.75%.

The Commission finds that Mr. Ballinger's recommended rate of return on equity for the divisional capital structure should be adopted. Mr. Ballinger's testimony outlines the flaws in Mr. Dunn's analysis, and those flaws are more than mere differences of opinion. Moreover, the Commission rejects MGU's argument that 11.8% is the appropriate rate of return if the Staff's adjustments are made to Mr. Dunn's analysis. MGU's calculation does not take into account the other deficiencies in Mr. Dunn's analysis, such as his use of an excessive growth rate.[8]

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[8]Mr. Dunn obtained a growth rate that was overstated because of the method he used to calculate it. He used a geometric mean to compute the year to year changes and arithmetic means to arrive at the average. He also excluded all negative or zero growth rate results from his analysis.

Further, the Commission finds that the ALJ properly excluded flotation costs in setting the rate of return on equity, because MGU did not establish any likelihood that it would need an infusion of equity capital. The Commission finds that this result is not inconsistent with its October 28, 1993 order in Cases Nos. U-10149 and U-10150, Michigan Consolidated Gas Company's (Mich Con) general rate case, in which the Commission found that "any utility seeking a financing cost adjustment should bear the burden of proving that stock will likely be issued for its benefit in the forseeable future . . . ." Id., p. 26.

Consonant with the Staff's position that the Commission should adopt the consolidated capital structure, Mr. Ballinger's testimony sets forth his analysis of the cost of equity for UtiliCorp as a whole to be in a range of 11% to 11.5%. Because a regulated gas distribution division has less risk than the diversified, nonregulated businesses of the consolidated company, Mr. Ballinger testified that if the Commission adopts the divisional capital structure, it should lower the rate of return on equity to 10.75%, the mid-point of a reasonable range of 10.5% to 11%. The Commission is not persuaded that the high end of the range, as adopted by the ALJ, is appropriate for MGU. For these reasons, the Commission concludes that the return on equity should be set at 10.75% as proposed by Mr. Ballinger.

Summary

Based on the previous findings and conclusions, MGU's overall cost of capital is 8.42%, calculated as follows:

	Structure Percent	**Cost Rate**	**Weighted Cost**
Long Term Debt	36.27%	8.76%	3.18%
Short Term Debt	7.32%	6.14%	0.45%
Common Equity	42.44%	10.75%	4.56%

Other Interest Bearing Balance Sheet Items	0.32%	8.33%	0.03%
Deferred FIT	11.51%	0.00%	0.00%
ITC	0.03%	0.00%	0.00%
JDITC	2.11%	9.52%	0.20%
TOTAL	100.00%		8.42%

V.

THROUGHPUT

Throughput is the total sales and transportation volumes delivered to end-user customers. It is calculated in a gas rate case as a prerequisite to projecting test year revenues and is also used in rate design.

Through the testimony of John J. Richard, State Regulatory Leader for the company, MGU presented its projected sales and transportation volumes. After adjusting for weather and certain differences in gas usage by large customers, Mr. Richard projected a total test year throughput of 41,951,193 thousand cubic feet (Mcf), which is 1,979,475 Mcf more than historical test year throughput. In his analysis, Mr. Richard predicted certain volume changes, including decreases for Guardian Industries Corporation (Guardian) and Jefferson Smurfit Corporation.

The Staff originally projected a total throughput of 42,900,091 Mcf (Exhibit S-80, Schedule F-2), which was based on historical year actual volumes. In Attachment A to its initial brief, the Staff changed its projection to 42,413,101 Mcf, which it asserted reflected adjustments for known and measurable changes, but without MGU's proposed decrease for Guardian.[9]

[9]In its brief, the Staff stated that all proposed adjustments to throughput had been resolved except the one for Guardian. Staff's brief, p. 63.

The ALJ adopted the Staff's projection of throughput after finding the Staff's position on the adjustment for Guardian more reasonable than MGU's position.

In its exceptions, MGU argues that the ALJ incorrectly adopted the Staff's position regarding Guardian and Jefferson Smurfit. It argues that it adequately supported both of these adjustments to historical throughput levels.

MGU states that Mr. Richard identified a plant closing as a reason for expecting reduced volumes would be delivered to Jefferson Smurfit. 5 Tr. 524-525. MGU states that, as of the time of rebuttal testimony in this case, Jefferson Smurfit had terminated service at its East Monroe plant, supporting MGU's original adjustment for this company.

Further, Mr. Richard testified that, based on a letter received from Guardian (Exhibit A-99), the shutdown of one production line at Guardian was certain and the only question was whether the shutdown would be temporary or permanent. 14 Tr. 2344-2345. Thus, MGU argues, throughput should be decreased to reflect three months of no sales to Guardian for that production line. MGU argues that the Commission should reject as speculative the Staff's argument that these load losses will be offset by increased sales to other customers.

The Staff responds in its replies to exceptions that the ALJ adopted the Staff's projection of throughput, which incorporated the decrease for Jefferson Smurfit, and the recommended revenue deficiency takes the Jefferson Smurfit loss into account. However, the Staff argues, the proposed decrease in throughput for Guardian should not be adopted. The Staff asserts that the record does not support a finding that Guardian is certain to shut down one line in the test year. The Staff argues that the letter upon which MGU relies does not state that Guardian will definitely close down or repair the second line during the test year.

Moreover, the Staff states, MGU incorrectly claims that its own adjustment reflects the lowest probable impact of a three-month shutdown. In fact, the Staff argues that it presented testimony that a three-month

shutdown might decrease MGU's throughput by only 346,592 Mcf rather than the company's projection of 510,409 Mcf. The Staff argues that even the lower adjustment is likely to result in overcompensating MGU, because the rates will likely be in effect for more than one year.

The Attorney General also supports the ALJ's determination that throughput should not be adjusted for the possibility that Guardian might shut down one line for an undetermined period at an undetermined time. In the Attorney General's view, MGU failed to meet its burden of proving the certainty of its projections.

The Commission finds that no adjustment to throughput should be made for service to Guardian. The letter from Guardian that MGU offered into evidence does not support MGU's position. The letter makes a case for Guardian's need for lower rates for energy in an industry that is extremely energy intensive. There is no definite determination either to shut down the line for repair, or to close it permanently, within the test year. In fact, the letter states that Guardian intends to continue negotiating with its energy providers to attempt to resolve its concerns about energy costs. Thus, at best, MGU has shown the possibility of a temporary decrease in throughput to Guardian. Such a showing is not sufficient to require an adjustment in throughput for ratemaking purposes. Finally, the Commission notes that MGU and Guardian received Commission approval of a special contract that contemplates an annual contract quantity of about 2.8 million Mcf.[10] That volume is close to the annual volume that the Staff projected for Guardian on Exhibit S-80, Schedule F-2, p. 1, line 25. Therefore, the Commission finds that throughput for the test year should be 42,413,101 Mcf.

VI.

ADJUSTED NET OPERATING INCOME

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[10]November 8, 1995 order in Case No. U-10956.

To determine whether a revenue deficiency (or sufficiency) exists, it is necessary to determine what MGU's net operating income will be in the future, based on current rates. The utility's net operating income is its operating revenues less allowable expenses, taxes, and depreciation.

In its initial brief, MGU proposed a test year adjusted net operating income of $9,006,000. The Staff proposed that the test year net operating income should be $10,638,000. After resolving the issues presented, the ALJ determined that MGU's adjusted net operating income for the test year should be $10,020,000.

Guardian Volumetric Adjustment

Consistent with his determination that throughput should not be decreased based on the letter from Guardian, the ALJ concluded that no related decrease to revenues would be necessary. Because the Commission adopts the ALJ's findings with regard to Guardian, no adjustment to income is necessary for this issue.

Company Use and Lost and Unaccounted for Gas

Mr. Richard testified that, in 1991, MGU investigated why it had experienced a line gain rather than a line loss for three of the previous four years. MGU determined that the line gains occurred only in districts served by Panhandle Eastern Pipe Line Company (Panhandle). During this period, the methods used by MGU and Panhandle to measure delivered volumes differed in that MGU used electronic meters and Panhandle used manually integrated charts. Early in the 1991-1992 year, Panhandle installed electronic meters. Thereafter, MGU states, it has not experienced a line gain in those districts.

MGU therefore argued that its five-year average company use and lost and unaccounted for gas should be adjusted to reflect nearly 170,000 Mcf of gas that Panhandle delivered without metering in 1991. To adjust for delivery of this "free" gas, which MGU asserted would be unlikely to occur again, the company proposed to increase the five-year average from 0.33% to 0.42% of total gas requirements.

The Staff opposed this adjustment and argued that recognizing only one distortion for one year would be contrary to the purpose of using a five-year average. The Staff argued that there might be other, unrecognized anomalies that would decrease the amount of gas in the system.

The ALJ concluded that the five-year average is used to smooth out distortions and that, therefore, no adjustment need be made for the extra gas delivered but not metered in 1991.

MGU excepts and argues that its proposal is consistent with past methods of calculating lost and unaccounted for gas, because the adjustment is "known, measured, and verifiable, properly reflecting conditions expected in the future." MGU's exceptions, p. 22. To ignore the anomaly, says MGU, would mean rates would be set based on the assumption that a line gain would occur again, which is unlikely.

In its reply to exceptions, the Staff states that the ALJ properly used a five-year average without reduction for the faulty measurement. Making a selective adjustment, the Staff argues is inconsistent with the purpose of using a five-year average. The Staff argues that the ALJ did not ignore MGU's arguments, but reasonably found the Staff's arguments to be more persuasive.

The Commission finds that MGU's proposed adjustment should be made to reflect the difference between Panhandle's manually calculated volumes and the volumes measured by electronic metering devices. The five-year average of lost and unaccounted for gas should be calculated using the most accurate measurement of gas delivered into the system, after taking into account a known change in the metering system. Therefore, the Commission finds that the lost and unaccounted for percentage should be increased to 0.42% of total gas requirements. For purposes of transportation rates, the gas-in-kind percentage to compensate MGU for company use and lost and unaccounted for gas should be 0.68% of total gas volumes received at the delivery point into MGU's system.[11]

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[11] See, Exhibit A-7, Schedules A-3-3a and A-3-3b.

Operation and Maintenance (O&M) Expense

1. Manufactured Gas Plant Cleanup Costs

MGU included a $78,000 increase[12] in amortized expenses related to the investigation and environmental remediation of its 12 contaminated former manufactured gas plant sites. The proposed increase is based on amortization of $1.5 million projected to be spent in 1996 for investigation and remediation of the sites. MGU asserted that there is no dispute that it will incur costs for investigation and remediation in order to comply with present environmental laws.

The Staff objected to inclusion of the $1.5 million in projected costs and proposed allowing an increase of $19,000 for the test year. In the Staff's view, the projected costs are too speculative to be included in rates because MGU had documentation for only $97,000 of the projected $1.5 million. The Staff further claimed that adopting MGU's position would allow the company to earn a return on costs not yet incurred. The Staff also argued that MGU's proposed treatment of manufactured gas plant costs is inconsistent with the Commission's prior orders concerning like costs.

The ALJ recommended that the Commission adopt the Staff's position regarding these costs. He noted that Richard W. Lewis, MGU's witness, presented the $1.5 million estimate based on reports prepared by other consulting firms, without the benefit of visiting the involved sites. Moreover, the ALJ found that MGU's failure to include these costs in its 1996 budget "casts doubt upon the credibility of [MGU's] estimate." PFD, p. 28. The ALJ further concluded that if MGU's position were adopted, the company would be allowed to earn a return on speculative and unsupported costs. Finally, the ALJ noted that the Commission

[12]MGU's amortized expense in the historical test year was $40,065. Thus, it proposed a total of $118,065 be collected through rates.

has previously ordered deferred accounting for these costs in vintage year accounts, with allowance for carrying charges only after the Commission has determined that the expenditures were prudently incurred.

The ALJ further recommended that the Commission reject MGU's proposal to implement a surcharge for manufactured gas plant costs, with annual supplemental filings. The ALJ noted that the Commission had rejected similar proposals by Consumers Power Company (Consumers) and Mich Con. Finally, the ALJ recommended that the Commission adopt the Staff's related adjustment to working capital on this issue.

In its exceptions, MGU argues that the ALJ improperly discounted the reasonableness of the estimated costs found in the testimony of its expert, Mr. Lewis. MGU asserts that expert testimony is often based on the results of others' work. Further, MGU states that whether MGU has budgeted this item is irrelevant to the reasonableness of the estimate for these costs. Typically, MGU states, it does not budget items that will be placed in deferred accounts. In fact, MGU states, it did not budget for the amount that the ALJ determined could be included in rates.

MGU argues that the ALJ's reasoning that adopting MGU's position would allow it to earn a rate of return on the costs not yet incurred could be applied to any projected cost in any rate case. MGU further argues that the test year should include anticipated increases in expense if it is to include anticipated increases in income. In MGU's view, the ALJ's treatment of these costs was arbitrary, and if adopted, would prevent the company from earning a reasonable rate of return on investment.

MGU urges the Commission to reconsider its prior decisions on this issue in light of the changing regulatory environment and developing competition. It argues that prior orders concerning accounting treatment should not prevent the Commission from including these reasonable estimates of fairly certain costs in rates. It asserts that its proposal for a surcharge mechanism for these costs, with annual true-up filings, offers sufficient protection for ratepayers.

In its replies to exceptions, the Staff responds that the ALJ rejected the estimate of costs provided by MGU's witness for reasons beyond his reliance on others' reports. For example, MGU did not choose Mr. Lewis's firm to complete the work at the Grand Haven site in 1996. The Staff argues that although Mr. Lewis's cost estimates are based on rates for work performed by his own firm, those costs could vary significantly if another firm is chosen to do the work. Therefore, the Staff recommends that the Commission hold that only those amounts actually incurred may be recovered in rates, consistent with the treatment afforded Consumers in the Commission's March 11, 1996 order in Case No. U-10775.

The Staff additionally argues that the record suggests that MGU's cost projections are not reliable. It asserts that MGU has no budget at all concerning how it expects the projected costs to be incurred and the items for which the company expects monies to be expended. In the Staff's view, this lack of budget reflects that MGU does not seriously believe that it will incur $1.5 million in costs in 1996. Also, the Staff argues, because MGU's estimates for these costs have been very inaccurate in the short term, it would be imprudent for the Commission to rely on the company's estimates of expense to be incurred in 1996. It points out that MGU originally projected $2.4 million in 1996 expense for manufactured gas plant cleanup costs.

The Staff notes that, unlike other cost and revenue projections, the costs for cleaning up these sites are very speculative. According to the Staff, these costs are not known and measureable, a standard that the Commission generally requires costs to meet before allowing recovery.

The Staff points out that the Commission has previously held that these costs are unique and require sharing between ratepayers and shareholders. In fact, the Staff states, the Commission authorized deferred accounting for these costs because of the inherent difficulty of estimating them with the precision necessary for ratemaking.

In the October 28, 1993 order in Cases Nos. U-10149 and U-10150, pp. 140-148, the Commission approved the Staff's deferred accounting approach for future environmental cleanup at Mich Con's

manufactured gas sites. The Commission's approach to Mich Con's manufactured gas plant cleanup costs included the following: (1) environmental cleanup costs to be recorded in a deferred account for each vintage year and amortized over ten years; (2) amortization of each vintage year's deferred balance to begin in the next calendar year; (3) rate recognition of amortization expense to occur after a prudence review in the next rate case; (4) carrying costs to be earned on balances included in rate base, at the authorized pre-tax rate of return, after the prudence review (i.e., no carrying costs earned prior to a rate case); and (5) tax effects to be recorded using deferred tax accounting. The order states that this approach provides an incentive to minimize cleanup costs, protects ratepayers from excessive costs, and allows a reasonable opportunity for rate recovery of a normalized level of expense.

In the Commission's April 13, 1995 order in Case No. U-10630, an application by Peninsular Gas Company (Peninsular) for recovery of similar costs outside a general rate case, the Commission found that these costs "are unique, extraordinary costs, which may not be exclusively categorized as either operating costs or non-utility operating costs." Id., p. 10. In light of Peninsular's circumstances, the Commission concluded that surcharges for 50% of estimated future assessment and investigation costs should be immediately approved, but the remaining costs should be addressed in a general rate case. It left for another case determining the percentage of reasonable and prudent remediation costs that Peninsular might be allowed to recover from its ratepayers.

In the March 11, 1996 order in Case No. U-10775, the Commission addressed the assessment and remediation costs for Consumers' manufactured gas plant sites. In that case, the Commission adopted the Staff's deferred cost approach, consistent with that approved for Mich Con. The Commission rejected Consumers' proposal that it recover anticipated future expenditures, but rather limited Consumers to the five-year historical average for these costs.

The Staff's proposal in this case is consistent with the approach the Commission approved in general rate cases for Mich Con and Consumers, and MGU has not presented a compelling reason to adopt a different approach. The Commission therefore rejects MGU's proposals and adopts instead the Staff's approach, which provides MGU with a reasonable opportunity to recover prudent expenditures in future proceedings. In addition, the Commission will have an opportunity to weigh equitable considerations that may require an apportionment of responsibility between ratepayers and shareholders. Thus, this approach strikes an appropriate balance between competing interests. Consonant with this resolution, MGU's exception proposing an adjustment to working capital related to manufactured gas plant cleanup costs is also rejected.

2. Post-Retirement Benefits Other than Pension

In the June 30, 1994 order in Case No. U-10616, the Commission approved a settlement agreement concerning certain changes in Michigan's property, sales, and real estate transfer taxes. The result of those changes was expected to be a decrease in expense for MGU. The settlement provided that MGU would use the amount by which its expenses decreased as a result of the tax changes to offset the liability for post-retirement benefits other than pensions, which MGU was then deferring according to the requirements of Statement of Financial Accounting Standards (SFAS) 106 and the Commission's December 8, 1992 order in Case No. U-10040. The settlement agreement provided in part: "MGU will recognize as an expense in 1994 a portion of [S]FAS 106 costs currently being deferred which is equal to the net computed reduction in taxes. MGU will fund that amount in accordance with Case No. U-10040." Settlement attached to June 30, 1994 order in Case No. U-10616. The settlement further provided that MGU would follow the same procedure in 1995.

The Staff raised concerns regarding MGU's failure to establish an external fund by depositing monies collected for SFAS 106 costs, although MGU began recovering these costs through rates following approval

of the settlement. In the Staff's view, MGU's agreement to fund the amount of SFAS 106 costs that was to offset the reduction in state taxes "in accordance with Case No. U-10040" meant that MGU promised to create such an external funding mechanism immediately. The Staff urged the ALJ to recommend that the Commission direct MGU to establish and deposit SFAS expenses collected to date in a trust fund by the end of 1996 and instruct the company that failure to do so would result in an obligation to refund those amounts to customers.

MGU admitted that no external funding had occurred, but argued that it had not violated either the settlement agreement or the order in Case No. U-10040. MGU argued that it had agreed only to "fund that amount in accordance with Case No. U-10040," which required creating an external fund after a final order in a general rate case was issued. MGU argued that such an order had not yet been issued and that when the Commission issues an order in this case, MGU would then comply with the external funding requirements contained in the December 8, 1992 order in Case No. U-10040.

The ALJ recommended that the Commission adopt the Staff's proposal to order MGU to deposit the amount already collected through rates into an external fund and, should MGU fail to create the external fund by the end of 1996, to require the company to refund that amount.

In its exceptions, MGU reasserts that it did not violate either the settlement agreement or the requirements of the December 8, 1992 order in Case No. U-10040. Although the company does not except to the recommendation that it should be required to externally fund SFAS 106 expenses collected in rates, it objects to the conclusion that it should have begun an external fund after the Commission's order in Case No. U-10616 was issued.

The Commission finds that the language in the December 2, 1992 order in Case No. U-10040 was intended to require utilities to create external funds for these costs when they collect related revenues in their rates. The Commission contemplated that utilities would not be able to recover these costs without a general

rate case. Thus, it stated that until a general rate case order issued, or the time had passed for filing a rate case, the costs need not be externally funded.

MGU's settlement with the Staff, in which it was agreed that savings due to tax decreases would be considered to offset the SFAS 106 liability, avoided the need to reduce MGU's rates. Rather, because of the settlement, MGU was allowed to begin recovering these costs before completing a general rate case. However, when MGU agreed "to fund that amount in accordance with Case No. U-10040," it agreed to create the external fund immediately upon its collection of those costs.

Therefore, the Commission finds that MGU should immediately begin to externally fund its SFAS 106 liability and include in that funding amounts collected beginning in 1994 to offset its lowered tax liability, together with interest on those funds at the authorized rate of return on common equity. Within 30 days of the date of this order, MGU shall submit a report to the Commission detailing the creation of the required external fund, including relevant calculations related to the amount deposited.

3. Inflation Adjustment Factor

The Staff proposed to add $1.18 million to the amount for O&M expense in order to account for inflation. MGU proposed to add $1.61 million to account for inflation.

The ALJ adopted the Staff's inflation adjustment because he concluded that the Staff's figures were closer to the actual rates of inflation that had been and would be experienced into the test year.

MGU excepts and argues that there is no record evidence supporting the Staff's proposed inflation factor over the inflation factor that MGU proposed. MGU argues that the record reflects that Staff witness Susan Crimmons Devon relied on Mr. Ballinger to provide the inflation factor for determining the O&M expense level for the test year. MGU asserts that there is no record evidence to suggest that the factor was more than a mere guess on the part of Mr. Ballinger. It objects to the ALJ's reliance on information provided in the

Staff's brief as extra-record evidence, reliance upon which, MGU argues, constitutes a violation of due process. In contrast, MGU states, it obtained projected inflation rates (Exhibit A-95) from the "Economic Report of the President." Thus, MGU argues, its projected O&M expense should be increased by at least $225,000.[13]

The Staff responds that the ALJ properly adopted the Staff's O&M inflation adjustment. In the Staff's view, its proposed inflation adjustment is amply supported by Mr. Ballinger's testimony as follows:

> I have looked at past trends to form my future economic and financial outlook. In 1996, I expect the current expansion to make it through its sixth year. The gross domestic product (GDP) grew at a 2.0% rate in 1995 and is expected to grow at a rate of near 2.5% in 1996 and 1997. . . . The annual rate of inflation in 1995 was 2.8% and is expected to show a gain of 2.75% in 1996 and 1997. The Federal Reserve lowered the Federal funds rate in mid 1995 after a series of moves upward aimed at preventing the buildup of inflationary pressures in the economy. Two additional cuts were made in December 1995 and January 1996. The Fed's policy continues to be restraining, keeping downward pressure on the growth of the economy.

11 Tr. 1524.

The Staff states that, in contrast to the relatively low inflation factors noted by Mr. Ballinger, MGU's actual O&M expense increases averaged 9% per year over the past four years, including a 15% increase in 1995. The Staff asserts that its proposal merely limits O&M expense increases to no more than the rate of inflation in the general economy.

The Commission finds that the ALJ properly adopted the Staff's inflation adjustment. It appears to the Commission that the Staff's projections for inflation more closely reflect likely near-term inflation. Contrary to MGU's argument, the Commission finds that the Staff's inflation adjustment is adequately supported by the record evidence. Although the cited portion of the testimony was offered in conjunction with establishing a proper rate of return, Mr. Ballinger's testimony adequately supports the Staff's proposed inflation adjustment factor.

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[13]This amount assumes that the Commission will resolve the other disallowances against MGU.

4. UtiliCorp Corporate Costs

a. Marketing services and UtiliCorp overhead

The ALJ found that the Staff's proposed adjustments for marketing services and UtiliCorp overhead should be adopted. The first proposal reduced marketing expenses to exclude costs associated with marketing services at the national level and for nonregulated affiliates. The second proposed adjustment reduced by 30% the amount of corporate costs allocated to MGU by UtiliCorp. MGU has not excepted to either of these adjustments. The Commission finds that the Staff's adjustments for marketing services and corporate overhead are reasonable and supported by the record, and should be adopted.

b. Gas Supply Services

The Staff proposed to reduce MGU's expense by $505,000 for gas supply services provided by UtiliCorp's Gas Supply Services (GSS), which is a separate cost center within UtiliCorp's corporate structure. According to the Staff, GSS provides gas supply functions to UtiliCorp's regulated gas distribution operations and its nonregulated gas brokering operations, including MGU and MG Ventures. The Staff stated that MGU's allocated portion of these costs is determined by GSS's full-time equivalent employees assigned to MGU.

The Staff pointed out that following the centralization of MGU's gas supply operations into GSS in 1994, MGU's gas supply services costs have risen dramatically, from $930,000 in 1993 to nearly $1,500,000 during the historic test period. Centralizing the services was intended to allow MGU to realize benefits of economies of scale and other efficiencies. However, the Staff argued that MGU had not demonstrated any benefits in this case. Although MGU claimed that the action of the Federal Energy Regulatory Commission (FERC) in

issuing its Order No. 636[14] had increased its costs, the Staff argued that the company did not quantify those additional costs. Therefore, the Staff recommended that MGU's gas supply costs be established at the 1993 level, escalated for inflation to the test year ended May 31, 1997.

MGU claimed that the Staff's proposed adjustment was not reasonable because it did not take into consideration the additional costs of operating in the changing gas market. MGU further claimed that its gas supply costs would have increased even more had the centralization not occurred.

The ALJ reasoned that MGU had not met its burden to demonstrate the reasonableness of costs associated with affiliated operations, citing the Commission's order in Cases Nos. U-10149 and U-10150, supra.

In its exceptions, MGU argues that it fully supported the reasonableness of its expenses on the record. MGU states that its approach in this case was to present evidence that its total level of O&M expense was reasonable and necessary. MGU says that it did not set out each component of its O&M expense, because it had no reason to do so. To require MGU to do otherwise, it argues, would be unduly burdensome, as the Commission recognized in the December 22, 1988 order in Case No. U-8635. In keeping with the Commission's desire to streamline rate cases, MGU says, the question should be whether the method and result in general are reasonable.

MGU further argues that it presented rebuttal testimony that demonstrated the errors in the Staff's analysis and justified full recovery of these costs. It argues that the Staff's use of 1993 gas supply costs is inappropriate because the Staff failed to recognize that 1993 expenses do not include payroll taxes and building and related support costs. MGU asserts that its Exhibit A-90 provides a detailed breakdown of 1993

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[14]Pipeline Service Obligations and Revisions to Regulations Governing Self-implementing Transportation Under Part 284 of the FERC's Regulations, 61 FERC ¶ 61,272 (1992); reh den 62 FERC ¶ 61,007 (1993).

gas supply expenses and test period expenses, and identifies the differences between them. For example, MGU states, payroll benefits in 1993 were $622,809, which increased in the test year to $674,887, an increase of about 4% per year. It states that the increase in legal services from $139,505 to $235,722 resulted from a greater level of company participation at the FERC.

MGU also states that some projected costs were incurred in 1993, but reported elsewhere. For example, MGU states that accounting and depreciation related to gas supply services was not segregated as gas supply costs in the data that the Staff used. MGU argues that because those data did not include all of the costs that the test year data include, the comparison is inappropriate.

MGU argues again that FERC Order No. 636 increased the company's responsibilities and resulted in the need for additional resources. The company argues that it demonstrated $300,000 in 1994 gas supply cost savings as a result. In addition, MGU states it saved $72,000 during 1994 by foregoing reserve capacity with Panhandle. MGU asserts that a transportation discount negotiated by GSS saved $26,000 and obtained annual administrative savings of $30,000. Thus, MGU argues, the decision to use the services of GSS was a correct one that resulted in lower costs than the company otherwise would have incurred.

In its replies to exceptions, the Staff incorporates its arguments from its brief and asserts that any inaccuracy in the Staff's presentation is due solely to MGU's reluctance or refusal to provide accurate and timely responses to data requests. Ms. Devon testified that, in one instance, MGU took eight weeks to respond to an initial request. 13 Tr. 2141. She testified that the company's responses to follow-up questions were essentially unresponsive. 13 Tr. 2178. She further stated that significant numbers of supporting vouchers that the Staff requested were never provided. 13 Tr. 2142. In Ms. Devon's view, the company failed to adequately support its cost projections, which reflected a 62% increase over a period of 17 months.

The Staff argues that the ALJ properly relied upon the Commission's order in Cases Nos. U-10149 and U-10150, which states that the utility bears the responsibility to demonstrate the reasonableness of the cost of

affiliated transactions. In the Staff's view, there is no material difference between the allocation of parent company costs addressed in Cases Nos. U-10149 and U-10150 and the allocation of costs by UtiliCorp to its regulated operating division, MGU. In both situations, the Staff argues, there is a transfer of traditional utility support functions from the direct responsibility of the regulated utility to an affiliate. Such transactions cannot be considered to be accomplished at arm's length and thus should be subjected to close scrutiny.

The Commission finds that the ALJ correctly adopted the Staff's adjustment to the GSS costs. Even in its rebuttal testimony, MGU failed to quantify or support with specifics the increased costs it claims resulted from FERC Order No. 636. Nowhere does MGU state how many additional personnel have been required for the functions or provide other details that would support its position. In fact, its employee numbers have declined over the last five years. MGU's claim that the Staff's analysis compared noncomparable numbers is not persuasive. Any inaccuracies appear to have been caused by MGU's failure to respond timely and appropriately to the Staff's data requests. MGU may not withhold information and then complain that the analysis is incomplete without the information that the company was asked for but did not provide.

Further, it appears that MGU's management has little ability to influence the types or amount of expense allocated to it by UtiliCorp, and there have been significant increases in affiliated company charges to MGU for which there is no adequate explanation. On this record, the Commission concludes that MGU has failed to meet its burden of demonstrating that the projected GSS costs are reasonable and prudent. Therefore, the Commission adopts the Staff's proposal to use 1993 costs for gas supply, adjusted for inflation into the test year.

5. Appliance Repair Training Costs

The Staff proposed a decrease in expense of $100,797 to exclude appliance repair training costs that it claimed were improperly charged to MGU rather than its nonregulated affiliate, MG Ventures. MG Ventures

is involved in an appliance repair program known during the historical test year as Assured Comfort Protection Program, but is now named Service Guard. MGU provided training to its own employees for gas and electric appliance repair. However, all appliance repair work is credited to MG Ventures. MGU employees perform the appliance repair on behalf of MG Ventures, for which MGU charges MG Ventures an hourly rate. MGU asserted that the hourly rate was sufficient to cover wages, benefits, transportation, supervision, and training costs. The Staff's audit revealed that of the more than $110,000 in appliance repair training costs incurred, only about $9,000 was paid by MG Ventures. The Staff sought to exclude the difference from MGU's test year O&M expense.

MGU argued that the Staff's proposed adjustment was neither appropriate nor consistent with the proposal to include certain MG Ventures revenue in net operating revenue for the test year. MGU further claimed that the Staff's adjustment fails to recognize the benefit to MGU of the appliance repair training.

The ALJ found that the Staff's proposed adjustment should be adopted. He reasoned that the hourly rate charged to MG Ventures was not sufficient to recover wages, benefits, transportation, supervision, and training related to MG Ventures activities. Because these costs were attributable to the nonregulated business of MG Ventures, the ALJ concluded that the difference between the actual training costs and the amount recovered from MG Ventures should be excluded.

In its exceptions, MGU objects to the exclusion and argues that the ALJ assumed that only MG Ventures benefits from the appliance repair training for MGU employees. MGU argues that the utility benefits because those employees will be able to more effectively investigate gas leak reports. According to MGU, the training allows its employees to respond in a safe and effective manner. The company states that allowing 50% of the training costs would be a fair allocation of costs related to benefits.

The Commission finds that the ALJ correctly adopted the Staff's adjustment for appliance repair training done on behalf of MG Ventures. In the Commission's view, the benefits to MGU from training its employees

in gas and electric appliance repair are incidental at best. The training was provided to those employees so that they might be able to perform repair tasks on behalf of MG Ventures. The charges to MG Ventures were reportedly designed to recover these training costs, but did not. Removing these costs from expenses is appropriate for ratemaking purposes.

6. Miscellaneous O&M Expense Adjustments

a. Uncollectibles

The Staff proposed a $135,000 reduction in MGU's proposed level of uncollectible accounts to reflect the five-year average percentage of actual net write-offs to revenues. Ms. Devon testified that the adjustment is consistent with Commission precedent and provides for recovery of expected net write-offs rather than providing an allowance for uncollectibles as MGU had proposed.

MGU responded that the Staff's approach is not reasonable because 1992 uncollectible expenses include 1991 and 1992 gas cost recovery (GCR) refunds pursuant to 1982 PA 304, MCL 460.6h et seq.; MSA 22.13(6h) et seq., as well as a large pipeline refund. In addition, MGU claimed that the Home Heating Tax Credit was reduced in 1995 and energy assistance monies have dwindled, both of which suggest that uncollectibles might rise in the future. MGU suggested using a three-year average, which would increase uncollectibles by $25,000 over the Staff's proposed five-year average.

The ALJ concluded that the Staff's $135,000 adjustment should be made. He reasoned that a five-year average is the normal method to smooth out anomalies. He noted that the five-year average includes the higher value for 1991 and the lower value for 1992. Thus, including both years evens out the GCR overrecoveries. Further, the ALJ stated, MGU's write-offs in 1994 were unusually high compared to the four other years.

The ALJ rejected MGU's argument that changes to its refund procedures would significantly affect the percentage of billings that would be written off. In the ALJ's view, uncollectible levels should be unaffected by whether refunds are done on a prospective or historical basis. He also rejected MGU's argument that changes in the funding level for energy assistance programs would significantly affect the percentage of uncollectibles. In the ALJ's view, the most important factor is the economy, because less money is needed to publicly fund energy needs in a healthy economy.

In its exceptions, MGU argues that using a five-year average for uncollectibles is not realistic for this case for the reasons that MGU advanced in its brief and reply brief. It states that the historic period does not reflect changes in procedures and requirements that will affect the level of uncollectibles. MGU argues that large pipeline refunds are unlikely to occur after FERC Order No. 636 and that the present roll-in methodology for GCR overrecoveries merely reduces the GCR factor, not uncollectibles. Actual uncollectibles will vary based on weather and energy consumption. MGU argues that this means the five-year average is not representative of what may be expected in the future. It again argues that a more realistic computation would use a three-year average.

The Commission is not persuaded that it should deviate from using the five-year average of uncollectibles in this case. Although there have been changes in how GCR refunds are recorded, in the way that pipelines operate, and in the funds available to support the energy needs of the poor, it is unclear what effect these changes will have on the level of uncollectibles that the company will experience. Therefore, continued use of a five-year average is appropriate in estimating the likely level of uncollectibles for the projected test year.

b. Michigan Underground Storage Tank Fund Authority (MUSTFA) receivable reversal

The Staff proposed a $204,000 reduction in MGU's distribution mains expense to exclude an out-of-period adjustment reflecting reversal of a receivable from the MUSTFA fund that MGU had established in prior years. The Staff viewed the reversal as a nonrecurring event that should be excluded for purposes of determining test year net operating income.

MGU argued that the adjustment unfairly removes one item from the test year. The company contended that the Staff's proposal violated "the fundamental approach underlying use of historical information to determine representative levels of expense." MGU's brief, p. 33. MGU further argued that accepting the adjustment would defeat the simplicity supporting the Commission's adoption of an historical test year.

The ALJ adopted MGU's position that accepting the Staff's adjustment would defeat the simplicity that supports using an historical test year.

The Staff excepts to the ALJ's conclusion and argues that use of an historical test year requires that adjustments be made for known and measurable changes. The Staff states that the company recorded $204,000 during the 1995 test year to reverse a receivable that had been recorded many years before. The Staff argues that this expense will not occur again in the projected test year and should be removed.

The Staff further argues that MGU's position that the adjustment is one-sided should be rejected. The Staff argues that MGU's failure to point out significant expense reductions for probable future reversal demonstrates that the Staff's adjustment is proper. The Staff argues that rejecting an adjustment is unreasonable when the adjustment is necessary to a reasonable estimate of the projected test year expenses. The Staff asserts that its adjustment is both reasonable and consistent with prior Commission policy.

In its replies to exceptions, MGU responds that the ALJ properly rejected the Staff's proposed adjustment. MGU asserts that the only standard on which to judge test year data is "whether the method and result are reasonable." MGU's replies to exceptions, p. 10. In MGU's view, adopting the Staff's position would require MGU to become clairvoyant in predicting what may later become out-of-period adjustments.

The Commission finds that the Staff's proposed adjustment should be adopted. Adjustments should be made for known and measurable anomalies in the historical test year figures. This adjustment is both known and measureable and unlikely to occur again.[15]

7. Affiliated Company Revenues

The Staff took the position that net revenues derived from MG Ventures' Service Guard, administrative services, and gas brokering operations should be included in MGU's net operating income. In the Staff's view, inclusion of these revenues is justified because these MG Ventures operations are closely intertwined with those of MGU. The Staff pointed out that MG Ventures has no employees of its own for these services, but uses MGU employees to perform required tasks. Ms. Devon testified:

> Service technicians and customer service representatives labor and expenses, accounting, billing, and postage expenses are directly charged or allocated at cost to these operations. . . . These programs would not exist without MGU. . . . Applicant has in effect taken synergies that it achieves within its utility operations and used them to make a profit in nonregulated areas without providing any of the synergistic benefits to its ratepayers. This is inconsistent with the treatment of similar programs at Mich Con and [Consumers].

13 Tr. 2158-2159.

Although the Staff agreed that the costs for materials and parts used in obtaining the additional revenues ($70,000) should be recognized in this case, it argued that no increase in costs should be recognized for labor, because MGU's customer service labor costs are already included in MGU's cost of service.

MGU urged the ALJ to reject the Staff's proposal and claimed that the Staff did not increase expenses for the additional work involved in this nonregulated business. MGU further argued that no MG Ventures revenue should be imputed to MGU because MG Ventures is not a public utility and because some of the work is performed by outside contractors. It further contended that if the Commission added revenues from

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[15]This conclusion is consistent with the Commission's treatment of, and MGU's arguments on, the Panhandle metering error.

MG Ventures to net operating income, it should also add MG Ventures assets to rate base. MGU argued that the Staff unreasonably recognized only the profitable portions of MG Ventures's business, ignoring storage operations, for instance, because that part of the business operated at a loss.

MGU further argued that, contrary to the Staff's position, ratepayers do benefit from MG Ventures operations. For example, MGU states, MG Ventures contributed about $186,000 towards MGU's metering, billing, and postage expenses that would have otherwise been borne entirely by ratepayers. MGU claimed that it has detailed nonregulated accounting procedures in place to assure that costs are charged appropriately.

The ALJ found the Staff's proposed adjustment, with the exclusion of $70,000 for costs associated with obtaining those revenues, to be a reasonable recognition of the increased revenues resulting from the expansion of MG Ventures's activities in gas brokering, administrative services, and appliance repair programs.

In its exceptions, MGU objects to the inclusion of revenues produced by its unregulated affiliate. MGU claims that the ALJ failed to allow recovery of costs associated with obtaining these revenues. MGU also argues that other MG Ventures business activities, which the Staff ignored, created losses that should offset any revenues attributed to MGU. Moreover, MGU argues, there should be two additional offsets to the net revenues for MG Ventures, the marketing costs allocated to Michigan from UtiliCorp ($325,000) and the disallowed training costs ($101,000). MGU argues that if its proposed adjustments are combined with the losses suffered by MG Ventures, the after-tax effect on rates for MG Ventures revenues would be only $21,000.

MGU argues that the Commission order upon which the ALJ relied, the October 28, 1993 order in Cases Nos. U-10149 and U-10150, pp. 53-54, does not apply to this case, because MG Ventures engages only in unregulated activities, including propane operations, merchandising, appliance repair service, gas brokering, administrative services, and gas storage services. MGU also argues that MG Ventures' activities are not

sufficiently intertwined with MGU's regulated activities to justify the Staff's proposed treatment. MGU further argues that MG Ventures does not engage in a market developed by MGU or in an area that was once an integral part of the traditional utility service. Thus, MGU argues, the Commission would act outside of its statutory authority if it reaches beyond the utility to capture revenues from an unregulated business entity.

MGU charges that the Staff essentially requests the Commission to ignore MG Ventures's separate corporate existence, without any evidence of fraud or other impropriety that might justify piercing the corporate veil. MGU argues that if it had contracted with an unrelated corporation for the same business activity, there would be no reason to add that company's revenues to MGU's for purposes of determining a revenue deficiency.

MGU states that the Staff admitted that MGU has no investment in MG Ventures, but that UtiliCorp supplied the necessary investment. MGU argues that because it has no investment in MG Ventures, its ratepayers have no claim on the proceeds obtained through MG Ventures's business activities. Moreover, if the Commission adds MG Ventures revenues to MGU's net operating income, MGU argues, all of MG Ventures assets should also be added to rate base.

In its replies to exceptions, the Staff argues that none of MGU's proposed adjustments to MG Ventures' revenues should be adopted. First, the Staff states, training costs are included in the net income that the Staff used and should not be double counted. Second, the Staff states, only the revenues from the portions of MG Ventures' business that are integrally related to MGU, carried out by MGU employees, should be attributed to the utility. According to the Staff, this is the reason it ignored the results of the propane operations of MG Ventures, as well as other functions that are more separate from the utility's operations.

The Staff further argues that the marketing costs assigned by UtiliCorp to Michigan should not be included. The Staff takes the position that no rate recovery is appropriate for these costs until MGU can

provide support for the reasonableness of the allocation methodology that UtiliCorp uses to assign these costs to Michigan.

The Staff next argues that the reason there is no adjustment to rate base for the assets of MG Ventures is that MGU failed to provide the information necessary to make the adjustment, even though it was asked to do so. In the Staff's view, MGU should not benefit from its failure to provide information.

The Staff further points out that, contrary to MGU's assertions, the Staff did not allocate 100% of nonregulated revenues to MGU. Rather, the Staff argues, it attributed to MGU only those revenues recovered from activities that are integrally related to utility activities, namely gas brokering, appliance repair, and administrative services.[16] These activities, the Staff argues, are structured the same as Mich Con's appliance repair and gas brokering operations, and should be treated in the same manner.

The Commission finds that, in keeping with the decision in Cases Nos. U-10149 and U-10150, supra, the net revenues from administrative services, gas brokering, and appliance repair services, as calculated by the Staff, should be attributed to MGU's net operating income. The record reflects that there is no real separation between MGU and MG Ventures for purposes of these services. MG Ventures does not have its own employees for these services, but carries out business through the use of MGU's employees, who charge the time spent on nonregulated activities to MG Ventures. MG Ventures relies upon the marketing, accounting, administrative, computer operations, and gas supply services of MGU and GSS. These MG Ventures operations appear to have no facilities separate from MGU. The advertising bill inserts for the Assured Comfort Program display MGU's logo. Customers are recruited through MGU, and MGU employees perform the vast majority of these services.

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[16]Ms. Devon testified that the Administrative Services Division of MG Ventures provides meter reading, billing, and collection services to communities within MGU's service territory using MGU service representatives or service technicians.

The Commission rejects MGU's argument that the Staff improperly recognized only those portions of MG Ventures's business that operated at a profit. The Staff did not advocate including the results of operations that are unrelated to the utility, including MG Ventures's propane operations, which recorded a profit of $41,409.67. Exhibit S-32.

The Commission is persuaded that no further adjustment need be made to the imputation of net revenues from these MG Ventures operations. MGU failed to provide record support for the allocation of marketing costs to Michigan operations, Ms. Devon testified that she removed the previously disallowed training costs from the calculation of additional revenues, and the amount included recognizes $70,000 of increased costs to obtain the revenues.

VII.

REVENUE DEFICIENCY

Based on the previous findings, MGU's revenue deficiency is calculated as follows:

Revenue and Cost of Service Adjustments

	Gross Adjustment	Net of Tax Adjustment
Revenue and Cost of Gas	$1,590,000	$1,009,000
Miscellaneous Revenues	409,000	259,000
Injuries and Damages	(27,000)	(17,000)
Pension Credit	(764,000)	(485,000)
Manufactured Gas Plant	(19,000)	(12,000)
SFAS 106 Expense	539,000	342,000
O&M Inflation Increase	(1,180,000)	(748,000)
Federal Income Taxes	26,000	26,000
Depreciation Expense	(155,000)	(98,000)
Property Taxes	(413,000)	(262,000)
Marketing Expense	335,000	212,000
Gas Supply Services	505,000	320,000
Corporate Costs	556,000	353,000
Miscellaneous O&M Adjustments	778,000	493,000
ACPP Appliance Service Revenues	140,000	89,000
MG Ventures 1995 Brokering Income		188,000
MG Ventures 1995 ACPP Income (Adjusted)		178,000
Total Cost of Service Adjustments	$2,320,000	$1,847,000

Adjusted Net Operating Income[17]

Recorded Net Operating Income	$ 8,414,000
AFUDC	37,000
Subtotal	$ 8,451,000
Cost of Service Adjustments	1,847,000
Interest Synchronization	41,000
Pro Forma Interest	(229,000)
Adjusted Net Operating Income	$10,110,000

Revenue Deficiency

[17]The methodology for calculating AFUDC, Interest Synchronization, and Pro Forma Interest are not disputed.

Rate Base	$132,915,000
Rate of Return	x 8.42%
Income Required	$ 11,191,000
Adjusted Net Operating Income	10,110,000
Income Deficiency	$ 1,081,000
Revenue Multiplier	x 1.5766
Revenue Deficiency	$ 1,704,000

VIII.

COST ALLOCATION

Having established MGU's revenue deficiency, the Commission must now allocate costs and design rates in a way that both satisfies this deficiency and establishes reasonable rates for all customer classes. Testimony and exhibits concerning the first step in this process, namely cost allocation, were submitted by MGU, the Staff, and the Attorney General. What follows is a discussion of the pertinent cost allocation issues raised by the parties.

Interclass Peak Demand

All of the parties offering testimony on cost allocation relied on the average and peak (A&P) method, which apportions capacity costs based on the average demand and the peak demand of each customer class. This comports with long-standing Commission practice, in which a weighted average is derived from a commodity (average use) factor and a capacity (peak) allocation factor. Although the parties reached a general consensus regarding both the use of the A&P method and the means of computing the average use factor, a dispute arose regarding how the peak demand factor should be determined. At the center of that dispute was the estimation of MGU's peak day transportation volumes for the projected test year.

Based on testimony offered by Russell A. Feingold, MGU proposed using a peak transportation load of 54,000 Mcf. According to the utility, this estimate of peak day transportation volumes was supported by its transportation customers' actual use of 54,823 Mcf and 53,952 Mcf, respectively, on January 18 and 19, 1994.

In contrast, and based on testimony provided by William G. Aldrich, the Staff recommended using a peak transportation load of 74,890 Mcf. In arriving at this figure, the Staff began by adding up the highest daily use registered by each transportation customer on either January 18 or 19, 1994, thus producing a total potential peak day use of 56,288 Mcf. The Staff then added 20,237 Mcf of peak load to reflect the addition of approximately 20 transportation customers to MGU's system since January 1994, as well as significant volumetric increases experienced by two of MGU's largest transportation customers, raising the total to 76,525 Mcf. Finally, the Staff reduced its estimate by 1,635 Mcf to reflect the previously-mentioned Jefferson Smurfit plant closing, thus arriving at 74,890 Mcf.

Citing MGU's failure to account for the substantial growth in transportation customers since January 1994, the ALJ concluded that the utility significantly underestimated peak day load for its transportation customers. PFD, p. 52. He therefore recommended that the Commission adopt the Staff's figure of 74,890 Mcf.

MGU excepts to this recommendation for several reasons. First, it argues that the Staff's figure should be rejected because it is not based strictly on historical usage, and therefore represents nothing more than an arbitrary estimate of transportation customers' future load demands. Second, the utility claims that it is inappropriate for the Staff to select the higher of each transportation customer's usage on either January 18 or 19, 1994 when estimating peak day load. Doing so, MGU asserts, improperly bases transportation customers' contribution to the system's coincident peak on the non-coincident peak loads exhibited by these customers. Third, MGU contends that the ALJ erred by adopting the Staff's proposal to add 20,237 Mcf, including 8,000 Mcf from Menasha Corporation and 5,494 Mcf from Wolverine Power Supply Cooperative, Inc. (Wolverine), to the historical peak achieved during January 1994. MGU claims that these proposed adjustments erroneously inflate the peak day usage of its transportation customers. The utility therefore argues that the

Commission should reject the ALJ's recommendation and adopt the utility's proposed figure of 54,000 Mcf instead.

In its replies to exceptions, the Staff argues that its proposal is based on historical transportation volumes, but that these volumes were appropriately adjusted to reflect known changes that MGU itself recognized and accounted for both in this proceeding and in its most recent GCR plan case application. The Staff further contends that its reliance on the higher of each transportation customer's usage on January 18 or 19, 1994 is neither arbitrary nor unreasonable and, in fact, produces a more accurate estimate of potential peak day transportation volumes than simply adopting the highest single-day total for either of those dates. Notwithstanding MGU's assertions to the contrary, the Staff argues that its proposed methodology does not result in basing transportation customers' contribution to the system's coincident load on the non-coincident peak loads of MGU's transportation customers. Rather, the Staff contends, its proposal merely chooses between the highest usage on either of two sequential days during a three-day coincident peak period. Finally, the Staff points out that one of MGU's own witnesses, Mr. Richard, included the increased transportation volumes for Menasha and Wolverine in his list of known and measurable changes when computing the utility's pro-forma sales and transportation volumes for the 1997 test year. For these reasons, the Staff asserts that the ALJ's recommendation should be adopted.

The Commission concludes that the peak day transportation load of 73,425 Mcf should be used to allocate capacity-related costs under the A&P methodology. In reaching this conclusion, it finds that a majority of the Staff's proposed adjustments to the peak day transportation load experienced on January 18, 1994 are necessary to reflect future conditions. The record indicates that between that date (when MGU's transportation customers posted peak day volumes of 54,823 Mcf) and the end of the historical test period (on May 31, 1995), approximately 20 additional customers signed up for transportation service. See Exhibits A-89 and S-115. Moreover, testimony offered by witnesses for both MGU and the Staff demonstrates that the

increased usage by Menasha and Wolverine and the reduced usage by Jefferson Smurfit constitute known and measurable changes that should be taken into account in estimating future test year transportation volumes. 5 Tr. 524; 12 Tr. 1916. Therefore, 18,602 Mcf should be added to peak day transportation load, as proposed by the Staff and recommended by the ALJ.[18]

However, the Commission finds unpersuasive the Staff's assertion that the starting point for this adjustment should be 56,288 Mcf, which is the sum of the highest daily uses registered by each existing transportation customer on either January 18 or 19, 1994. Rather, the Commission finds that the more appropriate starting point is 54,823 Mcf, which is the actual peak day transportation load experienced during the historical test year. When the 18,602 Mcf net adjustment for known and measurable changes is added to 54,823 Mcf, the resulting peak day transportation load becomes 73,425 Mcf.

Allocation of Storage Costs

In its April 20, 1989 order in Case No. U-8788, the Commission agreed with MGU's claim that "few, if any, transportation customers use a steady draw of gas, [thus creating] a mismatch between interstate pipeline deliveries and actual customer use." Order, pp. 7 and 9. The Commission therefore concluded that transportation customers should be entitled to some storage service under their Rate T-1 and T-2 contracts. This led to the creation of an authorized tolerance limit (ATL) equal to 10% of a transportation customer's annual contract quantity (ACQ), and concurrently called for the recovery from MGU's T-1 and T-2 customers of all costs associated with this incidental storage. The order went on to require that all determinations regarding whether a transportation customer's use of MGU's storage system had stayed within that 10% range were to be based on month-end storage balances. Id.

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[18]This figure is computed by subtracting the 1,635 Mcf peak load reduction caused by the Jefferson Smurfit plant closing from the 20,237 Mcf transportation load increase presented by the Staff.

In the present case, MGU proposed eliminating monthly balancing and asked to institute daily balancing instead. Rather than offering "the 10% of ACQ imbalance build-up on its system," it sought permission to require transportation customers to keep their gas use within plus or minus 10% of the specific transportation volumes nominated for any given day. 5 Tr. 532. Because MGU's daily balancing proposal would likely result in transportation customers making much less use of its storage system, the utility significantly reduced the storage costs allocated to transportation customers.

Citing numerous problems with MGU's presentation, the Staff opposed the utility's daily balancing proposal and instead recommended reducing each transportation customer's ATL to 5% of its respective ACQ. Noting that MGU's storage cost allocation methodology is inextricably tied to its proposal for daily load balancing, the Staff likewise argued for that allocation's rejection. Staff's initial brief, p. 122. Instead, the Staff asserted, the Commission should apply the 50/50 allocation approved for use by Consumers and Mich Con in their most recent rate cases. Under that methodology, 50% of MGU's cost of making 8,760,000 Mcf of storage available to its customers would be allocated based on peak-day deliverability and 50% would be allocated in accordance with the storage capacity available to each rate class.

The ALJ concluded that MGU's daily balancing proposal, and likewise its storage cost allocation methodology, should be rejected. He therefore recommended adopting the Staff's proposed methodology instead. In support of his recommendation, the ALJ noted that the Staff's 50/50 allocation methodology is consistent with past Commission practice and that it better recognizes transportation customers' continuing ability to use MGU's storage capacity for both seasonal storage and daily load balancing.

MGU excepts to this recommendation for four reasons. First, the utility argues that its proposal to implement daily balancing is simply an attempt to satisfy requests for increased customer choice by providing seasonal storage and daily load balancing service on a more fully unbundled basis. Rejecting its proposal and adopting the Staff's storage cost allocation factors instead, MGU contends, improperly reduces customer

choice. Second, the utility claims that the Staff's methodology overstates transportation customers' responsibility for storage costs. Despite limiting their respective ATLs to 5%, MGU asserts, the Staff's 50/50 allocation treats transportation customers as if they have unlimited ability to store gas on the utility's system. Third, MGU argues that there can be no rational justification for an allocation methodology that, like the Staff's, will assign as much storage costs to a 91% load factor customer as one with a 41% load factor. MGU's exceptions, p. 46. Fourth, the utility notes that in performing its storage cost allocation, the Staff improperly assumed that Guardian's ATL would remain at 10% while the ATLs for all other transportation customers would drop to 5% of their respective ACQs. MGU contends that there is no reason to single out the Guardian contract in this fashion. Id. The utility therefore asserts that the Commission should adopt its storage cost allocation instead of the 50/50 allocation proposed by the Staff.

Both the Attorney General and the Staff disagree with MGU's assertion. In his replies to exceptions, the Attorney General asserts that the ALJ correctly concluded that unless MGU's daily balancing proposal is adopted (and it should not be), the Staff's storage cost allocation should be approved instead. As for claims that the ALJ's recommendation eliminates long-demanded customer choice, the Attorney General points out that ABATE has consistently argued in favor of increasing transportation customers' access to daily storage, not eliminating it as MGU proposes. According to him, "transportation customers want a more liberal balancing service than MGU's proposed strict daily balancing, and the Staff's storage cost allocation method is necessary to attribute the costs of that more liberal balancing service to the transportation customers." Attorney General's replies to exceptions, p. 8.

In its replies to exceptions, the Staff likewise argues that MGU is not really proposing to increase customer choice, but rather seeks to unilaterally curtail transportation customers' ability to use a small portion of MGU's storage capacity. The Staff goes on to argue that the fact that a 91% load factor customer may not need to use this available storage as much as some other customer does not mean that it will not use that

storage anyway. As ABATE indicated throughout these proceedings, that type of storage service is too valuable to allow it to go unused. Finally, the Staff states that the Commission's potential adoption of a 5% ATL instead will not affect Guardian due to the way that Guardian's special contract was drafted. Specifically, the Staff notes that although other transportation customers' contracts are subordinate to all of the terms and conditions of Commission approved rate schedules, and consequently are subject to change whenever the Commission revises those terms and conditions, Guardian's special contract locks in a 10% ATL through November 8, 2001. Staff's replies to exceptions, p. 36.

The Commission agrees with the Attorney General and the Staff. As discussed subsequently, this order rejects MGU's proposal to implement daily load balancing and instead adopts the Staff's proposal to merely reduce the ATL to 5% of the transportation customers' respective ACQs.[19] The Commission is therefore faced with precisely the same situation as in Case No. U-10755, Consumers' most recent gas rate case. As correctly noted by Mr. Aldrich, approving the Staff's proposed ATL will:

> [A]llow transportation customers to "store" a limited amount of gas on MGU's system, and to secure some seasonal price differentials on their gas purchases. In addition, transportation customers will be able to utilize MGU's system extensively to provide [their] daily load balancing requirements, even on system peak days, at no additional cost.

12 Tr. 1928. These are valuable services that should be accounted for in the course of cost allocation. Moreover, the 50/50 cost allocation methodology proposed by the Staff (and adopted by the Commission's March 11, 1996 order in Case No. U-10755) recognizes some of the costs to MGU of providing seasonal storage and daily load balancing services to transportation customers, and is therefore an appropriate method

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[19]In doing so, the Commission notes that the language contained in the special contract entered into by MGU and Guardian on September 29, 1995, and approved by the Commission's November 8, 1995 order in Case No. U-10956, could enable Guardian to continue using an ATL of 10% until late 2001.

for allocating storage costs in this case. Id. The Commission thus concludes that the ALJ's recommendation to use the Staff's storage cost allocation methodology should be adopted.

Allocation of Gas Inventory Working Capital Costs

A related dispute has arisen concerning the allocation of MGU's gas inventory working capital costs. Specifically, Staff witness Aldrich pointed out that MGU's gas inventory consists of its own gas (which will ultimately be sold to GCR sales customers) and transportation imbalance gas (which ultimately will be delivered to transportation customers), and that MGU uses this "commingled inventory gas" to serve all of its customers. 12 Tr. 1931. Mr. Aldrich further noted that:

> [O]n any given day, transportation customers can "borrow" gas from MGU's owned gas by taking a disproportionate share of the total storage withdrawals. In fact, transportation customers can "borrow" gas from MGU even on a system peak day. Likewise, MGU can "borrow" gas from transportation customers in the same manner. Since both sales and transportation customers benefit from the total gas inventory pool, the total cost of the gas inventory should be allocated to all customers.

Id. The Staff therefore proposed adding the estimated carrying cost of transportation customers' imbalance gas ($1,188,749) to MGU's gas inventory working capital cost ($18,906,923), and assigning the $20,095,672 total to all rate classes using the 50/50 cost allocation methodology. Staff's initial brief, p. 125. As a final step, the Staff credited back to the transportation customers their original gas inventory working capital costs.

In their briefs, both MGU and ABATE expressed opposition to the Staff's allocation of these working capital costs. According to them, the Staff inappropriately mixed MGU's costs with those directly incurred by its transportation customers, resulting in a "misallocation and misrepresentation of the cost of serving [MGU's] customers." ABATE's initial brief, p. 18. They went on to object to the Staff's proposal on the grounds that it assigned costs based on what transportation customers might do, rather than on proof of what they will do. MGU and ABATE therefore requested that none of the utility's gas inventory working capital costs be allocated to transportation customers.

The ALJ disagreed with MGU and ABATE, and recommended adopting the Staff's proposed allocation of gas inventory working capital costs. According to the ALJ, this allocation is identical to that approved for use by Consumers in Case No. U-10755. The ALJ went on to state that because MGU does not impose minimum daily requirements for pipeline deliveries on behalf of its transportation customers, those customers can "borrow" gas from MGU "by taking a disproportionate share of the total storage withdrawals" for that day. PFD, pp. 53-54. Likewise, he noted, MGU can "borrow" from transportation customers in the same manner. He therefore recommended that because both GCR sales and transportation customers benefit from the total gas inventory pool, the Commission should allocate the total cost of gas in inventory to all customer classes through use of the Staff's allocation methodology.

In their exceptions, MGU and ABATE reassert many of the arguments raised in their briefs and reply briefs. For example, MGU contends that because transportation customers generally return the "borrowed" gas to the system within a short period, they do not truly give rise to the cost of storing that gas. Rather, the utility asserts, because that gas was purchased solely to satisfy the needs of MGU's GCR customers, all carrying costs arising from its storage should likewise be collected from those ratepayers. The utility therefore claims that the fact that transportation customers somehow benefit from the temporary use of sales customers' gas "does not give rise to a cost causation warranting a cost of service allocation." MGU's exceptions, p. 49. Similarly, ABATE argues that absent evidence that they will in fact rely on MGU's GCR gas to meet their withdrawal capabilities on any given day, it would be unfair to impose carrying charges on transportation customers in addition to those already paid for maintaining their own gas supply. ABATE's exceptions, p. 6. ABATE therefore insists that unless the Staff can irrefutably prove that transportation customers have used GCR customers' stored gas, and not simply that they "might" do so in the future, none of MGU's gas inventory working capital costs can be allocated to its transportation customers. Id., p. 8.

The Commission disagrees with these arguments and concludes that the ALJ's recommendation should be adopted. Gas held in storage by a utility for its GCR sales and transportation customers is commingled. Thus, because transportation customers have unlimited access to sales customers' stored gas on a daily basis, they are allowed to "borrow" that gas on peak days and "repay" it on warmer, nonpeak days. Moreover, the likelihood of that occurring is even higher on systems that, like MGU's, have no minimum daily requirements for pipeline deliveries on behalf of transportation customers. Furthermore, despite ABATE's assertions to the contrary, it is entirely reasonable to base ratemaking decisions on what a class of customers might do. As correctly noted by the Staff, actions that customers are allowed to take are relevant because they determine how the system is operated. These factors, the Commission concludes, provide sufficient justification for allocating a small part of MGU's gas inventory working capital costs to the utility's transportation customers. The Commission therefore adopts the ALJ's recommendation to apply the Staff's cost allocation methodology to MGU's gas inventory working capital costs.

Customer-Related Plant Allocation Factors

MGU performed several special studies to determine the nature of equipment recorded in its customer-related plant accounts. According to Staff witness Aldrich, although these studies provided a great deal of useful information, they also contained several mistakes that he corrected when performing the Staff's cost of service study. 12 Tr. 1929. First, he noted that MGU's study of Account No. 380 (involving service lines) failed to include the cost of four-inch plastic service lines, and ignored the fact that the larger customers taking service on MGU's Residential Multi-Family and Small General Service rates require more expensive service drops than the average residential customer. Second, Mr. Aldrich pointed out that the utility's study of Account No. 381 (regarding meters) mistakenly assigned the cost of its 122,501 smallest meters to MGU's Small General Service customers, instead of to its smallest residential customers. Third, he discovered that

the utility's study of Account No. 383 (concerning regulators and relief valves) erroneously allocated the cost of large regulators to its smallest sales customers, thus understating the costs that should have been assigned to larger customers on MGU's system.

The ALJ found that these proposed corrections to MGU's special studies were justified, and therefore recommended that the Commission adopt the Staff's allocation factors for customer-related plant. None of the parties except. The Commission finds that the proposed corrections are reasonable and supported by the record, and thus concludes that the Staff's allocation of customer-related plant costs should be adopted.

Allocation of Administrative and General (A&G) Expense

Based on testimony offered by Ralph E. Miller, the Attorney General expressed disagreement regarding one aspect of the Staff's cost of service study. Mr. Miller noted that after the direct assignment of $351,900 in A&G expense to MGU's transportation customers, the Staff spread the remaining $10.7 million of A&G expense among all customer classes by applying Mr. Aldrich's allocation factor number 18, which had initially been developed to allocate O&M expense other than the cost of gas.[20] According to Mr. Miller, the Staff's exclusive use of factor number 18 to allocate this $10.7 million did not adequately recognize the amount of MGU's A&G expense that was related to its plant in service. As a result, Mr. Miller stated, the Staff's methodology erroneously assigned an extra $674,669 of A&G expense to MGU's residential customers. 10 Tr. 1400-1401. To correct this problem, the Attorney General proposed applying factor number 18 to only one-half of this $10.7 million and using a plant-related factor (namely, Mr. Aldrich's allocation factor number 16) to assign the remainder to MGU's various customer classes.

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[20]In preparing his proposal regarding how various costs should be allocated among Consumers' 9 customer classes, Mr. Aldrich developed the 21 factors set forth on Exhibit S-80, Schedule F-6, p. 4. Some of these factors, such as those designated as allocation factors numbers 2 and 7, would be used to allocate particular groups of costs based on the percentage of throughput and the number of customers, respectively, that each customer class contributes toward the utility-wide total.

Neither MGU nor the Staff objected to the Attorney General's proposed 50/50 allocation of this $10.7 million in A&G expense. In contrast, ABATE asserted that his proposal should have been offered prior to the rebuttal phase of the case and that, in any event, it was not adequately supported on the record. The ALJ disagreed with ABATE and recommended that the Commission adopt the Attorney General's plan to allocate one-half of these costs through the use of factor number 18 (O&M expense other than the cost of gas) and the other half according to factor number 16 (plant in service).

In its exceptions, ABATE reasserts its claim that the Attorney General offered insufficient support for his proposed 50/50 allocation. ABATE points out that, according to the Attorney General's own witness, Mr. Miller, the allocation of A&G expense "ideally . . . should be developed by a careful examination of each of the A&G expense accounts." 10 Tr. 1401. Nevertheless, ABATE contends, no such examination was ever undertaken in this case. Rather, ABATE continues, the Attorney General's witness simply "inferred, without any supporting evidence," that half of the utility's A&G costs "are plant related and half are O&M related." ABATE's exceptions, p. 10. ABATE therefore asserts that the Commission should reject the Attorney General's proposal and, presumably, adopt the Staff's original allocation of A&G expense instead.[21]

The Commission disagrees with this assertion and concludes that the Attorney General's A&G cost allocation proposal should be adopted, as recommended by the ALJ. At least from the standpoint of precision, the ideal allocation of a utility's A&G expense would start with a careful examination of all underlying costs that are booked to account numbers 920 through 935. However, none of the three allocation methodologies submitted in this case begin with such a detailed (albeit time-consuming) examination. The Commission finds that the Attorney General's allocation methodology better satisfies these criteria for the following reasons.

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[21] ABATE's exceptions do not explicitly state that the Staff's proposal should be adopted. However, comments made in several of ABATE's filings in this case imply support for such a result.

First, although the Staff provided testimony regarding why $351,900 of the utility's A&G costs should be assigned directly to transportation customers, it offered no evidence in support of Mr. Aldrich's proposal to spread the remaining $10.7 million to MGU's various customer classes solely through the use of allocation factor number 18. Furthermore, despite the fact that MGU proposed assigning A&G expense on an account-by-account basis, the utility's methodology allocates too little of this expense on the basis of plant in service. Specifically, MGU's witness Feingold treated 100% of the A&G costs contained in accounts 920 (salaries), 921 (office supplies and expenses), and 923 (outside services) as being labor-related. This ignores the fact that many of the expenses included in those accounts have a significant plant-related component. 10 Tr. 1401-1402. Because the costs included in these three accounts comprise nearly 50% of MGU's total A&G expense, this represents a significant omission. The Commission therefore concludes that the Attorney General's proposal, which relies on a combination of allocation factors 16 and 18 to produce a more accurate division between plant- and labor-related costs, should be used to assign A&G expense to MGU's various rate classes.

Allocation of the Cost of Serving Guardian

On September 29, 1995, MGU entered into a special contract with Guardian to provide transportation service at prices below those authorized under Rates T-1 and T-2. According to MGU, it was necessary to offer this special contract in order to prevent Guardian from bypassing the utility's system and directly connecting with Panhandle's interstate transmission system, which MGU stated runs relatively close to Guardian's plant in Carleton, Michigan. In its November 8, 1995 order in Case No. U-10956, the Commission approved MGU's special contract with Guardian and directed the utility to account for that contract as a separate rate class in future cost of service studies. The Commission went on to state that if MGU later sought to reallocate any portion of the fully allocated cost of serving Guardian to other ratepayer

classes, the utility would bear the "substantial burden" of providing, at a minimum, "a clear, convincing, and unequivocal demonstration either (1) that the contract prices and terms are justified on the basis of the cost of service, or (2) that the benefits for other (non-participating) ratepayers are substantial and have a value that outweighs the costs that are not recovered" from Guardian. November 8, 1995 order, p. 3. In response to the Commission's requirements, MGU supplemented its initial cost of service study to treat all service provided to Guardian as a separate rate class.

According to MGU witness Feingold, the "fully-loaded" cost of serving Guardian (i.e., all direct and indirect costs plus a return on investment at MGU's proposed average rate of return, excluding customer-related costs recovered through the monthly service charge) is 17.4¢ per Mcf and produces an annual revenue requirement of $509,961. 5 Tr. 745-746. He further stated that (based on expected transportation volumes) MGU should recover approximately $302,000 per year in gross revenue under the special contract, thus leaving $208,000 of the Guardian-related revenue requirement to be recovered from the utility's other rate classes. Based on these figures, Mr. Feingold asserted that:

> Under the special contract rates charged to Guardian, all cost of service components incurred by [MGU] to serve Guardian are recovered except a full return and its associated income taxes. Specifically, page 1 of Schedule F-6-3 [on Exhibit A-6 (Revised)] indicates that Guardian generates a net income of $27,983 under the proposed rates, which equates to a positive return on net rate base of 1.52%.

5 Tr. 747. In light of Mr. Feingold's testimony, MGU asserted that it met both of the Commission's requirements for allowing collection of the Guardian special contract underrecovery from the utility's other rate classes. First, it contended that production of a positive return shows that the contract's prices and terms are cost-justified. Second, MGU claimed that the special contract's annual generation of $302,000 in revenue constitutes a "benefit" that "outweighs the costs not recovered from Guardian of $208,000 per year." MGU's initial brief, p. 50. The utility therefore argued that it should be able to collect the entire $208,000 annual cost underrecovery from its other customers.

The Staff and the Attorney General asserted that MGU failed to satisfy the requirements for collecting the Guardian underrecovery. According to the Staff, MGU's analysis significantly understated the cost of serving this customer. In support of this assertion, the Staff pointed out that the utility neglected to assign the appropriate portion of MGU's storage costs and interest expense to Guardian. Had MGU correctly allocated those costs, the Staff concluded, the fully allocated cost of serving Guardian would have been at least 19.85¢ per Mcf, and a net loss would have resulted from the special contract. Staff's initial brief, p. 130. As for the Attorney General, his witness argued that "by treating all of the revenues paid by Guardian as benefits to other ratepayers, [MGU witness] Feingold assumes that none of the costs of serving Guardian could be avoided by MGU if Guardian left the MGU system." 10 Tr. 1395. According to the Attorney General's witness, Mr. Miller, such an assumption "is absurd" due to the fact that, "at a minimum, the transportation administration, automated meter reading, and storage/transport (i.e., balancing) costs of serving Guardian could be avoided if Guardian left the system." Id.

The ALJ agreed with the Staff and the Attorney General, and recommended rejecting MGU's proposal to collect the Guardian cost underrecovery from its other rate classes. In reaching this conclusion, the ALJ found, among other things, that (1) MGU understated Guardian's storage costs by approximately $58,000 by assigning this customer only those costs that would arise from implementation of the utility's daily balancing plan, (2) the Staff's 19.85¢ per Mcf cost of service figure was more accurate than MGU's 17.4¢ per Mcf estimate, and (3) in projecting that the contract would produce $27,983 in annual net revenue, MGU forgot to include $66,855 in interest expense attributable to Guardian's share of the utility's rate base. He therefore concluded that MGU failed to meet the burden established in Case No. U-10956, and that the utility should not be allowed to allocate to its other customers the underrecovery produced by pricing its service to Guardian "below the fully allocated cost of service of $0.1985 per Mcf." PFD, p. 60.

In its exceptions, MGU argues that the ALJ was wrong to conclude that the utility failed to satisfy the prerequisites for collection of the Guardian cost underrecovery. MGU continues to claim that it met both of the requirements established by the Commission's November 8, 1995 order in Case No. U-10956 by (1) proving that the rates established by the contract are cost justified, and (2) showing that the benefits to other ratepayers exceed the costs that MGU proposes to shift to them. In support of this first claim, MGU reasserts that its special contract with Guardian generates a positive return of 1.52% and net income of $27,983. MGU goes on to argue once again that because it expects to recover approximately $302,000 per year in revenues under the special contract, and because this figure exceeds the $208,000 cost underrecovery that the utility seeks to allocate to other ratepayers, the special contract's benefit to nonparticipating customers outweighs the costs. MGU's exceptions, pp. 51-52.

The Commission disagrees with MGU and concludes that it should adopt the ALJ's recommendation. It reaches this conclusion for the following reasons. First, MGU's claims are based on Mr. Feingold's storage cost allocation, which assigned a relatively small amount of the utility's storage costs to Guardian. That proposal was rejected earlier in this order in favor of the cost allocation submitted by Staff witness Aldrich. Second, even if MGU's storage cost allocation had been adopted, the rates charged under the Guardian special contract would not produce a net income of $27,983. In asserting that such a net income would arise, MGU ignores the fact that this $27,983 represents the return on total rate base, including rate base supported by debt capital. The interest expense arising from Guardian's allocated share of the rate base must therefore be subtracted from the alleged net income. Doing so results in a net loss, rather than a net profit.[22] Third,

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[22]Based on the cost allocation factor set forth on Exhibit S-80, Schedule F-6, page 1 of 10 (0.017424), as well as the rate base ($132,915,000) and total weighted cost of long- and short-term debt (3.63%) adopted earlier in this order, the interest expense arising from Guardian's share of MGU's rate base would be $84,068. When applied to the utility's alleged net income from Guardian, this interest expense would result in a net loss of $56,085.

notwithstanding MGU's claims to the contrary, it is doubtful that the receipt of $302,000 in revenue under the special contract would outweigh the burden imposed on other rate classes from whom MGU seeks to recover the alleged $208,000 difference between that revenue and the fully allocated cost of serving Guardian. As noted by the Attorney General's witness, Mr. Miller, those claims ignore the cost of serving Guardian and incorrectly assume that there would be no reduction in MGU's transportation administration, automated meter reading, and load balancing expenses if Guardian left the system. 10 Tr. 1395. The Commission therefore finds that, based on the record in this case, MGU should not be allowed to recover from its other rate classes any difference between Guardian's fully allocated cost of service and the revenue derived from the Guardian special contract.

IX.

TARIFF AND RATE DESIGN ISSUES

Part of the controversy concerning the specific tariff language to be included in MGU's rate schedules has been resolved either by the parties or through the Commission's earlier rulings in this order regarding cost allocation. However, several tariff and rate design issues require further discussion.

Sales Rate Schedules

1. Monthly Customer Charges for Residential and Residential Multiple Family Dwelling Rate Classes

Based on Mr. Feingold's cost of service study, MGU sought increases in the monthly customer charges for several sales rate classes. Specifically, the utility proposed that the customer charge for its residential and residential multiple family dwelling (RMFD) customers in meter class I should be raised from $7.25 per month to $8.00 per month. MGU also proposed increasing the customer charge for RMFD customers in meter class II from $15 per month to $20 per month. In support of those proposals, the utility asserted that the

increases could be justified even if the Staff's cost allocation methodology was selected for use instead of that proposed by Mr. Feingold.

Both the Staff and the Attorney General disagreed with the utility. According to the Staff's lead witness regarding rate design, Michael L. Collins, MGU failed to support its requested increases. Mr. Collins testified that, notwithstanding the utility's claims to the contrary, MGU's existing monthly customer charges already exceeded the customer-related expense figures derived from the Staff's cost of service study.

The ALJ agreed with the Staff and the Attorney General, and concluded that MGU's residential and RMFD customer charges should remain at their existing levels. Among other things, the ALJ pointed out that of Utilicorp's 10 operating divisions, only 2 impose customer charges in excess of $7.50 per month. He went on to note that MGU's existing residential customer charge of $7.25 per month was already the second highest of all the gas utilities under the Commission's jurisdiction. The ALJ therefore recommended that the Commission reject MGU's proposal to increase the monthly charge for each of its residential, RMFD meter class I, and RMFD meter class II customers.

In its exceptions, MGU renews its assertion that the monthly customer charge should be increased for each of these rate classes. The utility contends that according to the portion of Mr. Feingold's cost of service study set forth on Exhibit A-6, Schedule F-6-5, it could justifiably impose a monthly charge of up to $16.13 on its residential customers. MGU goes on to assert that even if it applies the Staff's cost allocation approach, the charge for this rate class could be as high as $8.94 per month. MGU therefore argues that its proposal to increase this monthly charge to $8.00 is reasonable. Based on the same exhibit, the utility claims that the monthly customer charge for its RMFD meter class I and II customers could be as high as $21.06. Finally, the utility insists that "the PFD's comparisons of customer charges to MGU's sister divisions or other Michigan utilities are largely meaningless when there is no clear comparability of systems or methods for determining customer charges." MGU's exceptions, p. 53.

In their replies to exceptions, both the Attorney General and the Staff take issue with MGU's assertions. The Attorney General points out that because it was previously rejected by the ALJ, MGU's cost of service study offers no support for the utility's request to increase these monthly customer charges. As for MGU's claim that application of the Staff's cost allocation methodology likewise supports increasing the residential customer charge, as shown on Exhibit A-6, Schedule F-6-5, he notes that use of that exhibit "is somewhat misleading" and "fails to represent the full nature of Schedule F-6-5." Attorney General's replies to exceptions, pp. 11-12. Although MGU may have used the Staff's methodology to determine which cost components belong in the customer charge, the Attorney General continues, the magnitude of each component was based on the utility's flawed cost of service study. Finally, the Staff points out that contrary to MGU's assertions, the ALJ considered both of the parties' presentations (including their cost of service studies) before concluding that the Staff's was correct. Accordingly, the Staff contends, the fact that MGU's monthly customer charges are relatively high compared to those of other gas utilities did not, by itself, lead to the ALJ's recommendation. Staff's replies to exceptions, p. 38. Instead, the Staff claims, it simply reinforced his conclusion. For these reasons, the Attorney General and the Staff assert that the ALJ's recommendation should be adopted and that MGU's request to increase these customer charges should be rejected.

The Commission agrees with the Attorney General and the Staff. Earlier in this order, the Commission concluded that MGU's cost of service study was flawed and that the Staff's study should be used instead. Because they are based solely on the results of the rejected cost study, MGU's claims that the monthly customer charges for residential customers could be as high as $16.13, and that the charges for RMFD meter class I and II customers could be $21.06 per month, must also be rejected. Furthermore, the utility is wrong in asserting that use of the Staff's cost allocation approach would still support a monthly customer charge of up to $8.94 per month for residential and RMFD meter class I customers. As correctly noted by the Attorney General, the customer charge set forth on Exhibit A-6, Schedule F-6-5 is based on several overstated inputs.

For example, MGU's computation relies on an overall rate of return of 9.59% (whereas the rate approved in this order is 8.42%), and is based on an inflated income tax allowance. When the appropriate inputs are used, the Staff's cost of service study shows that the customer-related costs for a residential ratepayer are $7.02 per month. Exhibit S-80, Schedule F-6, page 3 of 10. The study further indicates that the cost of serving the utility's RMFD customers is only $13.98. Id. These figures show that MGU's existing customer charges for these rate classes, namely $7.25 and $15 per month, respectively, are more than adequate to recover the customer-related costs of service. The Commission therefore concludes that the ALJ's recommendation should be adopted and MGU's request to increase these charges should be denied.

2. General Service and Optional Service Rate Schedules

MGU's previous rate cases established two firm sales rates for use by its commercial and industrial customers. Its general service tariff, designed primarily for its small and mid-sized commercial accounts, had a customer charge of $15 per month and a distribution charge of $1.0565 per Mcf. The utility's optional service tariff, which attracted MGU's largest commercial and industrial customers, had a monthly customer charge of $250 and a distribution charge of $0.6779 per Mcf.

In its initial presentation, MGU proposed replacing the general and optional service classes with three new rate classes, namely small general service, large general service, and high volume service. Customers would qualify for service under one of these rate classes based on the amount of their annual gas consumption. Small general service would apply to non-residential customers that use no more than 10,000 Mcf per year, large general service would cover those using between 10,000 and 100,000 Mcf, and those using over 100,000 Mcf would take service under the high volume rate. Although the small general service tariff would include a fixed distribution charge of $1.216 per Mcf, the utility's proposed distribution charges

for the large general service and high volume sales service would be a negotiated rate ranging anywhere from 21¢ to 86¢ per Mcf.

Based on several parties' objections to the proposal to implement negotiated rates for its large general service and high volume service rate classes, MGU withdrew that proposal. Instead it requested authority to impose fixed distribution charges of 79¢ and 42¢ per Mcf, respectively, on customers assigned to its proposed large general service and high volume service tariffs. Based on Mr. Feingold's cost of service study, MGU advocated establishing monthly customer charges of $20 for small general service customers, $180 for large general service customers, and $300 for customers using its high volume sales rate. Exhibit A-11, Schedule F-8.

The Staff also proposed replacing the general service and optional service rate schedules. In their place, it recommended establishing two rate classes, small general service and large general service. Rather than assigning commercial and industrial sales customers to one class or the other, the Staff proposed setting rates that (1) create an economic break-even point at 10,000 Mcf and (2) allow each customer to choose the rate that would be most economical according to the customer's expectation of its annual usage. Based on its cost of service study, the Staff asserted that the customer charge for the small general service class should be $15 per month. Exhibit S-80, Schedule F-4-1, page 3 of 7. The Staff went on to assert that although the precise numbers would "depend on the Commission's final determination of MGU's revenue requirement," the large general service customer charge should be approximately $230 per month and the distribution charges for the small and large general service classes should be about 96¢ and 70¢ per Mcf, respectively. Staff's initial brief, p. 138.

The ALJ agreed with the parties that the existing general service and optional service rate schedules should be replaced. He went on to find that the Staff's proposed substitutions were more reasonable than those offered by MGU. The ALJ therefore recommended adopting the small general service and the large

general service rate schedules proposed by the Staff, as well as establishing the rates for those customer classes in accordance with the Staff's cost of service study.

MGU excepts to those recommendations. According to the utility, any replacements for its current general service and optional service rate schedules should be based on Mr. Feingold's cost of service study, not that prepared by Staff witness Aldrich. MGU therefore contends that its plan to implement three distinct rate classes (namely small general service, large general service, and high volume service) should be approved, and that the rates for each of those new customer classes should be established in accordance with Mr. Feingold's study.

The Commission disagrees with MGU for several reasons. First, as discussed earlier, the cost of service study undertaken by Mr. Feingold and sponsored by the utility is of questionable value in setting MGU's rates. This is because it is based exclusively on historical test year data, has not been updated to reflect changes in revenues, expenses, rate base, and throughput, and includes several cost allocation methods that have been specifically rejected in this order. Second, by establishing an economic break-even point and allowing customers to choose which rate schedule they would like to take service under, the Staff's proposal should prove less onerous to a ratepayer whose old rate class is being abolished. Third, there is no need to create the high volume service class proposed by MGU. As noted by Staff witness Collins, the utility failed to point out a single customer with a load greater than 100,000 Mcf per year that was likely to take service as a high volume sales service customer instead of using one of MGU's transportation rates. 13 Tr. 1992. The Commission therefore concludes that the ALJ's recommendation should be adopted and that the charges for sales service provided under the small and large general service rate schedules should be computed in the manner proposed by the Staff.[23]

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[23]Based on the revenue requirement and cost allocation methodology adopted by the Commission in this case, as well as its conclusion that the economic break-even point for these sales customer classes

3. Miscellaneous Sales Rate Proposals

The parties offered several other proposals concerning MGU's sales rates. As discussed below, none of the ALJ's recommendations regarding these proposals created significant controversy.

Historically, MGU's residential and RMFD rate classes were grouped together when calculating distribution charges. This was done so that all residential customers would pay the same cost per Mcf regardless of whether they resided in a single-family home, a duplex, or an apartment. This practice predated the era in which the Commission began looking to cost of service studies for help in setting rates. However, because rates are now based almost exclusively on cost of service principles, MGU proposed treating residential and RMFD customers as members of completely separate classes. The Staff supported this proposal and, like the utility, elected to compute its proposed distribution charges based on the cost of serving each customer class. The ALJ agreed with these parties and recommended that the distribution charges for MGU's residential and RMFD rate classes be computed separately and on a cost of service basis.

Next, the Staff recommended canceling MGU's interruptible service rate. Only two customers made use of this rate during the historical test year, with one of them using 6,517 Mcf and the other using 89,847 Mcf. According to Mr. Collins, the first customer clearly belongs in the small general service class and the large customer would likewise pay less by switching to transportation service. 13 Tr. 1997. Despite the fact that its initial presentation in this case assumed that MGU would continue offering interruptible service, the utility did not object to the Staff's proposed elimination of this rate schedule. The ALJ agreed with the Staff and recommended canceling that rate schedule.

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should be 10,000 Mcf, the exhibits attached to this order indicate that (1) MGU's small general service rate requires a monthly customer charge of $15 and a distribution charge of $1.0066 per Mcf, and (2) its large general service rate requires a monthly customer charge of $200 and a distribution charge of $0.7836 per Mcf.

Finally, MGU suggested leaving its gas lighting rate unchanged, and the Staff agreed. The ALJ found that this request was reasonable and therefore recommended leaving the gas lighting rate in its current form.

None of the parties except to the ALJ's recommendations regarding complete separation of the residential and RMFD rate classes, elimination of MGU's interruptible service rate, and retention of the utility's gas lighting rates. The Commission finds that all of those recommendations should be adopted.

Transportation Rate Schedules

1. Revising the Existing Rate Structure

MGU's previous rate case resulted in a two-part transportation rate structure consisting of separate T-1 and T-2 tariffs, and allowed customers to choose between those rate classes. The T-1 tariff required payment of customer charges and administrative fees totaling $1,280 per month, as well as a cost-based distribution charge of $0.5716 per Mcf. The T-2 tariff also required payment of monthly customer charges and administrative fees, but totaling $1,380. However, instead of establishing a single distribution charge, the tariff provided a range of rates within which MGU could negotiate with customers electing to take service under Rate T-2. The minimum rate allowed under Rate T-2 was $0.20 per Mcf, while the maximum rate was set at $0.75 per Mcf.

In the course of its presentation, MGU proposed significant changes to the rate structure for its transportation customers. Specifically, the utility sought to replace the T-1/T-2 rate structure with one that, like MGU's sales rate proposal, would specifically assign customers to one of three rate classes depending on annual usage. The small general service transportation rate (applicable to all customers transporting 10,000 Mcf or less per year) would impose a monthly customer and administrative charge of $565, as well as a fixed distribution charge of $1.065 per Mcf. The large general service transportation rate (for customers requiring between 10,000 and 100,000 Mcf annually) and the high volume transportation rate (for those using more

than 100,000 Mcf per year) called for monthly customer and administrative charges of $725 and $845, respectively. These two tariffs would also provide for a negotiated distribution charge similar to that currently imposed under Rate T-2. The only difference was that instead of establishing a range from $0.20 per Mcf to $0.75 per Mcf, MGU's proposal reduced the price floor to $0.10 per Mcf. According to John G. Bogatz, the Regional Sales Director of Key Accounts for Utilicorp, this reduction in the minimum distribution charge was necessary to allow MGU to respond to increased competitive pressures.

MGU claimed that its proposed flexible rate design for its large general service and high volume transportation classes would allow the utility to obtain from all customers within either of these classes the average cost of serving their respective classes. Specifically, Mr. Bogatz stated that any rates negotiated below the average cost of service for a particular class would be offset by charging other customers assigned to that class "more than the average cost of service." 6 Tr. 999-1000. That way, he continued, other customer classes would not be asked to subsidize the flexible rate proposed by MGU.

Although the Staff agreed with MGU that Rates T-1 and T-2 should be replaced with a three-part rate structure, all similarities between these parties' proposals ended there. Unlike the utility, the Staff recommended setting the rates for each of the three transportation classes (designated as TR-1, TR-2, and TR-3) solely on the basis of cost. In keeping with its belief that strict cost of service based rates represent the most equitable way to charge transportation customers, the Staff went on to recommend that seasonal rates be established for each of these classes.[24] It further suggested that rather than assigning them to a specific class, transportation customers should be allowed to choose between the three tariffs. However, the Staff noted that because its proposed rates were designed to have economic break-even points at 50,000 and 225,000 Mcf, customers using less than 50,000 Mcf annually would be better off on Rate TR-1, those using between 50,000

[24]Specifically, the Staff recommended charging customers 15¢ less per Mcf for gas transported during the off-peak months of April through October.

and 225,000 Mcf would do better on Rate TR-2, and those needing more than 225,000 Mcf of transportation would find it beneficial to use Rate TR-3.

Finally, in recognition of MGU's need to respond to a customer's access to competitive alternatives, the Staff's proposed tariffs allowed the utility to reduce the distribution charge for any transportation customer to as little as $0.20 per Mcf without obtaining prior Commission approval. However, according to Mr. Collins, MGU would have to satisfy three criteria before being allowed to seek recovery of any such discount in future rate case proceedings. Specifically, the utility would have to show that (1) the customer receiving the discount "clearly demonstrated the ability and a willingness to exercise economical alternatives to paying the cost based rate," and MGU took reasonable steps to maximize the discounted rate, (2) the discounted rate "recovers the long run cost of serving the customer," and (3) MGU's other customers are better off by absorbing the discount than by having the customer leave the system. 13 Tr. 2016-2017. Based on its initial calculation of MGU's revenue deficiency, which was somewhat lower than that approved in this order, the Staff proposed the following rates:

Rate Class	Monthly Customer Charge	On-Peak Distribution Charge	Off-Peak Distribution Charge
TR-1	$820	$0.6147 per Mcf	$0.4647 per Mcf
TR-2	$1,595	$0.4277 per Mcf	$0.2777 per Mcf
TR-3	$2,870	$0.3594 per Mcf	$0.2094 per Mcf

ABATE asserted that the Staff's transportation rate structure "is generally positive and a better alternative to the rate design proposal presented by MGU." ABATE's initial brief, p. 9. Specifically, ABATE claimed that the Staff's reliance on break-even points of 50,000 and 225,000 Mcf per year would help establish rates for MGU's transportation customers that better reflect these customers' load and cost characteristics. Id., p. 14. More important, it pointed out that the Staff's use of fixed, cost-based distribution

charges (instead of the broad range of rates proposed by the utility) provides an important safe harbor for transportation customers that have no competitive alternatives to service provided by MGU. ABATE argued that absent this type of safe harbor, the utility would use its monopoly power to charge each of these transportation customers the maximum rate of $0.75 per Mcf.

According to ABATE, the only problem with the Staff's proposed rate structure was the provision allowing MGU to negotiate rates as low as $0.20 per Mcf without requiring prior Commission approval.[25] ABATE claimed that this provision offers too little flexibility in those instances where MGU is negotiating with customers that have highly competitive alternatives. It therefore recommended revising the Staff's plan to authorize the negotiation of transportation rates as low as $0.10 per Mcf.

The Attorney General expressed concern that the Staff's proposal might prove too beneficial to MGU's transportation customers. He therefore suggested retaining the existing range of rates for MGU's distribution charge and merely adopting the lower customer charges proposed by the utility. However, the Attorney General expressed disagreement with at least one aspect of MGU's proposal.[26] According to his witness, Mr. Miller, the utility unjustifiably assumed that distribution charge revenues from its transportation customers will drop by $1,151,000 from the levels achieved historically. 10 Tr. 1382. The Attorney General therefore asserted that if the Commission rejected the ALJ's recommendation and implemented MGU's rate structure instead, these additional revenues should be imputed to the utility, thus reducing the revenue requirement assigned to MGU's other rate classes.

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[25] Although ABATE also asserted that transportation customers had been allocated an excessive amount of MGU's storage costs, that argument was discussed and rejected earlier in this order.

[26] The Attorney General also claimed that MGU's proposed rates should be adjusted to reflect the utility's failure to justify allocating all of the Guardian discount to its other customer classes. This issue was resolved earlier in this order.

The ALJ recommended rejecting MGU's proposed flexible transportation rates. This was based on the fact that those rates would eliminate the safe harbor for many transportation customers, subjecting them to distribution charges that greatly exceed the cost of service. The ALJ further noted that under the utility's proposal, "any discounts MGU offered to certain of its transportation customers could be shifted to other transportation customers without any showing that the discounts were reasonable or in the captive transportation customers' best interest." PFD, p. 69. He also concluded that the Attorney General's request to impute $1.15 million of additional revenue to MGU's transportation customers should be rejected. In support of that conclusion, the ALJ noted that arbitrarily increasing the revenue requirements assigned to MGU's largest two transportation classes would create additional incentives for the utility to overcharge its captive transportation customers. The ALJ asserted that this, in turn, would inappropriately "force transportation customers to subsidize sales customers under the guise of market based rates." Id., p. 70.

For those reasons, the ALJ recommended that the Commission adopt the Staff's proposed transportation rate structure. Specifically, he suggested (1) replacing Rates T-1 and T-2 with three rate classes having break-even points of 50,000 and 225,000 Mcf per year, (2) basing monthly customer charges and administrative fees on the Staff's cost of service study, presumably as revised to include the Attorney General's 50/50 A&G expense allocation, (3) establishing fixed, cost-based distribution charges for all three transportation rate classes with a 15¢ per Mcf price differential between on-peak and off-peak seasonal usage, and (4) allowing MGU to discount its distribution charges for some transportation customers to as low as $0.20 per Mcf where necessary to meet competitive pressures.

In its exceptions, MGU argues that its proposed rates, unlike those suggested by the Staff, are designed to respond to market risk and customer preferences and to make transportation service a viable option for a wider range of customers. MGU's exceptions, p. 54. MGU points out that its proposal reduces monthly customer charges and administrative fees, thus eliminating one barrier to greater customer choice. Id. In

contrast, the utility asserts, the Staff's proposal increases transportation customers' monthly charges. MGU goes on to claim that the Staff's proposal to use fixed distribution charges unnecessarily limits the utility's options in dealing with its customers. For example, MGU contends, establishing seasonal distribution charges would preclude the utility from offering a flat, year-round charge to customers that might find such a rate more desirable than separate on-peak and off-peak charges. MGU further asserts that establishing a $0.10 per Mcf price floor instead of the $0.20 per Mcf minimum rate recommended by the ALJ is necessary to allow the utility to respond to market pressure and to attract new business. Finally, MGU argues that customers' desire for a fixed transportation rate could be satisfied (should the Commission be so inclined) by simply adding a fixed distribution charge option to the utility's proposed large general service transportation tariff. Id., p. 56. It contends that a reasonable rate for this optional service would be $0.6040 per Mcf.

Despite supporting the ALJ's position on all other transportation rate issues, in its exceptions ABATE agrees with MGU that the utility should be allowed to negotiate transportation rates as low as $0.10 per Mcf. ABATE contends that in reaching a contrary conclusion, the ALJ "either ignored or failed to adequately consider the substantial record evidence in this case as to the increasing competitive pressures faced by several of MGU's customers and the need for MGU to have adequate flexibility to respond to these competitive pressures." ABATE's exceptions, p. 10. Specifically, ABATE cites testimony by Mr. Bogatz to the effect that approving a minimum price of $0.10 per Mcf would (1) give MGU greater flexibility when negotiating with its at-risk customers, and (2) establish a price floor that is consistent with that approved for other Michigan utilities. ABATE therefore argues that although it should adopt the remainder of the transportation rate design proposed by the Staff and recommended by the ALJ, the Commission should reject the $0.20 per Mcf price floor and replace it with a minimum price of $0.10 per Mcf.

Notwithstanding these arguments to the contrary, the Commission concludes that it should accept the ALJ's recommendation and adopt the Staff's transportation rate structure, including its use of a $0.20 per Mcf price floor. The Commission reaches this conclusion for several reasons.

First, the Staff's proposal to use three rate classes with break-even points of 50,000 and 225,000 Mcf per year will separate MGU's transportation customers into "homogeneous groups" in which each of the members has "similar cost characteristics." 13 Tr. 2013. This makes the rates assigned to each member of a customer class less arbitrary than they otherwise might be.

Second, contrary to MGU's assertions, the Staff's rate structure makes transportation service available to a wider range of ratepayers by reducing total customer charges and administrative fees for the utility's smallest customers from their current level of $1,280 to $820 per month. Exhibit S-80, Schedule F-4-1, p. 4. Although the Staff's proposal does increase the portion of the overall rates that larger, existing transportation customers pay through monthly charges, those increases are more than offset by significant reductions in distribution charges resulting from the adoption of the Staff's cost-based rates. Thus, the overall rates for Rate TR-1, TR-2, and TR-3 customers will drop by an average of nearly 17%, as reflected in the rate schedules attached to this order.

Third, the Staff's proposed rate structure does a better job of responding to customer preferences than that proposed by MGU. In addition to significantly reducing average transportation rates, the Staff's use of fixed (instead of negotiated) distribution charges provides the type of safe harbor sought by ABATE witness James J. Mulholland "to protect those customers who realistically have no alternative to MGU's distribution system and thus must rely solely on MGU to meet their energy needs." 14 Tr. 2298. This will preclude the type of monopolistic pricing practices feared by the utility's transportation customers. Moreover, the Staff's

fixed distribution charge program has several advantages over MGU's late-filed proposal[27] to offer a $0.6040 per Mcf fixed charge option to its large general service transportation customers. For example, the utility's proposed rate appears to be based on Mr. Feingold's previously rejected cost of service study. In addition, because it is limited to customers using between 10,000 and 100,000 Mcf per year, MGU's option would be available to only 34 of the utility's 68 existing transportation customers. Exhibit S-80, Schedule F-4-2. In contrast, the Staff's proposal provides a safe harbor to all transportation customers.

Fourth, despite MGU's assertions to the contrary, the Staff's proposal to implement seasonal rates does not unnecessarily limit the utility's options in dealing with its customers. Rather, MGU would not be precluded from negotiating a special contract with any transportation customer that demands a flat, year-round distribution charge instead of the paying the on-peak and off-peak distribution charges advocated by the Staff. See, 13 Tr. 2062.

Fifth, the Commission finds unpersuasive the arguments offered by MGU and ABATE in support of reducing the price floor for transportation service to $0.10 per Mcf. Although these parties claim that the only way to provide MGU with adequate flexibility to negotiate with at-risk customers is to set the minimum price at this lower level, they ignore the fact that special contracts may be used to achieve the same result. Furthermore, Mr. Bogatz's assertion that a minimum rate of $0.10 per Mcf would be consistent with the price floors established for other Michigan utilities is incorrect. Pursuant to the Commission's October 28, 1993 order in Cases Nos. U-10149 and U-10150, as well as the March 11, 1996 order in Case No. U-10755, the minimum distribution charge approved for Mich Con and Consumers is $0.23 per Mcf.

2. Capacity Assignment

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[27] MGU's offer to provide a fixed distribution charge option was first unveiled in the utility's initial brief. Thus, no supporting testimony or documentation has been placed in the record regarding this proposal.

____MGU proposed including a provision entitled "Pipeline Capacity" in each of its transportation tariffs. This provision stated that whenever a sales customer elects to switch to transportation service, the utility would have the option of assigning to that customer all pipeline capacity that MGU previously contracted for to serve the customer's needs. The utility went on to indicate that the capacity "would be assigned to the customer through [the respective interstate] pipeline's release mechanism." MGU's initial brief, p. 60. Such a capacity assignment would occur, the utility asserted, whenever MGU determined that the departing sales customer's share of pipeline capacity would not be necessary to maintain system integrity. According to MGU, its capacity assignment proposal was designed to protect its remaining sales customers from bearing the cost of capacity left stranded by a customer's decision to switch to transportation service.

The Staff opposed MGU's capacity assignment proposal for several reasons. First, it noted that capacity assignment is equivalent to capacity release. The Staff therefore asserted that because the appropriate level of capacity release is a GCR case issue,[28] questions regarding capacity assignment do not belong in this rate case. Second, the Staff pointed out the threat of capacity assignment could pose a potential barrier for all customers considering a switch to transportation service. Third, according to Staff witness William K. Bokram, "MGU's proposed provision invites undue discrimination and potentially anticompetitive affiliate preferences." 12 Tr. 1804. Specifically, he claimed that adopting this proposal might encourage MGU to assign to its Michigan customers excess pipeline capacity from the other states that Utilicorp serves. Mr. Bokram further asserted that MGU could use this provision to ensure that its marketing affiliates have access to the utility's lowest cost pipeline capacity.

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[28] As noted in the Commission's September 9, 1996 order in Case No. U-10982, involving MGU's 1996 GCR plan, the utility recognized that (1) it has an obligation to prudently manage its gas supply portfolio, (2) this obligation "specifically includes responsibility to sell unused transportation capacity in the capacity release market," and (3) its failure to satisfy this obligation can result in cost disallowances in its GCR proceedings. Order, p. 3.

The ALJ agreed with the Staff and recommended that the Commission reject MGU's request to incorporate this provision into its transportation tariffs. In support of this recommendation, the ALJ found that capacity assignment (1) is equivalent to capacity release, as asserted by the Staff, (2) represents an issue to be resolved in MGU's GCR cases, rather than in rate cases, (3) creates an unnecessary barrier to entry for customers seeking to convert to transportation service, and (4) invites undue discrimination and potentially anticompetitive affiliate preferences, due to the fact its application is based solely on the utility's discretion. PFD, pp. 71-72.

In its exceptions, MGU renews its argument that the proposed capacity assignment provision is necessary to protect the utility's remaining sales customers from the cost of stranded capacity. MGU further contends that, contrary to the ALJ's conclusion, its capacity assignment proposal is not equivalent to capacity release. Rather, the utility argues, its plan is more beneficial to GCR customers because it guarantees that the full cost of the assigned capacity will be recovered. In contrast, MGU continues, full recovery is not assured under capacity release because the price received for such capacity is determined entirely by the market. The utility therefore claims that the ALJ's recommendation should be rejected and that MGU's capacity assignment provision should be approved.

The Commission finds that MGU's claims are not well taken. Contrary to the utility's assertions, GCR customers can be adequately protected without implementing capacity assignment. If exercised appropriately, MGU's ability to use capacity release (as opposed to capacity assignment) should eliminate much, if not all, of the risk of stranded capacity. This is particularly true in light of the fact that 24% of MGU's pipeline transportation capacity is provided under contracts that will expire in less than one year, and an additional 34% will expire within two years. 12 Tr. 1811; Exhibit S-80, Schedule F-8-4, p. 3.

Furthermore, the proposed capacity assignment provision could create an unjustifiable disincentive to the exercise of customer choice, while providing an opportunity for discriminatory and anticompetitive activities.

The provision specifically states that implementation of capacity assignment is at the "sole discretion" of MGU. Exhibit A-11, Schedule F-8, pp. 16, 21, and 26. Thus, as noted by Mr. Bokram, the utility could effectively create an "exit fee" by selectively forcing certain of its departing sales customers to accept capacity that they do not want (due to price) or cannot use (due to a lack of interconnections between the designated pipeline and the customer's source of gas). 12 Tr. 1807. Similarly, MGU could base its decision regarding whether to assign capacity to a particular customer on whether the departing customer will be served by one of the utility's affiliated marketing companies when it begins taking transportation service.

Therefore, the Commission concludes that it should adopt the ALJ's recommendation and reject MGU's capacity assignment provision.

3. Load Balancing

As noted earlier, MGU's Rate T-1 and T-2 transportation customers historically have been provided with an ATL equal to 10% of their respective ACQ. Each customer was therefore allowed to accumulate without penalty positive storage imbalances to the point where the cumulative imbalance equaled 10% of the ACQ set forth in its transportation contract with MGU. However, MGU was authorized to charge the customer $0.10 per Mcf per month for the storage of any month-end balance of gas exceeding 10% of the customer's ACQ. Conversely, if during any month the measured volume of gas delivered by (or on behalf of) a transportation customer into MGU's system was less than the measured volume of gas consumed by the customer, the month-end difference was deemed unauthorized gas usage. The customer was required to pay an unauthorized gas usage charge equal to $10 per Mcf plus the then-designated GCR sales rate for all such unauthorized usage. Nevertheless, because positive daily imbalances could be netted against negative daily imbalances on a month-end basis, both the likelihood and magnitude of those potential charges were reduced.

MGU requested authority to implement daily, as opposed to monthly, balancing. Specifically, it proposed requiring transportation customers to maintain daily balances within a tolerance range of plus or minus 10% of the gas nominated by each customer for delivery into MGU's system on that particular day. Under MGU's proposal, a daily scheduling charge would be imposed on any customer that consumed 10% more or 10% less gas than it nominated for that day. The proposed charge, which would be applied to all volumes in excess of the plus or minus 10% tolerance limit, equaled the average of (1) the sum of Panhandle's interruptible transmission commodity rates applicable to its transmission access charge and its transmission mileage charge for between 401 and 500 miles, on the one hand, and (2) the highest applicable interruptible transmission rate charged by ANR Pipeline Company (ANR) for service to the northern zone, on the other. 5 Tr. 532. At the time that MGU filed its application in this case, the utility estimated that the daily scheduling charge would be approximately 32¢ per dekatherm (Dth), or approximately $0.32 per Mcf.

In an effort to keep its system in balance on a monthly basis, MGU also proposed instituting a monthly cash-out provision under which the utility would credit a transportation customer's account for positive imbalances and charge the customer for negative imbalances, regardless of their magnitude. MGU's witness on this issue, Mr. Richard, testified that these credits and charges would be based on the monthly average of the Mich Con city gate index for large end-users as published in Gas Daily (Mich Con index), and that they would be implemented on a tiered basis. 5 Tr. 533. Specifically, month-end credits were to be computed on a sliding scale having a maximum price equal to 100% of the average Mich Con index (for positive imbalances of 5% or less) and a minimum price equal to 50% of that index (for positive imbalances exceeding 20%). Conversely, month-end charges were designed to increase from a minimum price equal to 100% of the average Mich Con index (for negative imbalances of 5% or less) to a maximum price equal to 150% of that index (for negative imbalances exceeding 20%).

MGU also requested authority to declare an "extreme condition situation" whenever one of the interstate pipelines providing gas to its system issued a restriction on the tolerance level of gas deliveries above nominations previously submitted by the utility. 5 Tr. 538. According to Mr. Richard, once they were notified of an extreme condition situation's existence, MGU's transportation customers would have to begin functioning under daily tolerance levels as low as those imposed on the utility by the interstate pipelines. Failure to adhere to the narrower tolerance levels would expose customers to an extreme condition overrun charge equal to the greater of $10.00 per Mcf or the volumetric charge assessed by the pipeline(s) for any such overrun charges MGU would incur as a result of transportation customers that did not keep within the restricted tolerance declared by MGU. 5 Tr. 539-540. Once such a situation was declared, the extreme condition overrun charge would remain in effect until the utility notified its customers to the contrary.

The Attorney General asserted that MGU failed to adequately support its proposal to eliminate balancing services beyond a tolerance of plus or minus 10% on a daily basis. According to him, the only testimony offered in favor of MGU's daily balancing proposal was Mr. Richard's statement that the utility's decision to cease offering "the 10% of ACQ imbalance build-up on its system" was merely an attempt to "more closely resemble the types of balancing provisions as exist on the [interstate] pipelines serving MGU." 5 Tr. 532. The Attorney General asserted that the problem with Mr. Richard's approach was that "there is no proper linkage between the pipeline balancing provisions and the storage service that MGU now provides to its transportation customers, but wishes to discontinue." Attorney General's initial brief, p. 24.

The Attorney General's witness, Mr. Miller, recommended having MGU continue to offer unlimited load balancing, although only "on a best efforts basis," with the cost of that service recovered in base rates and without imposing a separate daily balancing charge. 10 Tr. 1407. The way to achieve this, he asserted, was to (1) require customers to make daily nominations covering both the amount of gas the customer expected to burn and the volume of gas that its supplier would deliver to MGU's city gate that day, (2) obligate MGU to

provide load balancing service for the difference between these two quantities, but only on a best efforts basis, (3) have MGU check with the interstate pipeline to get confirmation of the proposed deliveries for each transportation customer into the utility's system, and (4) require MGU to inform each customer regarding whether their requested load balancing could be provided. 10 Tr. 1413-1414. Only when an unscheduled imbalance occurred, meaning when the customer's actual usage differed from the customer's scheduled usage at the same time that MGU faced an extreme condition situation, would the utility be allowed to impose its daily scheduling charge. Id.

The Attorney General offered no specific opinion regarding MGU's monthly cash-out proposal. Finally, finding that it was compatible with his best efforts load balancing proposal, he supported approval of the utility's proposed extreme condition overrun charge.

The Staff also opposed MGU's daily balancing proposal. Like the Attorney General, the Staff cited the lack of proof regarding the need for daily balancing. Specifically, Staff witness Bokram noted that MGU has never paid penalties to interstate pipelines that were caused by transportation customers. 12 Tr. 1813. He further pointed out that, although MGU likely uses GCR supply gas to provide load balancing service to its transportation customers, the utility made no attempt to quantify the GCR costs involved. The Staff therefore viewed MGU's plan as "an extreme solution for an unquantified problem." Staff's initial brief, p. 168.

The Staff further asserted that the utility's daily balancing proposal was unworkable and not well thought out. As evidence of this, the Staff noted that MGU (1) failed to define which "gas day" would be used in determining whether customers had positive or negative imbalances, (2) did not explain how it would read all of its transportation customers' meters simultaneously at the conclusion of each day, (3) was unable to explain which of several gas nominations would be compared to a customer's actual usage, (4) expressed confusion over whether and to what extent the utility would be able to change a customer's nomination, and

(5) indicated that the scope of the phrase "any other charges" would depend on the outcome of some future proceeding. 5 Tr. 675.

Thus, despite its belief that daily balancing is not necessarily a bad idea,[29] the Staff argued that MGU's proposal to implement it in this case should be rejected. Instead of effectively eliminating the ATL for each of MGU's transportation customers, as the utility's daily balancing proposal would do, the Staff recommended retaining monthly balancing and simply reducing the ATL to plus or minus 5% of a customer's ACQ.

The Staff supported MGU's proposal to institute a monthly cash-out program, assuming of course that it would apply only to volumes in excess of the Staff's recommended 5% ATL. However, it disagreed with the utility's proposed pricing mechanisms. Mr. Bokram stated that use of the average Mich Con index to price month-end credits and charges could encourage transportation customers to go out of balance by making it advantageous to borrow gas from MGU's system supply when the price is relatively low and to loan gas to MGU when the price is high. Mr. Bokram went on to note that this would result in an unjustifiable increase in MGU's GCR costs. To remedy this problem, he recommended applying a "high-low price index" to all positive or negative month-end imbalances that exceed a customer's ATL by more than 5%. 12 Tr. 1832. Under the Staff's proposal, any positive or negative month-end imbalances that exceeded a customer's ATL by up to 5% would be cashed out at the average Mich Con index. However, positive imbalances in excess of 5% of the ATL would in effect be purchased from the transportation customer at the lowest price registered by the Mich Con index during that month. Similarly, negative imbalances in excess of 5% beyond the ATL

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[29]In this regard, the Staff proposed that the Commission adopt five criteria for use in analyzing the propriety of future requests for daily balancing. These criteria consisted of (1) a demonstrated need for daily balancing, (2) proof that the program's provisions are workable, (3) sufficient clarity in drafting as to make the program understandable to customers, (4) the waiver of penalties for imbalances caused by the utility's actions, as opposed to the customer's actions, and (5) the inclusion of a mechanism to net customers' positive and negative imbalances. See, 12 Tr. 1812-1823.

would be cashed out through the "sale" of system supply gas to transportation customers at the highest price recorded by the index during that period. The Staff further proposed treating the month-end purchase and sale of imbalance gas as a source and disposition of gas in MGU's GCR reconciliation proceedings.

The Staff went on to assert that, as a practical matter, the extreme condition overrun charge proposed by MGU in this case cannot be applied absent approval of the utility's daily balancing proposal. Because MGU's daily balancing program must be rejected due to its numerous flaws, the Staff continued, the Commission must also reject the utility's extreme condition overrun charge. Nevertheless, the Staff recognized that some means of dealing with extreme condition situations announced by MGU's pipeline suppliers might be appropriate assuming that (1) MGU adequately defines what constitutes a "system constraint," (2) the utility demonstrates that "adequate prior notice" would be given to all of its transportation customers, and (3) MGU explains how any new extreme condition provision would be applied to each of its system's separate geographic divisions. 12 Tr. 1828-1829. The Staff therefore suggested requiring MGU to file an application within 90 days seeking approval of all tariff language necessary to implement, as a part of its gas curtailment rule, an appropriate extreme condition overrun charge. The Staff concluded by stating that any such application should be accompanied by testimony showing how the new tariff language would satisfy those three criteria.

Like the Attorney General and the Staff, ABATE asked the Commission to reject MGU's proposal to implement daily balancing. According to ABATE, the utility's plan to eliminate the existing ATL was unnecessary and would undermine the benefits that Michigan businesses receive from using transportation service. Specifically, it cited Mr. Mulholland's assertion that:

> The ATL currently provided under MGU's transportation tariff service is important for industrial companies, such as Ford, to make appropriate production planning decisions and to maintain their supply security. Sufficient availability of incidental storage and load balancing capacity, not just on a daily basis, is critical for meeting energy demands during peak winter periods and greater than expected production

periods. In addition, Ford sometimes uses its gas inventory to help reduce its purchase cost of natural gas, enabling it to be more competitive with respect to its energy supply costs.

14 Tr. 2298. ABATE went on to note that MGU failed to demonstrate that providing an ATL has at any time placed undue strain on its system or significantly impaired its ability to provide continuous, reliable service to its GCR sales customers. ABATE's initial brief, p. 25.

Despite agreeing with the Staff that MGU's daily balancing proposal should be rejected, ABATE objected to its suggestion that the utility's ATL be reduced to 5%. ABATE claimed that although the Staff's proposed change was less severe than that sought by MGU, it was still unnecessary. ABATE therefore asserted that MGU's daily balancing proposal should be rejected and that the existing 10% ATL should be retained. ABATE went on to argue, as did the Staff, that the utility's extreme condition proposal was "fraught with problems and should be rejected." Id., p. 33.

The ALJ agreed with the Attorney General, the Staff, and ABATE that MGU's proposal to implement daily balancing should be rejected. In reaching this conclusion, he specifically found that the utility "failed to effectively demonstrate a need" for daily balancing, and that MGU's proposal was "unworkable and not understandable." PFD, pp. 77-78. Based on his recommendation to reject MGU's daily balancing program, the ALJ went on to find that the utility's proposed extreme condition overrun charge should not be approved. Nevertheless, he recommended that the Commission order MGU to file an application within 90 days seeking approval of an appropriately structured extreme condition overrun charge. According to him, that application should be accompanied by evidence "showing how MGU's proposed language meets the threshold criteria described in the Staff's proposal." PFD, p. 78. The ALJ further recommended reducing the utility's existing ATL to 5% of a transportation customer's ACQ. According to him, the Staff's proposal to make this change was reasonable, corresponded to the Commission's decisions regarding the ATLs approved for Consumers and Mich Con, and should be adopted.

MGU excepts to the ALJ's conclusions and recommendations regarding daily balancing and the extreme condition overrun charge. The utility states that these programs are forward looking. It therefore contends that the fact that MGU has not yet incurred pipeline imbalance charges is insufficient to justify rejecting the utility's proposals. MGU goes on to assert that its proposed load balancing provisions are workable and understandable. According to the utility, any concerns regarding the clarity of key definitions and notice requirements can be addressed by adding provisions to the tariff. MGU's exceptions, p. 63. The utility concedes that its extreme condition situation proposal would help support its daily balancing program. Nevertheless, MGU goes on to argue that its extreme condition proposal stands alone and therefore does not have to be tied to the success or failure of the utility's daily balancing proposal. Id., p. 64.

Despite agreeing with the ALJ's recommendations regarding all other load balancing issues, ABATE excepts to his recommendation to reduce transportation customers' ATL from 10% of their respective ACQs to 5%. According to ABATE, the ALJ's reliance on past Commission orders regarding the ATLs established for Mich Con and Consumers was misplaced. Specifically, ABATE notes that the October 28, 1993 order in Cases Nos. U-10149 and U-10150 retained the 10% ATL previously provided by Mich Con. Similarly, it points out that the March 11, 1996 order in Case No. U-10755 rejected as unnecessary a proposal by Consumers to reduce its ATL from 8.5% to 6% of a customer's ACQ. ABATE goes on to argue that any justification offered in support of a 5% ATL in this case "is nominal" when weighed against Mr. Mulholland's testimony that the existence of a reasonable ATL is important and that "stripping transportation customers of their ATLs would make MGU's customers less competitive at a time when there are increasing pressures to be more competitive." ABATE's exceptions, p. 4; citing 14 Tr. 2298-2299. ABATE therefore contends that the Commission should reject the ALJ's recommendation and retain the existing 10% ATL.

In its exceptions, the Staff notes that the ALJ did not specifically rule on two issues regarding load balancing. The first of these issues involves the monthly cash-out provision and the appropriate charges to be used to cash out positive and negative imbalances. The second issue involves the Staff's recommendation to account for MGU's purchase and sale of imbalance gas volumes in the utility's future GCR reconciliations. Nevertheless, the Staff asserts that "a fair reading" of pages 72 through 78 of the PFD indicates that the ALJ recommended adopting the Staff's load balancing program "in its entirety, including the monthly imbalance charge structure and treatment of the gas as a source and disposition of gas in the GCR reconciliation." Staff's exceptions, p. 10. It therefore contends that the Commission should expressly adopt the Staff's proposal as a whole, including its suggested treatment of these two issues.

The Commission concludes that it should adopt the ALJ's recommendations regarding load balancing and reject the utility's various proposals concerning this issue. This conclusion is attributable in large measure to shortcomings in MGU's evidentiary presentation.

First, MGU failed to show that daily balancing is necessary at this time. Even Mr. Richard, MGU's primary witness on this issue, was unable to cite a single instance in which imbalances on the part of its transportation customers either created operational problems for the utility or led to the imposition of penalties by MGU's interstate pipeline suppliers. 5 Tr. 580.

Second MGU did not present a workable and understandable proposal for the implementation of daily balancing. Critical terms and conditions of the utility's proposal lack definition. Thus, it is impossible to determine such things as (1) how MGU will account for the fact that the utility and its pipeline suppliers each have a different "gas day," (2) which of several daily gas nominations will be used in determining whether a customer is out of balance, and (3) what limits should be placed on the ability of the utility and its customers to subvert the system by moving imbalances between the utility and the pipelines to try to get the best cost each month. 12 Tr. 1814-1819.

Third, no evidence was presented in support of MGU's claim that its daily balancing proposal would advance goals set forth in the Michigan Jobs Commission's December 20, 1995 report to the Governor, like increasing competition and customer choice. Instead, testimony offered on this issue indicates that MGU's proposal would place "significant additional administrative burdens" on its transportation customers, "substantially increase [their] cost of doing business," and "significantly impair the benefits" currently available through the use of transportation service. 14 Tr. 2298-2300. By making transportation service less attractive to its customers, MGU's daily balancing plan would likely reduce (rather than increase) competition and customer choice.

Thus, although the concept of daily balancing is intriguing, the evidentiary shortcomings noted above require its rejection in this case.

Some of the same reasons support rejecting the Attorney General's proposal to offer unlimited daily balancing on "most" days, while imposing a daily scheduling charge only when a customer registers an unscheduled imbalance on the same day that MGU is subject to reduced interstate pipeline tolerances. Specifically, numerous terms and conditions must be proposed, evaluated in detail, and adopted before such a program can be safely implemented. However, as with the utility's proposal, no such specificity was provided in conjunction with the Attorney General's plan. Furthermore, whether they are an absolute necessity (as under MGU's proposal) or primarily serve as an informational tool (as in the Attorney General's plan), the continuous submission of daily nominations can require a significant investment of resources on behalf of transportation customers. For example, it is estimated that it could cost Ford Motor Company as much as $100,000 per year to compute and submit nominations on a daily basis. 14 Tr. 2300. Therefore, the daily balancing proposals submitted by MGU and the Attorney General should both be rejected.

The Commission further agrees with the ALJ that it should reject MGU's extreme condition overrun charge proposal. Notwithstanding MGU's claim that this proposal stands alone, testimony received in this

case indicates that "as a practical matter, MGU's proposed extreme condition [overrun charge] cannot be enforced unless MGU has a daily balancing requirement." 12 Tr. 1826. Thus, because it is dependent upon approval of a daily balancing program, and because this order rejects all such proposed programs, MGU's extreme condition overrun charge is likewise rejected.

Nevertheless, the parties should investigate whether a program can be developed that, despite the absence of a daily balancing requirement, would allow MGU to better deal with extreme condition situations announced by its pipeline suppliers. The potential benefit of such a program is shown by the fact that, when faced with unusually cold weather during early February 1996, imbalance restrictions announced by ANR and imposed upon MGU raised the cost of making a scheduling mistake from $10 per Dth to $182 per Dth. 12 Tr. 1825. Efforts should therefore be made to establish a fair, unambiguous, and easily imposed extreme condition overrun charge. The Commission thus adopts the ALJ's recommendation to order MGU to file an application within 90 days of the date of this order seeking approval of an appropriately structured extreme condition overrun charge. In addition to proposing a charge that can function independent of daily balancing, that application should satisfy the three criteria outlined by Mr. Bokram and mentioned earlier in this order. In addition, the application should be evaluated in conjunction with a review of MGU's gas curtailment rule, as suggested by the Staff and addressed later in this order.

The Commission goes on to find that ABATE's arguments in opposition to reducing MGU's ATL to 5% are not well taken. It is true that adopting the ALJ's recommendation on this issue leaves transportation customers with a lower ATL than is available from either Mich Con or Consumers. Nevertheless, any alleged detriment arising from this difference is offset in significant part by the fact that both Mich Con and Consumers can impose strict monthly withdrawal and injection limits on their transportation customers. In contrast, the tariffs requested in this case and approved by this order provide no comparable restrictions on the use of MGU's system. The Commission further finds that it is appropriate to reduce the level of ATL service

provided on MGU's system in favor of allocating fewer fixed costs to the utility's transportation program, as was done in developing the cost allocation approved in this order. Making this change allows each of MGU's transportation customers to determine whether it needs additional storage service beyond that provided by the 5% ATL, rather than mandating that each customer pay for the higher volume of available storage. The Commission therefore finds that the ATL provided on MGU's system should be reduced to 5% of each customer's ACQ.

The Commission further concludes that it should adopt MGU's proposed monthly cash-out program, as amended by the Staff. None of the parties expressed opposition to that type of program, assuming that it would apply solely to those volumes in excess of a customer's ATL. Moreover, although MGU and the Staff initially proposed different mechanisms for pricing month-end credits and charges, MGU subsequently agreed to use the Staff's price structure. Finally, the Commission finds that the Staff's proposal to account for MGU's purchase and sale of imbalance gas volumes in the utility's GCR reconciliations should be adopted. Although the ALJ did not offer a recommendation on this particular issue, the method suggested by the Staff appropriately recognizes that transportation customers' use of system supply gas and storage likely affects overall GCR revenues and expenses. Moreover, none of the parties cited a problem with, or offered an alternative to, the Staff's proposal.

4. ATL Balance Trading and Imbalance Paper Pooling

The Staff proposed implementing two provisions that can best be described as adjuncts to MGU's load balancing program. The first, referred to as ATL balance trading, would allow transportation customers to trade, on a prospective basis only, any balances held in their ATL accounts after all monthly cash-outs have occurred. Staff witness Collins stated that this service could be provided at little or no cost, would prove valuable to many of MGU's transportation customers, and could help make its package of services more

attractive than those offered by the utility's competitive alternatives. 13 Tr. 2004. The second provision, referred to as imbalance paper pooling, would allow customers to net their imbalances during the month (in hopes of avoiding month-end imbalances in excess of their respective ATLs) so long as certain requirements were met. Specifically, the customers would be required to (1) enter into a written pooling agreement specifying all parties involved, (2) provide written notice to MGU at least one month prior to the due date for nominations for the month of effective service, and (3) receive gas at a common delivery point. Exhibit S-80, Schedule F-8-3, p. 13. As with its ATL balance trading proposal, the Staff suggested providing imbalance paper pooling free of charge.

Despite describing these two proposals, the PFD included no specific recommendation regarding whether they should be approved.

Notwithstanding this absence of a specific recommendation, the Staff continues to request that these provisions be included in MGU's tariffs. MGU opposes this request. The utility points out that although the Staff has suggested from the beginning that these programs should be offered for free, Mr. Collins subsequently conceded that MGU would have to assign a person to handle these inter-company transfers and to confirm that all involved parties consented to the transaction. MGU claims that this admission shows that the Staff "had not completely thought out the details or the costs of these proposals." MGU's replies to exceptions, p. 12. The utility therefore argues that "given the gaps in the Staff's proposals," the Commission should reject these two provisions. The utility goes on to assert that, at a minimum, a charge of $25 per transfer should be established as was done for Consumers as part of the Commission's March 11, 1996 order in Case No. U-10755.

The Commission finds that the Staff's proposed ATL balance trading and imbalance paper pooling provisions should be approved. The record indicates that although their implementation and operation will cost the utility relatively little, these programs could provide significant benefits to MGU's transportation

customers. Nevertheless, the Commission agrees with the utility that some charge should be imposed to defray the cost of overseeing these inter-customer transfers. Due to the absence of any cost data concerning these services, and in light of the Commission's decision in Case No. U-10755, the Commission finds that a charge of $25 per transaction should be assessed against each transferor of gas under the ATL balance trading program. Likewise, the Commission finds that a fee of $25 per month should be imposed on each imbalance paper pool, with the fee billed to the marketer, broker, or aggregator that is designated as the pool's representative.

5. Curtailment

ABATE and the Staff expressed concern regarding MGU's existing procedures for curtailing or diverting gas deliveries in times of gas shortage. Specifically, they asserted that these procedures (which predate the movement of MGU's largest customers from sales to transportation service) raise questions concerning the potential confiscation by the utility of gas owned by its transportation customers. However, ABATE noted that MGU's witnesses were not prepared to discuss curtailment issues in this case. ABATE's initial brief, p. 35. ABATE and the Staff therefore asserted that, consistent with its February 24, 1995 order in Cases Nos. U-10149 and U-10150, as well as its March 11, 1996 order in Case No. U-10755, the Commission should order MGU to initiate a separate proceeding to address all issues concerning the curtailment and diversion of gas receipts and deliveries on behalf of sales and transportation customers alike.

The ALJ agreed with ABATE and the Staff. He therefore recommended that the Commission order MGU to file, within 90 days, an application for approval of all tariff language necessary to establish an updated service curtailment and gas diversion program. No exceptions have been filed concerning this recommendation, and the Commission finds that it should be adopted. The Commission further finds that, as

noted earlier in this order, this application should be included with MGU's previously discussed filing concerning the creation of an appropriately structured extreme condition overrun charge.

6. Unauthorized Use Charge

As alluded to earlier in this order, whenever the volume of gas drawn by a transportation customer exceeds the amount transported for or maintained in storage by that customer, it has inappropriately used MGU's planned system supply purchases. To discourage these unauthorized gas takes, the utility has been given authority to impose an unauthorized use charge of $10 per Mcf. This charge is assessed in addition to MGU's GCR rate.

In the present case, ABATE proposed reducing the unauthorized use charge to $6 per Mcf. The Staff opposed that proposal. Because delivered gas prices in Michigan went as high as $40 per Dth during the unusually cold weather experienced in early February 1996, Mr. Bokram stated that an unauthorized use charge of $6 would be an insufficient penalty to deter carelessness on the part of MGU's transportation customers. 12 Tr. 1807. The Staff further asserted that it would make little sense to revise this charge until the Commission has established an updated gas curtailment and diversion program for MGU.[30]

The ALJ agreed with the Staff and recommended rejecting ABATE's proposal to reduce the unauthorized use charge. He further suggested that the Commission consider the proper level of this charge in the context of MGU's subsequent case regarding creation of an updated curtailment and diversion program.

None of the parties except to these recommendations, and the Commission finds that they should be adopted. MGU is therefore ordered to retain its unauthorized use charge of $10 per Mcf. The utility is

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[30]It should be noted that because the monthly cash-out program will cover all other situations, this charge will apply solely to unauthorized use that occurs during a period of curtailment.

further ordered to include in its upcoming filing regarding the curtailment and diversion of gas a discussion of what unauthorized use charge will be most appropriate in the future.

General Tariff Issues

In addition to the sales and transportation rate design issues discussed in the preceding two sections, several general tariff proposals were presented in this case.

1. Choice of Rates

MGU expressed concern that if customers were free to choose between its small and large general service sales classes, as would be allowed under the rate structure proposed by the Staff and adopted earlier in this order, they might switch back and forth during the course of the year to get the most economical rate based on each month's projected usage. Likewise, the Staff noted that although the Commission should end the existing requirement that customers remain on transportation rates for five years after they first switch from sales service, this could produce a similar problem regarding the perpetual movement of customers between sales and transportation rates.

To avoid both of these problems, the Staff recommended implementing a choice of rates rule similar to the one designated as Rule B5 in Consumers' existing tariffs. That rule states, in pertinent part:

> After the customer has selected the rate under which the customer elects to take service, the customer shall not be permitted to change from that rate to another rate until at least 12 months have elapsed.

Consumers' choice of rates rule goes on to state that the utility may waive the one year requirement at its discretion.

The ALJ found that the Staff's suggestion should be adopted. According to him, implementing a choice of rates rule like this would allow customers to reasonably exercise their choice while preventing them from "frequent switching between rate schedules to avoid paying their full share of costs." PFD, p. 66. None of

the parties except to that recommendation, and the Commission finds that the proposed rule is necessary to the efficient operation of MGU's system and should be adopted.

2. Miscellaneous Rule and Tariff Language Changes

Eleven other changes were proposed concerning MGU's rules and tariffs. Although some were contested by the parties prior to issuance of the PFD, none of them are now in dispute. Specifically, the ALJ offered the following recommendations: (1) Rule D3.7b should be revised to require the acceptance by both MGU and the customer, rather than just MGU, of any agency agreement between the utility and a transportation customer. (2) In light of the elimination of MGU's interruptible service rate, all references in category 4 of Rule B4.2 to interruptible sales should be deleted. (3) Because Rule 21 has been superseded by Rule B4.2, all mention of the old rule in paragraph D of Rule D3.6 should be revised to reflect that change. (4) MGU's tariffs should be amended to reflect the fact that Rates T-1 and T-2 are being replaced by Rates TR-1, TR-2, and TR-3. (5) Sheet B-50.00 should be revised to include language changes suggested by the Staff concerning customer deposits. (6) The utility should include in its rate book a tariff sheet, designated as Sheet A-24 and entitled Supplemental Utility Service Charges, listing specific charges for utility service that only MGU can provide to its customers and that are not included in the utility's regular tariffs. (7) The non-sufficient fund check charge should be increased from $10 to $15, as recommended by the utility. (8) The reconnection charge set forth in Rule B6.4 for a customer whose service was discontinued due to nonpayment should be increased from $15 to $20, and the rule should be revised to specifically indicate that it does not apply where disconnections occurred due to theft or meter tampering.[31] (9) Rule B6.2 should be revised to better describe the situations in which a customer can be disconnected without notice, and to better specify the

[31] As noted on Exhibit S-80, Schedule F-8-1, reconnections following theft or meter tampering are covered by Rule B6.2 and result in a reconnection charge of $45.

potential costs and penalties that a customer may incur for theft or meter tampering. (10) Rule B6.5 should be amended to describe in more detail the treatment of customer deposits. (11) Rule B6.7 should be expanded to provide more detail regarding the payment of bills, as suggested by MGU.

No exceptions have been submitted with regard to these 11 recommendations. The Commission finds that they are reasonable and should be adopted.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCL 462.2 et seq.; MSA 22.21 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; MSA 22.1 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; MSA 22.13(1) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACS, R 460.17101 et seq.

b. MGU’s adjusted net operating income is $10,110,000, resulting in a revenue deficiency is $1,704,000.

c. MGU’s rules, regulations, and rate schedules should be revised as indicated in this order.

d. Within 30 days of the date of this order, MGU should notify all sales customers (other than those taking service on its residential and RMFD rate schedules) of the 10,000 Mcf economic break-even point between its large and small general service rate schedules, advise each of these customers as to which general service rate class will be least expensive for it based on the customer’s historical usage, and begin billing it under the terms of that rate schedule unless directed by the customer, in writing and within 45 days of this order, to assign it to a different rate class.

e. Also within 30 days of the date of this order, MGU should notify its transportation customers of the economic break-even points at 50,000 and 225,000 Mcf between Rates TR-1, TR-2, and TR-3. MGU should further advise each customer as to which of these three transportation rate classes will be the least expensive

for it based on the customer's historical usage, and begin billing it under the terms of that rate schedule unless directed by the customer, in writing and within 45 days of this order, to assign it to a different rate class.

f. MGU should begin allowing ATL balance trading, on a prospective basis only and for a fee of $25 per transaction, within 60 days after issuance of this order.

g. Within 60 days of the date of this order, MGU should implement the imbalance paper pooling program approved in this order.

h. Within 90 days of the date of this order, MGU should file an application for approval of all tariff language necessary to establish a service curtailment and gas diversion program and to establish an appropriately structured extreme condition overrun charge.

THEREFORE, IT IS ORDERED that:

A. Michigan Gas Utilities is authorized to increase its rates and charges for gas service by $1,704,000 annually for service rendered on and after the day after issuance of this order.

B. Michigan Gas Utilities shall, within 30 days of issuance of this order, submit a report verifying its creation of an external fund for its liability under Statement of Financial Accounting Standards 106, which shall include amounts collected beginning in 1994 to offset its lowered tax liability, together with interest on those funds at the authorized rate of return on common equity.

C. Michigan Gas Utilities' rules, regulations, and rate schedules shall be revised as provided for in this order to be consistent with those attached as Exhibit A to the original order contained in the Commission's files.

D. Michigan Gas Utilities shall file, within 30 days of issuance of this order, all tariff sheets necessary and appropriate to comply with this order.

E. Within 30 days of the date of this order, Michigan Gas Utilities shall (1) notify its sales customers (other than those taking service on its residential and residential multiple family dwelling rate schedules) and its transportation customers of the economic break-even points established by this order, (2) advise these customers as to which rate class will be least expensive for them based on their historical gas usage, and (3) begin billing those customers on their respective rate schedules unless specifically advised by the customers, within 45 days of this order, to assign them to a different rate class.

F. Michigan Gas Utilities shall, within 60 days of the date of this order, begin allowing transportation customers to trade their authorized tolerance level balances and implement its paper pooling program, all in accordance with the parameters established by this order.

G. Within 90 days of the date of this order, Michigan Gas Utilities shall file an application for approval of all tariff language necessary to establish a service curtailment and gas diversion program and to establish an appropriately structured extreme condition overrun charge.

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, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

(S E A L)

John G. Strand
Chairman

John C. Shea
Commissioner

By its action of March 27, 1997.

Dorothy Wideman
Executive Secretary

David A. Svanda
Commissioner

sive for them based on their historical gas usage, and (3) begin billing those customers on their respective rate schedules unless specifically advised by the customers, within 45 days of this order, to assign them to a different rate class.

F. Michigan Gas Utilities shall, within 60 days of the date of this order, begin allowing transportation customers to trade their authorized tolerance level balances and implement its paper pooling program, all in accordance with the parameters established by this order.

G. Within 90 days of the date of this order, Michigan Gas Utilities shall file an application for approval of all tariff language necessary to establish a service curtailment and gas diversion program and to establish an appropriately structured extreme condition overrun charge.

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, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

____
Chairman

______________________________ By its action of March 27, 1997.
Commissioner

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Executive Secretary

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Commissioner

In the matter of the application of **MICHIGAN GAS UTILITIES** for authority to increase its rates for natural gas service and for other relief. ____________________________________	)))))	Case No. U-10960

Suggested Minute:

> "Adopt and issue order dated March 27, 1997 authorizing MGU to increase its rates by $1,704,000 per year and to revise its rules and regulations regarding the provision of gas service, as set forth in the order."