STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **MICHIGAN CONSOLIDATED GAS COMPANY** for approval of new Dual Fuel Industrial and Large Volume Commercial Rates (Rate Schedule Nos. 4 and 4-I).	Case No. U-7609

At a session of the Michigan Public Service Commission held at its offices in the City of Lansing, Michigan, on the 22nd day of November, 1983.

PRESENT: Hon. Eric J. Schneidewind, Chairperson
Hon. Edwyna G. Anderson, Commissioner
Hon. Matthew E. McLogan, Commissioner

OPINION AND ORDER

History of Proceedings

On March 29, 1983, Michigan Consolidated Gas Company (Applicant) filed an application for approval of two new Dual Fuel Industrial and Large Volume Commercial Rates (Rates Nos. 4 and 4-I). Those two rates would be available to customers who have the capability to burn either fuel oil or propane as an alternative to natural gas. Rates 4 and 4-I (Rate 4) would be set enough below existing natural gas rates to make them competitive with prices for fuel oil and propane. These dual fuel customers would thus have an incentive to continue burning natural gas.

After due notice, a prehearing conference was held on July 6, 1983. At that time, the Administrative Law Judge (ALJ) granted Motions to Intervene by the Association of Businesses Advocating Tariff Equity (ABATE), the Attorney General (AG), the Port Huron Paper Company and Masco Corporation. The ALJ

denied the AG's motion to consolidate this case with similar cases pending before the Commission.

Hearings were held on July 14 and August 9, 1983. Applicant presented the testimony of two witnesses and offered four exhibits. The Commission Staff (Staff) presented the testimony of one witness and offered two exhibits. The AG offered the testimony of one witness. The record consists of 271 pages and six exhibits.

On August 30, 1983, the Commission issued an Opinion and Order granting a motion filed by Applicant for the Commission to read the record. Accordingly, a Proposal for Decision was not prepared. The briefs filed by the parties on August 31, 1983 were submitted directly to the Commission.

Summary of Evidence

Applicant presented testimony that it has already lost approximately 9 billion cubic feet (Bcf) of industrial load and expects to lose as much as another 17 Bcf unless Rate 4 is approved. The industrial load has been lost because of the price of natural gas. Currently, under Rate Schedule 1, natural gas costs approximately $6.00 per million Btu, and under Rate Schedule 7, it costs approximately $5.50 per million Btu. No. 6 fuel oil, on the other hand, costs approximately $4.00 per million Btu. Even more expensive No. 2 fuel oil is only $6.00 per million Btu. Rate 4, if approved as requested by Applicant, would price gas at between $4.00 and $4.25 per million Btu. To be competitive with No. 6 fuel oil, natural gas does not have to be priced lower. In fact, it can be priced somewhat higher. Industrial users are willing to pay a premium for gas, because it burns cleaner, is easier to control, requires no inventory, burns better at low loads and causes less need for maintenance.

Rate 4 would benefit Applicant's customers on other rates because Rate 4 would recover the total incremental cost of gas and include a spread which would

help to pay fixed costs which would otherwise be paid by Applicant's other customers. Retention of the industrial load would also reduce Applicant's exposure to take-or-pay penalties.

Applicant presented testimony that the rate would not be available to all customers. Only customers with a capacity of 50,000 Bcf per hour or more would be eligible for the rate. Further, customers applying for the rate would be required to sign an affidavit stating that, except for the rate, they would burn an alternative fuel. Finally, the rate would be available only until the end of October 1984. At that time, Applicant would need Commission approval to continue the rate. This would provide an opportunity to reevaluate the effect of the rate and decide whether it should continue in light of market conditions at that time.

On cross-examination, Applicant's witness conceded that on a fully allocated cost of service basis Rate No. 4 could not be justified. But he maintained that the rate was nevertheless beneficial to Applicant, its industrial customers and customers who would not be eligible for Rate 4.

The Staff's witness supported Applicant's need for a special rate, but proposed a different rate schedule. Rather than a rate which would vary in relationship to the price of No. 6 fuel oil, the Staff proposed a fixed rate.

Applicant would benefit because it could obtain up to $23,800,000 in revenues that would be lost if additional industrial load left the system. That money could be used to cover Applicant's fixed expenses. Customers on this rate would benefit by obtaining a lower price for gas. Customers who were not eligible for the rate might benefit as well. Under the Staff's proposal, if the cost of providing the gas to industrial customers were below the fixed price, a credit would be generated which would be distributed among Applicant's other customers in the gas cost recovery (GCR) reconciliation proceedings. If the

cost of providing the gas were to rise above the fixed level, Applicant would sell the gas at a loss, but Applicant's shareholders would bear the loss.

The AG's witness testified to the effect that Applicant's proposal constitutes an illegal automatic adjustment clause.

Discussion

The natural gas market has undergone dramatic changes in recent years. It has gone from a time of low prices and shortages to a market characterized by high prices and surpluses. More important to this proceeding is the reversal in the traditional relationship between natural gas prices and No. 6 fuel oil prices. Fuel oil is now cheaper than natural gas. It is particularly difficult at this time to predict developments in the natural gas market during the next several years.

It is against this background that Applicant has proposed a special, temporary rate. Commission approval of the rate will enable Applicant to retain its industrial load, at least temporarily, and "buy time" to seek a long-term solution to the loss of industrial load. The rate by its terms will expire at the end of October 1984. By then, it may be possible to predict more accurately the direction of the natural gas market. It may be best at that time to allow industrial customers to leave the system. On the other hand, it may be possible to retain industrial customers without offering special rates. For those reasons, the Staff has supported Applicant's proposal.

If no special rate is approved, Applicant will lose additional industrial load and Applicant's revenues will drop. The effect on Applicant's remaining customers will be neutral until the Commission approves Applicant's next rate increase. At that time, rates for Applicant's other customers might have to increase to cover Applicant's fixed expenses.

A rate such as that proposed by the Staff can benefit Applicant, its

industrial customers and its other customers, at least in the short run, while preserving the possibility that all will benefit in the future as well. In the short run, Applicant can collect as much as $23,800,000 in distribution charge revenues that are built into the "spread" in the proposed rate. That will strengthen Applicant's financial condition. Applicant's industrial customers can obtain natural gas at a price competitive with the price of their alternative fuels. Applicant's other customers receive the benefit of lower rate increases in the future and may receive the current benefit of up to $3,800,000 in credits generated by the difference between the new industrial rate and the cost of purchasing gas for these industrial customers. Retaining the industrial load also helps to reduce Applicant's exposure to take-or-pay penalties, and that is desirable, whether those penalties are paid by Applicant's ratepayers, its shareholders or are split between them. It also provides an additional buffer of customers on interruptible service, which is useful in meeting peak day demand and setting curtailment volumes.

The effect of approval of the rate in the long run is less clear, but the rate must be reevaluated in 1984. At that time, the Commission can determine whether it is appropriate to continue the rate.

The Commission has concluded that the Staff's proposal with minor modifications should be approved. The Commission agrees with the suggestion that Applicant should require customers on the rate to be able to demonstrate their ability to switch to an alternative fuel. The Commission also agrees that the parties to this case should be free to request a reopening in the event that the price of alternative fuels changes. If these prices rise, there may be a need to increase the rate so that customers on the rate do not obtain a windfall through the use of cheap gas. If the price of alternative fuels drops dramatically, there may be a need to decrease the rate to make it competitive again.

The Commission does not agree that a customer who relies upon the rate and foregoes a long-term alternative fuel contract should be able to qualify for the alternative rate for the term of the foregone contract. A customer who chooses the rate is not required to make a long-term commitment to buy gas at that price regardless of how low the price of alternative fuels falls. Corresponding to this right is the burden that a customer who chooses the rate cannot remain on it if the price of alternative fuels rises above the cost of gas on the customer's existing rate schedule. In other words, the price of alternative fuels would _not_ cause the customer to cease using natural gas, and the customer becomes ineligible.

The AG is the only party to oppose adoption of a special industrial rate. He argues that the rate is unreasonably discriminatory, that it constitutes the worst abuses of monopolistic pricing, that it usurps the authority of the Commission to set rates, that it is an illegal automatic adjustment clause and that it illegally removes revenues from the gas cost recovery (GCR) proceedings.

The AG's argument that all gas costs and gas revenues must be part of the GCR clause and factors has been considered in the context of the GCR clause and plan cases. The argument was rejected then and the Commission rejects it now. Applicant's GCR Clause provides that all rates "unless otherwise provided" will include a GCR factor. The intent of that phrase was to allow flexibility to exclude some rates from the GCR process.

The AG's argument that Applicant's plan constitutes an illegal automatic adjustment clause is moot. The Staff's proposal which is adopted contains no adjustment of the price of gas.

The AG argues that this rate, if adopted, would usurp the authority of the Commission to set rates and would constitute an undesirable precedent. The argument is that approval of the rate allows Applicant to select a particular low-

priced source of gas as a supply for only certain of its customers. The AG argues that all gas from all sources must be rolled into one average-priced gas. That argument ignores the purpose of the rate. Applicant's current average cost of gas is high enough that industrial load will be lost. That load can be retained only at a lower price. Further, the Staff's proposed rate is not set on the basis of the cost of any particular source of gas. It is set to be competitive with the cost of alternative fuels. Only the credit is a function of the cost of gas from a particular source.

There is no substance to the AG's argument that the rate usurps the Commission's authority to set rates. The Commission, and not Applicant, is setting the rate.

The AG argues that the rate constitutes an abuse of monopolistic pricing. Customers who are most likely to leave the system will be charged a lower price and customers who are captive will be charged a higher price. The ability of some customers to leave the system quickly and at little cost to themselves is, of course, what this proceeding is all about. If the higher price is charged to industrial customers who have the ability to use alternative fuels, they will leave the system. They can be retained only by charging a price which is competitive with alternative fuels. Applicant, the Staff and the Commission are not responsible for that fact of economic life. The Commission is adopting the rate only as a short-term effort to remedy the effects of this market condition.

The AG argues that the rate is unreasonably discriminatory because the ability to burn fuel oil is not related to the cost of providing natural gas service, the rate discriminates between residential and industrial customers, and the rate discriminates between those who use more than 50,000 cubic feet per hour and those who use less. The AG supports the argument with a reference to MCLA 460.557 which forbids charging different electric rates for "like contemporaneous service

rendered under similar circumstances and conditions" and by reference to court decisions from other states which prohibit discrimination between customers receiving the "same service under like circumstances." While there are no Michigan statutes prohibiting discrimination in gas rates and there are no Michigan cases directly on point, the Commission is committed to the principle that there shall be no unreasonable discrimination between customers receiving natural gas service. But as the AG's citations indicate, when the service is different or supplied under different circumstances, different rates can be justified. A review of court decisions from other jurisdictions supports the principle that rate discrimination is illegal only when it is not based on a difference in cost of service or other rational basis. See, for example, New York State Council of Retail Merchants v Public Service Commission, 45 NY 2d 661, 384 NE 2d 1282 (1978); Associated Electric Cooperative, Inc. v Morton, 507 F 2d 1167 (1974); City of Frankfort, Indiana v FERC, 678 F 2d 699 (1982); Wisconsin Association of Manufacturers v Public Service Commission, 287 NW 2d 844 (Wisc Ct of Appeals, 1979). A distinction between customers that can burn only natural gas and customers that can readily switch to alternative fuels is not an irrational distinction. The distinction is particularly justified when the purpose is to retain industrial load to reduce the burden upon ratepayers who cannot readily switch.

The Commission does agree that the proposed distinction in Applicant's rates between those who use more than 50,000 cubic feet per hour and those who use less is not supported on the record as having a rational basis. Accordingly, the Commission declines to adopt that restriction. Without that restriction, any customer that has the capability to burn an alternative fuel and can meet the other requirements of the proposed tariff will be able to take advantage of the rate. This change answers the AG's argument that the rate unreasonably discriminates

between residential, industrial and commercial customers.

The AG also argues that the special rate will send the wrong signals to gas producers and gas suppliers. Because more gas will be sold under the rate than would otherwise be sold, producers and suppliers may conclude that even high-priced gas can be sold. The Commission believes that in relationship to the total U.S. natural gas market, the quantity that will be sold under the rate is too small to make a difference to suppliers or producers. Furthermore, Applicant is under a continuing duty to take reasonable steps to keep down its overall cost of gas. Only reasonable and prudent costs are recoverable through the GCR mechanism. Finally, if the AG's argument were accepted, Applicant and therefore the suppliers and producers would sell somewhat less gas. But that would not have the effect of materially decreasing the price which Applicant's other customers would pay for gas and it would increase their share of Applicant's fixed costs.

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCLA 462.2 et seq.; 1919 PA 419, as amended, MCLA 460.51 et seq.; 1939 PA 3, as amended, MCLA 460.1 et seq.; 1969 PA 306, as amended, MCLA 24.201 et seq.; and the Commission's Rules of Practice and Procedure, 1979 Administrative Code, R 460.11 et seq.

b. Applicant has lost industrial customers and risks losing additional industrial load.

c. A rate designed to retain dual fuel customers is reasonable and justified.

d. The Staff's proposal as modified in this Opinion and Order reasonably balances the interests of Applicant, its dual fuel customers and other customers.

THEREFORE, IT IS ORDERED that Michigan Consolidated Gas Company is authorized to implement a new alternate discount rate, a copy of which is attached

hereto as Exhibit A, effective November 23, 1983.

The Commission specifically reserves jurisdiction of the matters herein contained and the authority to issue such further order or orders as the facts and circumstances may require.

Any party desiring to appeal this order must perfect an appeal to the Ingham County Circuit Court within thirty (30) days after issuance and notice of this order, pursuant to MCLA 462.26.

MICHIGAN PUBLIC SERVICE COMMMISSION

/s/ Eric J. Schneidewind
Chairperson

(S E A L)

/s/ Edwyna G. Anderson
Commissioner

/s/ Matthew E. McLogan
Commissioner

By the Commission and pursuant to its action of November 22, 1983.

/s/ Thomas R. Lonergan
Its Secretary

EXHIBIT A

ALTERNATE DISCOUNT RATE

AVAILABILITY:

Available to any customer who has installed capability to use an alternate fuel in place of natural gas and who can obtain that fuel at a price which would cause the customer to cease using natural gas. To become eligible for this rate schedule, the customer must have been taking service on a different rate schedule of the company and must have executed an affidavit certifying the customer's eligibility. To remain eligible for this rate schedule, the customer must continue to be able to obtain the alternate fuel at a price which would cause the customer to cease using natural gas and must re-execute its eligibility affidavit at least once every 90 days. A customer may be required to demonstrate its ability to switch to an alternate fuel.

CUSTOMER CHARGE:

This rate schedule has no customer charge per se, but the customer must continue to pay the customer charge of the rate schedule on which the customer was taking service at the time the customer became eligible for this rate.

COMMODITY CHARGE: $4.25 per Dth.

GAS COST RECOVERY:

This rate is not subject to adjustments for fluctuations in the cost of purchased gas as stated in Rule No. 30 of the applicable Rules, Regulations, and Rates, M.P.S.C. No. 3 of the Company.

TERMINATION:

This rate will not be available for gas service rendered on and after November 1, 1984.

COST OF GAS CREDIT:

If the commodity charge in this rate schedule is greater than the sum of: (1) the cost of gas from Michigan Wisconsin Pipe Line Company's Rate Schedule MC-1 commodity rate, (2) the distribution charge in the rate schedule on which the customer previously received gas service, and (3) supplemental charges set forth on Sheet No. S-1; then a credit will be made

to customers on all other rate schedules of the Company. The amount to be credited will be the product of the difference between the commodity charge and the above mentioned sum, multiplied by the sales volume on this rate schedule. This credit will be used as an offset to the cost of gas in a GCR Reconciliation proceeding.

ALTERNATE FUEL CHARGE:

If the customer is subject to the Incremental Pricing provisions of the Natural Gas Policy Act of 1978 and if the price published by the Energy Information Administration for High Sulfur No. 6 Fuel Oil is greater than the commodity charge on this rate schedule, then the customer will also be charged an alternate fuel charge. This alternate fuel charge will be the product of the difference between the price published by the Energy Information Administration and the commodity charge, multiplied by the sales volume which is subject to the Incremental Pricing provisions. This alternate fuel charge will be refunded in accordance with the provisions of the Michigan Public Service Commission's Order of December 11, 1979 in Case No. U-6178.

LATE PAYMENT CHARGE AND DUE DATE:

A late payment charge of 2% of the bill, net of taxes, not compounded, may be added to any bill which is not paid on or before 21 calendar days from the date of mailing.

SPECIAL TAXES:

(a) In municipalities which levy special taxes, license fees, or street rentals against the Company, and which levy has been successfully maintained, the standard of rates shall be increased within the limits of such municipalities so as to offset such special charges and thereby prevent the customers in other localities from being compelled to share any portion of such local increase.

(b) Bills shall be increased to offset any new or increased specific tax or excise imposed by any governmental authority upon the Company's production, transmission or sale of gas.

STANDBY SERVICE:

(a) Definition: "Standby" service is defined as that gas service provided by Michigan Consolidated Gas Company which is capable of being used in place of the primary energy source and is normally used only for emergencies.

(b) Surcharge: A customer taking standby service for a facility or equipment under this rate schedule shall pay a monthly charge equal to 6.5¢/cf or $65/MMBtu for each cf or MMBtu of nameplate rating of the facility or equipment taking standby service.