

S T A T E   O F   M I C H I G A N  
B E F O R E   T H E   M I C H I G A N   P U B L I C   S E R V I C E   C O M M I S S I O N

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In the matter of the application of  
MICHIGAN CONSOLIDATED GAS COMPANY for  
authority to file a revised rate sched-  
ule.

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Case No. U-7895

At a session of the Michigan Public Service Commission held at its offices  
in the city of Lansing, Michigan, on the 26th day of June, 1985.

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

OPINION AND ORDER

I.

HISTORY OF PROCEEDINGS

On February 10, 1984, Michigan Consolidated Gas Company (Mich Con) filed an application, together with supporting testimony and exhibits, seeking to increase its natural gas rates by approximately \$85,700,000 annually. Mich Con subsequently revised its rate request downward to approximately \$83,500,000, and finally downward to \$62,300,000. Mich Con properly served and published a notice of hearing in its service area.

Prehearing conferences were held on April 16 and June 1, 1984. Administrative Law Judge George Schankler (ALJ) presided at the prehearing conferences and all subsequent hearings. Attorney General Frank J. Kelley (Attorney General), the Association of Businesses Advocating Tariff Equity (ABATE), Michigan Business Utility Users Committee (MBUUC), Port Huron Paper Company (Port Huron) and Total

Petroleum Company (Total) were granted intervenor status at the first prehearing conference, while Enterprise Oil Company (Enterprise), Lakeside Refining Company (Lakeside) and Crystal Refining Company (Crystal) were granted such status at the second prehearing conference. Traverse City Light and Power Board (Traverse City) was granted intervenor status on July 18, 1984. The Commission Staff (Staff) also participated.

At the June 1, 1984 prehearing conference, Mich Con indicated that it would withdraw its Case No. U-7719, which addressed senior citizen rates and increased reconnect charges. Mich Con also agreed to publish a supplemental notice indicating that issues which were to be considered in Case No. U-7719 would now be considered in Case No. U-7895.

Hearings were held on April 19, 1984 in Detroit and Ypsilanti and on April 25, 1984 in Muskegon for the purpose of allowing members of the public to make their views known. Six members of the public spoke at the Detroit hearing, one at the Ypsilanti hearing, and seven at the Muskegon hearing.

Cross-examination of Mich Con's prefiled direct case began on July 2, 1984 and continued through July 18, 1984. Cross-examination of the Staff and intervenor witnesses commenced on September 4, 1984 and concluded on September 13, 1984. Rebuttal testimony was filed by Mich Con and ABATE and that testimony was cross-examined on October 24 and 25, 1984. The Staff filed surrebuttal testimony on October 22, 1984, but this testimony was later withdrawn. The record in this proceeding, which consists of 23 transcript volumes containing 3,088 pages and 105 exhibits, was closed on October 25, 1984.

Mich Con, the Attorney General, the Staff, Port Huron, ABATE, Total, Traverse City and Lakeside filed briefs on December 10, 1984. MBUUC filed its brief on December 14, 1984. Mich Con, the Staff, the Attorney General, Port Huron and Traverse City filed reply briefs on January 14, 1985. ABATE filed a

reply brief on January 17, 1985.

The ALJ issued a Proposal for Decision (PFD) on March 7, 1985, recommending a rate increase of \$25,623,000 annually. Mich Con, the Attorney General, the Staff, Total, ABATE and Traverse City filed exceptions.

On May 9, 1985, the Attorney General filed a Motion to Reopen Record (Motion I). Mich Con filed its response to Motion I on May 28, 1985.

On June 17, 1985, the Attorney General filed a second Motion to Reopen Record (Motion II).

## II.

### DESCRIPTION OF MICH CON

Mich Con furnishes natural gas at retail to approximately 1,000,000 customers in Michigan. It serves about 68,000 non-residential general service customers, 965,000 residential customers, 160 large-volume firm industrial customers, 196 interruptible customers and about 265 school customers. Its service area includes Detroit, Grand Rapids and Ann Arbor, as well as communities in the central and northern sections of the Lower Peninsula and the central and eastern sections of the Upper Peninsula. Mich Con's current gas rates are those set by the Commission in its order in Case No. U-7298 dated November 9, 1983.

## III.

### TEST YEAR

In each rate case it is necessary to select a test period which can be used to determine the appropriate level of revenues and expenses. Those levels can then be adjusted for known or projected changes in revenues and expenses. In this way, the adjusted operating results of the test period should be representative

of the future and should, therefore, provide a reasonable basis upon which to predicate rates that will be effective in the future.

Mich Con employed the 12 months ended June 30, 1983 as the historical test period in this proceeding, and all parties, including Mich Con, utilized a projected test year ended June 30, 1986 as the period during which rates determined in this case will be effective.

The ALJ accepted the position of the parties and based his findings on the premise that the rates developed in this proceeding should represent conditions which will exist during the 12-month period ending June 30, 1986. The Commission agrees that the projected test year proposed by the parties is appropriate.

#### IV.

#### RATE BASE

##### Net Utility Plant

Net utility plant is the capital invested in new and useful plant, less depreciation. In this proceeding, the ALJ determined that the Staff's method of calculating net plant additions was reasonable and that net plant, accordingly, should be set at \$834,495,000. No party excepted to that figure, and the Commission concludes on the basis of the record that that figure is appropriate.

##### Working Capital

Working capital is that amount of funds required to bridge the gap between the time of payment of a utility's expenses and the receipt of revenues from its customers. The proper methodology for determining working capital allowance has been a controversial item in recent Mich Con rate cases. The controversy, however, has been resolved since the Commission approved the balance sheet method in its Opinion and Order in Case No. U-7350 dated June 11, 1985. In that case,

the Commission determined that a fair and equitable rate base is one that reflects the cost of all the assets used by a utility to provide its ratepayers with utility service, but only to the extent that the cost of such assets were provided by funds supplied by investors which participate in or have a call on the earnings of the utility company (order, page 7). Although that order did not require the use of the balance sheet method in currently-pending cases, the Commission believes that the use of that approach is warranted in this proceeding based on the record evidence and the fact that all of the parties have agreed that the balance sheet method is the most appropriate measure of working capital requirements.

Following the balance sheet methodology, the ALJ determined that \$53,088,000 provided an adequate allowance for working capital which constitutes the Staff's recommended allowance of \$51,703,000, plus \$1,385,000 associated with an accrued common stock dividend offset. The parties, however, disagree on three issues underlying that determination.

Mich Con argues that the ALJ erred in adopting an offset for accrued federal income taxes in his balance sheet working capital calculation. Mich Con agrees that while such an offset normally would be made to a balance sheet working capital calculation, it is not appropriate in this proceeding since Mich Con suffered a taxable loss during the historical test period and also during calendar year 1983. Consequently, Mich Con argues, ratepayers could not have provided the funds for the accrual and no cash benefit would have occurred. Since shareholders would have been required to fund any accrual to this account, an offset is inappropriate, it contends.

The Staff, ABATE and the Attorney General argue that there is, in fact, a cash flow benefit resulting from the accrual of current federal income tax accounts. According to these parties, all liabilities, including accrued income tax, are sources of funds and therefore, by definition, provide cash flow

benefits. They maintain that the critical question is whether the funds provided by these accrued taxes are interest free or provided at a cost to Mich Con. Since Mich Con is not required to pay interest on this balance, the Staff, ABATE and the Attorney General contend, these funds are provided interest free and should be used as a working capital offset.

The Staff, ABATE and the Attorney General also argue that the fact that Mich Con suffered a tax loss during the historical test year is irrelevant. The Staff and Mich Con have projected that there will be taxable income in the test year ended June 30, 1986. Since there is no controversy over whether the taxable income will be realized, an adjustment to the historical working capital requirement is justified.

The Commission agrees with the arguments presented by the Staff, ABATE and the Attorney General. The purpose of this proceeding is to establish rates based upon those circumstances which are likely to exist during a projected test period. Although the historical test period is important, its value lies in forecasting conditions reasonably expected to exist during the projected test period. When the facts and circumstances in the historical period are not representative of those anticipated in the projected test year, adjustments should be made. Only in that way can the Commission set reasonable and just rates. Accordingly, since a taxable gain is presumed by Mich Con and since accrued taxes do not participate in or have a call on earnings, an offset for accrued income tax in the amount of \$22,420,000 is appropriate.

Mich Con also argues that the ALJ erred in failing to properly include conservation program-related working capital. Mich Con believes this policy of isolating elements of cost of service related to conservation programs is selective rather than comprehensive. It also believes that the policy is inappropriate since it could easily result in conservation cases being transformed into

complex proceedings requiring the same effort as a general rate case. Finally, Mich Con argues, this proceeding offers the only opportunity to recover these legitimate costs of providing service.

The Staff maintains that this adjustment is necessary to be consistent with prior rate cases. In past cases, according to the Staff, working capital for conservation programs has been excluded by not recognizing conservation-related operation and maintenance (O&M) expenses in the calculation of formulistic working capital. However, when using the balance sheet method, this specific adjustment is necessary.

The ALJ concluded that it is appropriate, wherever possible, to segregate conservation program expenses from general rate case expenses. Since the Staff had identified \$333,000 as the amount of working capital requirement which is associated with the conservation programs, that amount should constitute an offset against Mich Con's working capital requirement.

The Commission agrees with the ALJ that \$333,000 of conservation program-related working capital should be excluded. In reaching its decision, the Commission has considered Mich Con's arguments and found them unpersuasive. First, the Commission has never allowed Mich Con to collect working capital cost of conservation programs through gas utility rates and is not prepared to do so at this time. Accordingly, even though this may appear to be a selective adjustment, it is necessary to maintain previous Commission policy. The Commission agrees with the Staff that the \$333,000 exclusion represents a reasonable and conservative estimate of conservation program working capital. While it may not be entirely precise, it is an appropriate estimate given the data available. Finally, the Commission notes that since Mich Con has never recovered the cost of conservation program working capital in rate cases, its argument that adjustment in this proceeding will eliminate any opportunity for such

recovery is ingenious.

The remaining working capital issue in controversy is the ALJ's treatment of accrued common stock dividends. The Staff used these dividends as a working capital offset. Again, to the Staff, the critical question is whether the funds provided by the accrual are interest free or provided at a cost to Mich Con. According to the Staff, the benefits are, in fact, interest free. Since there is no cost to Mich Con, the Staff proposes an offset of \$1,385,000. The Attorney General has supported the Staff's position.

Mich Con maintains that there is no economic difference between these accrued dividends and other retained earnings on a balance sheet; the difference is in name only. Accrued dividends are a segregation on the company's books of a portion of retained earnings, earmarked for, but not yet paid to, shareholders. Mich Con argues that the fact that shareholders may be granted a legally enforceable right as a result of a declaration of a dividend is not relevant (20 Tr. 2467). The only cash flow difference occurs upon payment when the shareholder receives the dividend. Accordingly, if accrued dividends are not recognized as investor-supplied funds, shareholders will not be compensated for the use of these funds between the time the dividend is declared and characterized as an accrued dividend for accounting purposes and the time dividends are paid.

The ALJ accepted Mich Con's arguments. He determined that the act of declaring a dividend and the timing of that act do not provide Mich Con with any additional working capital but, as Mich Con points out, simply segregate a portion of Mich Con's equity, retained earnings, for the purpose of paying out dividends at some future date.

A review of the economic impact of accrued common stock dividends convinces the Commission that the Staff's treatment is correct. Because accrued dividends are the property of the stockholders, there might be some basis for the contention



that there is interest cost related to these funds and excluding the accrual from working capital offsets. This contention is negated, however, when one considers that accrued dividends are, in fact, quite different from common equity. When dividends are declared, the company creates an obligation to pay dividends where no prior obligation existed. The existence of this obligation transforms a portion of the company's common equity into a liability, thereby requiring a reduction in its common equity and an increase in its accrued dividend liability. In that sense, dividends are indistinguishable from any other liability of the company and should therefore be used as a working capital offset.

In reaching its conclusion, the Commission also notes the Staff's concern over potential double counts in Mich Con's favor. Mich Con expressed disbelief that fiscal changes in equity ratios associated with the average balance of accrued dividends could possibly be taken into account in the Staff's equity percentage. Nevertheless, the Commission believes that the increase in the return required by investors is intended to properly balance the reduction of working capital. Since accrued dividends are a liability, are interest free and pose a potential risk of double count, the Commission finds that \$1,385,000 related to the dividends should be used to offset working capital.

Based on the discussion above, the Commission finds a rate base of \$886,198,000, computed as follows:

|                                     |                  |
|-------------------------------------|------------------|
| Plant in service                    | \$1,437,671,000  |
| Construction work in progress       | 31,308,000       |
| Accumulated depreciation            | (629,259,000)    |
| Retained from contractors           | (209,000)        |
| Customer advances for construction  | (3,851,000)      |
| Disallowance for conversion costs   | (661,000)        |
| Surplus plant                       | <u>(504,000)</u> |
| Net Total for Net Gas Utility Plant | \$ 834,495,000   |

Calculation continues . . .

|   |                       |
|---|-----------------------|
| Cash  | \$ 10,035,000         |
| Accounts receivable net                       | 260,089,000           |
| Unbilled revenue                              | 57,572,000            |
| Gas and underground storage                   | 29,158,000            |
| Material and supplies                         | 8,755,000             |
| Prepayments                                   | 1,890,000             |
| Property taxes                                | 16,507,000            |
| Other current and accrued assets              | 1,736,000             |
| Deferred debits                               | <u>3,773,000</u>      |
| Total Assets                                  | \$ 389,515,000        |
| Accounts payable                              | \$ 146,506,000        |
| Refunds to customers -- Interest              | 8,619,000             |
| Accrued taxes                                 | 57,872,000            |
| Interest                                      | 9,671,000             |
| Other current and accrued liabilities         | 109,157,000           |
| Other deferred credits and operating reserves | <u>5,654,000</u>      |
| Total Liabilities                             | \$ 337,479,000        |
| Adjusted working capital                      | 52,036,000            |
| Conservation programs working capital         | (333,000)             |
| Unadjusted working capital                    | 51,703,000            |
| Rate Base                                     | <u>\$ 886,198,000</u> |

## V.

### RATE OF RETURN

In order to calculate Mich Con's income requirement, it is necessary to select a rate of return to be applied to Mich Con's total rate base. Rate of return is the product of a capital structure and the assignment of a return value to each component of the capital structure. Mich Con's overall rate of return request is 10.07%, while the Staff recommends a range of overall return between 9.26% and 9.41%. The Attorney General has endorsed the Staff's calculation of overall rate of return. The parties have been able to agree on all issues surrounding the appropriate capital structure. The Commission has reviewed the record as it pertains to these uncontested issues and concludes that the capital structure agreed to by the parties is appropriate (see page 17).

The parties also agreed in large part with the cost to be assigned to each component of the capital structure. They were unable to agree, however, on the cost to be assigned to Mich Con's return on common equity. Thus, a full discussion of this issue is warranted.

Mich Con's present authorized rate of return on common equity is 14.82%. For purposes of this proceeding, Mich Con proposes a rate of return on common equity of 17.5%. The Staff argues that the appropriate range of return is 14.8% to 15.3%. The Attorney General, the only other party to take a position on the issue, adopted the Staff's recommendation.

Both Mich Con and the Staff used a discounted cash flow (DCF) analysis. This approach is based on the hypothesis that the current required rate of return on an investment is equal to the current anticipated yield plus future growth. Although the approaches followed by Mich Con and the Staff in determining the proper rate of return on common equity share a number of similarities, differences exist in the application of the approach and, thus, the results reached.

Mich Con's position was presented by its witness, Dr. Charles E. Olson. Dr. Olson conducted several DCF studies. The first study included 13 companies which Dr. Olson deemed to be comparable in risk and character to Mich Con. In reviewing the dividend yields during the six-month period ended November 1983, and by analyzing the five- and ten-year growth rate of earnings and dividends in relation to the booked value of the stock of the 13 companies, Dr. Olson determined that the total investor requirement for the group was 15.6% to 16.1% based upon a dividend yield of 9.6% and an estimated investor expectation of growth of 6.0% to 6.5%.

Dr. Olson also performed two additional DCF analyses and arrived at similar or greater results. His analysis of People's Energy & Pacific Lighting resulted in a range of return of 17.1% to 17.8%, and his analysis of the group of 18 gas

distribution companies analyzed by the Staff in Case No. U-7298 resulted in a range of return of 16.2% to 16.7%. Finally, Dr. Olson conducted a DCF analysis of Primark, Mich Con's parent company, and found an investor requirement of 17.4%.

In addition to the DCF analyses, Dr. Olson ran a "debt equity risk premium study." This study attempts to measure the difference, or risk premium, between a company's debt rate and return on equity. Dr. Olson found a 5.5% gap between debt yield and yield on common equity, and adding this 5.5% to Mich Con's 12.5% current bond yield produced an 18% required return on common equity.

Based on the studies he had undertaken, Dr. Olson concluded that an investor requirement of approximately 16.5% to 17.0% was required. To that figure, Dr. Olson recommended the addition of 10% to account for financing costs and market pressures on the basis that this is necessary to ensure that the net proceeds of any sale of common stock would equal its booked value. Thus, according to Dr. Olsen, a return of 17.5% is required.

The Staff's DCF analyses began with the study of 18 natural gas distribution companies which its witness, Brian Ballinger, deemed comparable to Mich Con. Comparability was determined on the basis of a beta factor, earnings coverage, market-to-book ratio and equity ratio. Mr. Ballinger also performed a DCF analysis of a narrower group of 13 utilities using the criterion that at least 90% of the revenues were derived from natural gas distribution business. Finally, Mr. Ballinger completed a DCF study of Primark.

In performing his DCF analyses, Mr. Ballinger calculated the dividend yield average for the months of April through June 1984. He thus determined that the yield for the group of 18 utilities was 9.40%. For the group of 13 companies, the dividend yield was calculated to be 9.31%. Mr. Ballinger assumed a growth rate of 5.5% to 6.0% based on application of a statistical technique of regression analysis, a review of compound growth over the past one, five and ten years

and a review of short-term projections of growth for each gas company in the 18- and 13-company groups. An analysis of dividend yield and growth rate for these two company groups thus resulted in a recommended range of return of 14.8% to 15.3%. Mr. Ballinger's study of Primark assumed a 6.85% dividend yield and a 7.72% growth rate, which resulted in a 14.75% rate of return on common equity.

As a means of checking his other results, Mr. Ballinger also performed a capital asset pricing model (CAPM) study of return on common equity. The CAPM study resulted in a range of return of 15.0% to 15.3%.

Mr. Ballinger rejected the addition of a 10% margin to cover financing costs and market pressure adjustments. His rejection of this adjustment was based on the fact that Mich Con had no plans to issue new common stock during the near term. He also was of the opinion that market pressure does not exist.

The ALJ rejected Mich Con's suggested return of 17.5%. He concluded that the more recent data employed by the Staff tended to be more reflective of conditions during the time that the rate established in this proceeding would be in effect. Accordingly, he found that a range of return on common equity of 14.8% to 15.3% was reasonable and appropriate. Although the ALJ also rejected Mich Con's argument with respect to financing costs and market pressure, he adopted its argument as to the effect of a lower equity ratio. To neutralize this effect, the ALJ recommended an adjustment of .5% in Mich Con's favor. In his final recommendation, the ALJ suggested that rate of return on common equity be set at 15.5%, which is just below the midpoint of the range he had established.

Mich Con excepted to the ALJ's recommendation and set forth several specific arguments. First, Mich Con maintains that there is no record evidence to support the assumption that marginally more recent statistics on dividend yields are somehow more representative of future dividend yields. According to Mich Con, neither the Staff's witness, nor any other witness, analyzed any facts which

would tend to show, as the Staff alleged, that a decline in interest rates would have any impact at all on equity cost for natural gas companies.

Mich Con also argues that the Staff's use of one-year dividend growth rates is of very little value in assessing investor growth expectations because they reflect one-time arbitrary dividend decisions (which may be related to such happenstance as warmer than normal weather) much more so than five- and ten-year composites. Mich Con maintains that over a longer period of time dividend decisions balance out and thus provide a more rational basis for growth expectations. Consequently, Mich Con asserts that the one-year growth statistics used by the Staff should be given little, if any, weight.

Mich Con next argues that the ALJ's decision is flawed in that it gave weight to Staff witness Ballinger's CAPM check. Mich Con contends that Mr. Ballinger admitted in his direct testimony that even the smallest of changes in the base period used in the model produces significant changes in result (18 Tr. 2188). Since the choice of a specific time period is arbitrary and because such an arbitrary decision can have a significant impact on the results, the methodology, according to Mich Con, is misleading, if not worthless.

Finally, Mich Con contends that the most significant flaw in the ALJ's recommendation is the fact that he ignored market pressure and financing costs. Mich Con argues that allowing an increment in return only when stock is issued does not even provide recovery of the costs of that issue that are supposed to be allowed. This is because recovery through allowed return on equity occurs over the life of the stock issued. Since issuance costs are not allowed as an operating expense in the year of financing, an adjustment in the rate of return on common equity is the only way that provides a mechanism for recovery of this legitimate cost.

The Commission is unpersuaded by Mich Con's arguments. The Staff's statistics on dividend yields are not simply marginally more recent. They are, in fact, more reflective of economic realities for both groups of companies studied during this proceeding than those proposed by Mich Con. Accordingly, they should be accepted.

The Commission is also unprepared to reject the Staff's recommended return solely on the basis of its use of one-year growth rates. The fact is, the Staff utilized not only one-year dividend growth rates but also analyzed dividend growth over five- and ten-year periods. While the Commission might have accepted Mich Con's argument had the Staff's recommendation been based only upon a single one-year measure, the additional considerations are more than sufficient. For the same reason, the Commission does not accept Mich Con's argument with regard to the ALJ's giving some measure of weight to Staff witness Ballinger's CAPM check.

Finally, the Commission does not agree that the rate of return on common equity should be adjusted to accommodate Mich Con's financing costs and market pressures. Mich Con set forth no plans to issue new common stock in the immediate future, thus it faces no financing costs. Moreover, if properly performed, the DCF analysis and other studies should produce a rate of return which accounts for all factors inherent in investor expectations regarding yield and growth, including market pressure. Thus, no specific adjustment in rate of return on common equity for these factors is necessary.

The Staff and the Attorney General have also excepted to the PFD. Specifically, they argue against a .5% addition to rate of return on common equity to account for the lower equity ratio experienced by Mich Con as a result of the transfer of leased storage facilities to Primark. According to the Staff, the ALJ is not necessarily correct in his conclusion that a higher equity ratio

would increase the overall rate of return to Mich Con and, thus, the cost to ratepayers. The Staff believes, moreover, that by agreeing with Mich Con's position in allowing the addition, ratepayers will be required to pay more now and they will have to pay more in the long run. Finally, the Staff and the Attorney General argue that the ALJ's recommendation sanctions Mich Con's management decision to not improve the financial position of its core utility business and to, instead, send most of Mich Con's earnings in the form of dividends to Primark for investment in non-utility business.

The Commission believes that the Staff and the Attorney General are correct in their analysis. The degree to which Mich Con is experiencing a lower equity ratio and the concomitant risks involved in that ratio are entirely attributable to Mich Con's own actions. It cannot expect this Commission to shore up its equity ratio while the company pays out in excess of 90% of its earnings as dividends to its parent company for non-utility investment.

Elimination of the .5% adjustment relative to the lower equity ratio results in the ALJ's recommendation of a 15% return on common equity. The Commission believes that such a return is too generous. The cost of common equity is the compensation investors require for postponing consumption and for exposing capital to risk. The differences in risk of investments are translated into price differences by the competitive capital market. In Mich Con's last rate case, the Commission authorized a return on common equity of 14.82% based on the risk at that time. In reviewing the computation of "risk" by the parties, the Commission is not persuaded that the risk to the common shareholders has increased. In fact, the risk appears to have remained constant or to have diminished, as evidenced by Mich Con's earning well in excess of its authorized return on common equity. Furthermore, the burden of proof with respect to increasing the cost of equity lies with Mich Con. As stated, the Commission



finds that Mich Con has failed to sustain that burden. Thus, the Commission concludes that, based on lowered risks and administrative notice of earnings well above authorized, it is clearly reasonable and in the public interest to retain the cost of common equity at 14.82%.

Based upon the discussion above and the uncontested costs of the other components of capital structure, the Commission finds Mich Con's overall rate of return to be 9.26% computed as follows:

Capital Structure and Return

|                     | <u>Amount</u> | <u>Percent</u> | <u>Cost Rate</u> | <u>Weighted<br/>Cost Rate</u> |
|---------------------|---------------|----------------|------------------|-------------------------------|
| Long-term Debt      | \$349,379     | 38.37          | 9.55%            | 3.66%                         |
| Short-term Debt     | <u>32,000</u> | <u>3.51</u>    | 10.25%           | <u>.36</u>                    |
| Subtotal            | \$381,379     | 41.88          |                  | 4.02%                         |
| Preferred Stock     | \$ 46,944     | 5.16           | 11.18%           | .58                           |
| Common Equity       | 255,000       | 28.01          | 14.82%           | 4.15                          |
| Deferred ITC        | 4,885         | .54            | -                | -                             |
| Deferred Income Tax | 172,000       | 18.89          | -                | -                             |
| JDITC               | <u>50,275</u> | <u>5.52</u>    | 9.26%            | <u>.51</u>                    |
| Total               | \$910,483     | 100%           |                  | 9.26%                         |

VI.

NET OPERATING INCOME

In order to establish whether a revenue deficiency exists it is necessary to determine Mich Con's net operating income under existing rates adjusted for appropriate changes in the projected test period. Net operating income is determined by adjusting booked net operating income for the historical test period for known changes beyond the test period and for projected changes in revenues and expenses into the projected test period.

In its exceptions, Mich Con requested that rates be based on an adjusted

net operating income of \$64,660,000, as compared to recorded test period net operating income of \$54,048,000. In its exceptions, the Staff proposed an adjusted net operating income of \$69,398,000 and the Attorney General proposed \$91,325,000. The discussion which follows considers those components of net operating income which remain in controversy.

#### Gas Sales

Mich Con initially proposed a sales level of 249.7 Bcf based on estimates of actual sales for the projected test period. Mich Con's residential and commercial sales estimates were developed by forecasting each of the determinants of those sales, number of customers and usage per customer for the 12 months ended June 30, 1986. The number of customers was developed by district and month through the use of a time series model using an exponentially weighted moving average (5 Tr. 201). Average usage per customer was developed by district and month utilizing historical consumption data and assuming that conservation would continue at the same rate as it had in the recent past. Customer accounts were checked against an independent forecast of customer additions prepared by field consultants, and usage per customer was checked against a price elasticity model, as well as an analysis of specific residential and commercial conservation measures (Exhibit A-12; 5 Tr. 208-10). Figuring thusly, Mich Con determined that sales to residential and commercial customers would equal 210.4 Bcf.

Mich Con's industrial sales were projected based upon the end use study of over 50 of the company's large-volume customers. The study indicated that approximately 30.0 Bcf of sales could be lost to alternate fuels such as coal, No. 6 fuel oil and propane. Mich Con had proposed a reduction of 5.0 Bcf for potential unidentified losses, but it has since withdrawn that proposal. Mich

Con's projection of industrial sales assumes the absence of Rate 5 or an alternative discount rate.

The Staff proposed a sales level of 254.7 Bcf. This level of sales was based upon no alternate discount rate being in effect. Its sales projection for residential and commercial customers was developed using a two-step process very similar to that used by Mich Con. The number of customers by class and district was developed using a seasonal, exponential smoothing technique. Usage per customer was developed based upon historical declines of approximately 3% per year. The resulting Staff sales forecast was so similar to that proposed by Mich Con that the Staff adopted Mich Con's sales level of 210.4 Bcf for residential and commercial customers (19 Tr. 2290).

To develop its forecast of industrial sales, the Staff reviewed Mich Con's end-use study of industrial customers. Finding no basis upon which to make refinements, the Staff adopted Mich Con's projection. The Staff, however, did not agree with Mich Con's adjustment for unidentified growth, conservation and losses. The Staff maintained that it was arbitrary and unreasonable to perform a detailed end-use study and then include a "fudge factor" for unknown contingencies. Thus, Mich Con's original industrial forecast of 39.3 Bcf was adjusted by 5.0 Bcf in order to eliminate the adjustments for unidentified growth, conservation and losses. Once Mich Con withdrew its proposal for this adjustment, the Staff and Mich Con ultimately supported the same sales figure of 34.3 Bcf.

ABATE proposed a sales level of 277.6 Bcf, or 27.8 Bcf more than Mich Con. Of this 27.8 Bcf, 10.3 Bcf was attributable to the higher usage figure per residential and commercial customers employed by ABATE's witness, Mark Drazen. Mr. Drazen maintained that, in his opinion, most conservation, such as insulation and dialing down of thermostats, had already occurred and that additional conservation in the residential sector would be primarily in terms of new furnaces

and hot water heaters. Therefore, he felt that the additional 10.3 Bcf of sales should be added to Mich Con's estimate for the commercial and residential sectors. The remaining 12.5 Bcf reduction proposed by ABATE was based on testimony of Mr. Drazen which was stricken.

The Attorney General's witness, Howard E. Lubow, proposed a sales level of 297.1 Bcf, or 47.4 Bcf more than that proposed by Mich Con (16 Tr. 1986). According to Mr. Lubow, historical conservation was a response to rapid rises in the real price of gas and, since such rapid rises in the real price of gas are not expected to occur in the near future, the rate of conservation can be expected to decline substantially. Mr. Lubow used a price elasticity model in order to quantify the results of his assumptions and testified that, on the basis of his analysis, 17.8 Bcf should be added to Mich Con's proposed commercial and residential sales. Mr. Lubow's projection of industrial sales differed from Mich Con's in that it included 30.0 Bcf of industrial sales which would be retained through adoption of an alternate fuel discount rate.

The ALJ found that conservation in the residential and commercial sectors would not dramatically decline in the period of 1984-1986 below that experienced in recent years and, therefore, the projection of residential and commercial consumption presented by Mich Con and the Staff for the projected test year was reasonable and appropriate. He also recommended that, aside from the question of a fuel discount rate, the appropriate level of industrial sales was 34 Bcf.

The Attorney General excepts to the failure of the ALJ to adopt his recommendation of a residential and commercial sales adjustment of 17.8 Bcf. It is his position that the price of gas influences consumption patterns and that the difference in projected nominal gas price increases compared to the historical period prices will result in a change to the historical pattern of consumption. According to the Attorney General, the ALJ's criticism of the addition of price

influence in the projection of an appropriate sales figure was inappropriate. While the ALJ maintained that the Attorney General's approach did not go far enough in considering economic factors, the Attorney General maintains that Mich Con's approach is even more simplistic.

The Commission rejects the Attorney General's position. While it may be possible to characterize Mich Con's approach to forecasting residential and commercial sales as more simplistic than that of the Attorney General, it does have the advantage of incorporating past experience as well as economic conditions existent in Mich Con's territory. The Attorney General's method, on the other hand, isolates only one variable which affects gas consumption. It assumes that that variable will supersede any and all other variables, yet, it is unable to substantiate that fact. It is obvious that consumers are sensitive to natural gas prices. The Commission, however, is not prepared to conclude that increases or decreases in usage are related to price only. The Commission therefore finds that the Attorney General's price elasticity model is not the better methodology.

ABATE also excepts to the ALJ's determination that the Staff's proposed industrial sales level was appropriate. It argues that the Staff's projection of industrial sales should be rejected because the Staff did not perform any independent analysis to determine the accuracy of Mich Con's forecast. It did little more than review Mich Con's study and, because no defect appeared on its face, adopted that study without additional verification. ABATE maintains that if the Staff had verified the accuracy of Mich Con's study, it would have concluded that Mich Con's forecast was overly pessimistic.

ABATE's position is based on the fact that ABATE did attempt to verify the accuracy of the study by performing a spot check of Mich Con's industrial customers representing 90% of its sales. In that study, ABATE witness Drazen recommended that Mich Con underestimated sales by 12.5 Bcf. Testimony regarding

ABATE's study, however, was stricken from the record because the ALJ determined that Mr. Drazen was not sufficiently familiar with the study upon which his testimony was based. ABATE requests that the Commission either reinstate Mr. Drazen's testimony and add 12.5 Bcf to the industrial sales level or adopt either the 1983 historical industrial sales of 74 Bcf or adopt the Attorney General's recommended 29.994 Bcf increase to Mich Con's proposed industrial sales. While not entirely accurate, ABATE asserts that either of the latter two figures more accurately reflects forecasted industrial usage than does Mich Con's figures.

The Commission is not prepared to reinstate Mr. Drazen's testimony. It believes that the ALJ is the best judge of the reliability of testimony presented or proposed to be presented in his hearing room. He alone has the best opportunity to judge the credibility of the testimony before him. In this case, the ALJ determined that Mr. Drazen did not have sufficient knowledge of the underlying study performed by ABATE. As a result, Mr. Drazen could not discuss the study accurately. Accordingly, his testimony was unreliable. The ALJ's decision was based on sound reasoning. ABATE has presented no argument showing that the ALJ abused his discretion in this matter. Therefore, the Commission affirms the ALJ's decision to strike Mr. Drazen's testimony.

Since the Commission has refused to reinstate Mr. Drazen's testimony, his recommendation that 12.5 Bcf be added to Mich Con's sales forecast is also rejected. Likewise, the Commission also rejects ABATE's alternate industrial sales forecast. It does not believe it would be appropriate to adopt the 1983 historical sales since Mich Con presented credible evidence showing that historical sales are not representative of the sales to be expected in the projected year. ABATE's final alternative, recommending that the Commission adopt the Attorney General's adjustment of 29.994 Bcf, will be considered in the context of the discussion of alternate discount rates.

Based on the findings and conclusions above, the Commission adopts the sales level of 254.7 Bcf proposed by Mich Con and endorsed by the Staff, exclusive of alternate fuel sales.

#### Company Use and Lost and Unaccounted for Gas

The calculation of adjustments for company lost and unaccounted for gas requires the determination of the volumes of gas to be assigned to each aspect and the assignment of a unit cost. The parties have agreed that the Staff's proposed volumes of 1,746 MMcf for company use gas and 3,668 MMcf for lost and unaccounted for gas are appropriate. They disagree, however, with respect to the cost of gas to be assigned to these units of gas.

The Staff projected a cost of gas of \$4.50 per Mcf for on-system regular rate schedule sales, excluding Rate 5 and off-system sales (21 Tr. 2695). The Staff's projection was based upon its best knowledge of the rates expected to be in effect by December 1984 applied to projected supply volumes for the projected test year ended 1986. In developing this projection, the Staff considered the cost of gas it proposed (\$4.48 per Mcf) in Mich Con's Gas Cost Recovery (GCR) Plan case, Case No. U-7777, and the reported June 1984 cost of gas of \$4.36 per Mcf. Compared to those gas costs, the Staff was confident that the \$4.50 per Mcf cost of gas was a reasonable approximation of the cost of gas that Mich Con will experience in the test year. This cost of gas, according to the Staff, provides an increase in excess of 3% through the end of the test year.

Mich Con projected a cost of gas of \$5.00 per Mcf (12 Tr. 1249) for the test year ended June 1986, relying on the forecast of 1985 and 1986 LIFO rates of \$5.00 per Mcf and \$5.17 per Mcf, respectively (9 Tr. 838) presented by its witness, Stephen B. Shaw. Mr. Shaw's forecast was based on the results of a computer model which matched future supplies and markets based on least cost mix.

The ALJ determined that gas costs would not increase substantially in the near term, and that the Staff's projected gas cost was consistent with the testimony and evidence. He therefore recommended the adoption of the Staff's \$4.50 projected cost of gas.

Mich Con filed exceptions, arguing that \$4.50 represented an unrealistic cost of gas projection. Mich Con maintains that the Staff's own workpaper (Exhibit I-68) demonstrates that even if one were to erroneously ignore any factors which might tend to raise supplier prices for the 1985-1986 period, a cost of \$4.60 per Mcf is an absolute minimum and a cost of \$4.93 is a more reasonable estimate. Mich Con maintains that the Staff's witness incorrectly assumed Commission approval of Michigan supply contracts at levels below take-or-pay requirements in two of his four scenarios. Correcting the Staff's study to reflect contractual supply levels, but still ignoring any intrastate price increases, would yield the minimum of \$4.60 per Mcf. Moreover, a projected 1985 price of \$4.74 per Mcf for Michigan purchases would yield an Exhibit I-68, Case 1, price of \$4.93 per Mcf (19 Tr. 2325). Thus, according to Mich Con, if one uses the only realistic Staff supply mix on Exhibit I-68 and recognizes contractual price escalation on Michigan production, but still ignores all other upward pressures, a projected cost of gas of \$4.93 per Mcf is dictated by the Staff. Based on this analysis, Mich Con maintains that its \$5.00 per Mcf projection for the future test period is reasonable.

The record reflects that the parties agree that gas prices have stabilized significantly. Despite this fact, Mich Con would have the Commission adopt a cost of gas projection amounting to an approximate 15% increase from June 1984 to the projected test period. There is no basis for projecting an increase of that magnitude. Clearly, the Staff's 3% increase is more realistic. The Commission is also unpersuaded by Mich Con's manipulation of the Staff's figures.



What Mich Con has done is isolate elements in the Staff's four scenarios and used this patchwork approach to build the Staff's figure into one that approximates Mich Con's figure. In so doing, it failed to consider all the factors that go into the cost of gas projection. Because the Staff's projection is the more reasonable one and Mich Con has not demonstrated otherwise, the Commission finds that company use and lost and unaccounted for gas should be set at \$4.50 per Mcf.

#### Alternate Fuel Discount Rates

Mich Con has proposed the implementation of a new Rate 5 applicable to customers with alternate fuel capabilities. Rate 5 would be a replacement for the present Rate 4, which also provides a discounted rate to customers who have alternate fuel capabilities. Rate 4 was adopted by the Commission in late 1983 (Opinion and Order, Case No. U-7609, issued November 22, 1983). Mich Con's proposed Rate 5 has some parallels to Rate 4, but Mich Con argues that it is more responsive to the problem of meeting alternate fuel competition. Specifically, the Rate 5 commodity charge would be equal to 95% of the lesser of the price of No. 6 fuel oil at the Detroit average or 95% of U.S. Gulf Coast's spot price, as reported in Platt's Oilgram Price Report. Mich Con would file the recalculated commodity charge on the first business day of the month preceding the billing month. On the same day, copies of the filing would be served on all parties to this proceeding or any other parties requesting notice. If the filed rate varied from the existing rate by 2% or more, then a hearing would be scheduled for the tenth business day of the month. That hearing would be held for the sole purpose of updating the rate, and any party wishing to introduce testimony or other evidence would be required to do so at that hearing.

Mich Con further proposed that no Rate 5 sales should be included in the sales level established in this proceeding, but that the revenue received from

these sales would be utilized as a gas cost credit under Mich Con's GCR mechanism. In all other respects, the Rate 5 proposal is similar to the existing Rate 4. In fact, if the proposal is rejected, Mich Con requests that the Commission continue the current Rate 4.

While Port Huron supported Rate 5, several other parties to the proceeding expressed opposition. The Attorney General argued that Rate 4 was established by the Commission as a stop-gap measure until a long-term solution could be devised. Since the proposed Rate 5 does not represent such a long-term solution, it should be rejected. The Attorney General also contended that alternate fuel discount rates, in general, are unjust and unreasonable discrimination against ineligible industrial customers and against other classes of customers. The Attorney General further contended that Rate 5 or similar discounted rates block market signals to producers, informing them that there is no industrial market for gas at the prices which producers are charging. Should the Commission approve Mich Con's Rate 5, the Attorney General argues, the \$11,700,000 spread should be included in the rate determination in this proceeding so that the risk of making such sales would be on Mich Con and its shareholders and not on its customers.

Rather than Rate 5, ABATE would propose the establishment of Rate 11 for large-volume sales. Rate 11 would be an interruptible rate, set closer to the cost of service, under which customers would have to commit to take certain minimum volumes. Under this rate, the customer would sign a 12-month contract with Mich Con for a specified volume of gas. The customer would commit to buy a minimum of 25% of the contract amount or 250 MMcf, whichever is greater, or pay a deficiency charge of \$1.11 per Mcf for all volumes not taken below the minimum take obligation. Gas purchased in the contract year in excess of the level of the contract amount would be priced at an over-run charge equal to the Rate 6

commodity charge.

The rate for service under ABATE's proposal would include a customer charge to recover the full customer-related cost of providing service and a commodity charge. Based on Mich Con's current costs, the commodity charge for such a Rate 11 would be from \$4.14 to \$4.28 per Mcf.

With respect to how Rate 11 would or would not relate to the GCR mechanism, ABATE suggested two alternatives. First, Rate 11 could actually be tied to the GCR mechanism. Alternatively, the rate could be excluded from the GCR and the commodity charge could remain at the level fixed by the Commission until the next general rate case or until the Commission otherwise modified the rate.

As its primary position, the Staff opposed Rate 5 and other special rates because they had outlived their usefulness. The Staff agreed with the Attorney General that Rate 5 originally was adopted as a short-term attempt to alleviate the effects of high gas costs. The Staff believes that the corner on gas prices has been turned and that these prices are now declining. Accordingly, a discount rate should not be necessary. The Staff also took the view that Mich Con's proposed Rate 5 would do nothing to combat high gas prices. Instead, according to the Staff, the rate would shield Mich Con from the need to compete with alternate fuels. The Staff maintains that the rate, as designed by Mich Con, removes all of the company's risk regarding its sales to alternate fuel customers so that Mich Con's earned rate of return is completely independent of its sales to these customers. The Staff next contended that implementation of special discount rates on a long-term basis can have the effect of institutionalizing the cause of the problem.

In the alternative, the Staff argued that should the Commission decide to implement a special discount rate, it should not adopt Mich Con's proposed Rate 5. The Staff believes that Rate 5 has design defects which require correction. Rather

than approve Mich Con's proposed rate, the Staff suggested an alternate dual fuel discount Rate 5. The tariff for this rate schedule was shown on Exhibit S-87. The rate would be a modification of the existing Rate 4 to more fully glean the benefits which could be derived from a discount rate and provide Mich Con with an incentive to hold down gas costs. The rate provides a sliding scale of commodity charges with an average charge of approximately \$4.45. Under the Staff's proposal, Rate 5 sales would be removed from the GCR process at the overall average cost of all gas supplies (both on system and off system) to the company. The most recent overall average cost of gas to Mich Con was \$4.07 and gas costs have been declining. The Staff thus selected a target spread of \$.45 per dekatherm (Dth) (21 Tr. 2695). The Staff also proposed that the risk of sales should be shared between Mich Con and its customers. Accordingly, 50% of the target spread and commodity charge would be included in operating revenues for purposes of determining rates in this case.

Each of the oil distributor intervenors argued strenuously against adoption of Mich Con's proposed Rate 5. Total contends that Rate 5 would constitute an unreasonable establishment of a non-cost-based rate on a permanent basis rather than on an interim stop-gap basis as initially intended. Total also contends that Rate 5 may constitute a violation of state and federal anti-trust laws.

Lakeside and Crystal maintain that Rate 5 is discriminatory and preferential, that it blocks market signals to producers, that it will provide windfalls to eligible customers, and will cause the price of No. 6 fuel oil to be further driven down, thereby defeating the intended purpose of such discount rates. They argue further that the cost of oil assumed in Rate 5 is understated in that it does not account for transportation costs, nuisance costs and quality variation. Finally, they argue that alternate fuel discount rates should not be approved because they were intended as a temporary solution.

The ALJ determined that some mechanism should be provided to assist Mich Con in retaining its large industrial customers since retention of these customers is a necessary adjunct to keeping the cost of gas down for customers who remain on the system as regular rate schedule customers. Despite this, the ALJ did not believe that Mich Con's Rate 5 was an appropriate method. He also rejected the alternatives proposed by the Staff and ABATE on the basis that they would not be responsive to changes in the energy market. Rather than adopt any of the proposals, the ALJ recommended that Mich Con should be left to negotiate on an individual basis with its largest industrial customers who can obtain energy, whether through alternate fuels or direct contracts with producers, at rates cheaper than would be available under rate schedules based on cost of service. He also recommended that Mich Con be allowed a transition period of three to six months during which its Rate 4 would be extended. To address the impact of these revenues on the rate setting process in this proceeding, the ALJ recommended that Mich Con be placed at risk for \$9,000,000 of these negotiated sales. Any spread above the the \$9,000,000 would be refunded to customers through the 90-10 refund mechanism.

Exceptions to the ALJ's recommendations were filed by ABATE and Total. Additionally, Mich Con filed a conditional exception. ABATE's exception was founded on its position on cost-of-service allocation methodologies. It argued that, were the Commission to agree with ABATE's methodologies, the problem of load loss would be substantially solved by adoption of Rate 11 and the implementation of fully cost-based rate schedules. In that event, according to ABATE, it might then be appropriate to permit negotiation of special contracts.

Total's exceptions were, in large part, a repeat of its arguments on brief. It maintains that non-cost-based rates should not be implemented on a permanent basis. It contends that the ALJ erred in failing to find that alternate discount

rates were incapable of an accurate estimation and in holding that antitrust considerations are beyond the jurisdiction of this Commission. It also argued that the ALJ erred in not rejecting Mich Con's proposal on the basis that it was in violation of the Sherman Act and the Robinson Patman Act.

In approving Mich Con's dual fuel rate (Rate 4), the Commission determined that a special rate was necessary to prevent the loss of additional industrial load and to assure that Mich Con's revenues would not drop precipitously. Though it approved Rate 4 as a special temporary rate, it did not specify when that rate would be terminated -- only that it would be reevaluated. This proceeding provides an opportunity for such reevaluation. Upon review of the record, the Commission concludes that the industrial load loss problem has not been resolved. Accordingly, it finds that the ALJ was correct in his determination that some mechanism for the retention of industrial load is still warranted.

The Commission has reviewed the special rates proposed by the parties and finds that the ALJ was correct that there are flaws in each of these proposals. Mich Con's Rate 5 responds only to those customers with the capability to burn No. 6 fuel oil as an alternative to gas. It does not address the additional potential threat posed by gas purchases directly from producers and the availability of ethane. Additionally, because there is significant variation in the price of fuel oil quoted to individual industrial customers, Mich Con's proposal to use the average price in the Detroit market would be unattractive to larger industrial customers. Thus, a significant portion of the market would not be retained despite the implementation of the special rate.

The Staff's proposed Rate 5 is limited to alternate fuel customers. It would, therefore, not be responsive to potential losses of industrial customers who purchase gas directly from producers. Rate 11 would also not be particularly

responsive in that it does not address changes in the energy market. Further, it affords the benefits of a special rate to many customers who do not warrant the lower rate on the basis of capability to burn alternate fuels at lower cost or the ability to purchase gas directly from the producer at lower cost.

The Commission has also reviewed the ALJ's special contract recommendation and finds that it has some merit. In fact, the Commission reached similar conclusions in Case No. U-8140, dated April 23, 1985, when it approved special contracts between Mich Con and its integrated steel mill customers. This proceeding has provided an additional opportunity to consider special contracts as a mechanism for an alternate fuel rate and, while the Commission is not inclined to adopt the ALJ's parameters for special contracts, it nevertheless finds that Rate 4 should be terminated and that the special contracts envisioned by Case No. U-8140 should continue and should be encouraged between Mich Con and its other customers who have alternate fuel capability or who require only transportation service. To facilitate the negotiation of such contracts, the Commission agrees with the ALJ that a transition period should be provided. Accordingly, the Commission concludes that Rate 4 should terminate six months from the date of this order.

The Commission believes that special contracts constitute a reasonable and appropriate method of counteracting Mich Con's disadvantageous position in the energy market. Within the constraints of its incremental cost of gas, Mich Con would be able to tailor its services and prices to the needs and competitive position of its individual customers. These contracts, further, will enable Mich Con to obtain the maximum spread possible given market conditions and the unique situation of each customer.

In approving and encouraging the use of special contracts, the Commission is mindful of the fact that the discrepancy between alternate fuel costs is

somewhat unstable. Accordingly, it directs Mich Con to retain sufficient flexibility in its contracts to accommodate market fluctuations. It is noteworthy that special contracts offer such an advantage, unlike Rate 4-type rate structures. That advantage weighs heavily in favor of special contracts.

Despite its encouragement of special contract arrangements, the Commission nevertheless reaffirms its belief that these arrangements should constitute a transitional mechanism between Rate 4 and the elimination of alternate discount rates. Mich Con should therefore limit the duration of the contracts to a maximum of one year. The contracts can thereafter be renegotiated if justified.

The Commission notes the objections to the continuation of special rates for industrial customers. It reiterates the position it expressed in originally establishing Rate 4 that special rates are not illegal when based on a difference in cost of service or some other rational basis. In this proceeding, a distinction has been made for customers who can burn only natural gas and customers who can readily switch to alternative fuels. These distinctions are not irrational and are particularly justified where the purpose is to retain industrial load to reduce the burden upon ratepayers who cannot readily switch.

The Commission will not address antitrust questions in this proceeding since they are beyond the Commission's jurisdiction. Nevertheless, the Commission does not believe that the approach it is adopting in this case in which customers are allowed to purchase gas at a price above incremental cost constitutes unfair competition.

With regard to revenues associated with sales under the special arrangement adopted in this rate proceeding, the Commission finds that a significant portion of the special contract sales should be included in order to give Mich Con an incentive to vigorously pursue such sales. This is particularly so since Mich Con will have the ability to negotiate specific contractual commitments. The ALJ



believed it was reasonable to include in rates an amount equivalent to approximately 25% of the \$35,000,000 calculated by Mich Con's witness -- the amount in spread which was jeopardized by the loss of alternate fuel customers. The Commission does not believe that the resulting \$9,000,000 is sufficient.

Mich Con has already received approval from the Commission of special contracts with three of its largest customers. Under the terms of those contracts, it is assured a sales volume of 13,500,000 Dth. At a spread of \$1.2524, it therefore anticipates a revenue savings of \$16,907,000. The Commission is persuaded that those revenues should be reflected in this proceeding.

Mich Con also has the potential of transacting the sale of an additional 12,800,000 Dth to its alternate fuel customers. At the spread indicated above, it stands to realize another \$16,031,000 in revenues. Although it is impossible to determine exactly what portion of these additional revenues Mich Con will secure, the Commission believes that since Mich Con will be in a position to tailor its contracts to the specific needs of individual customers, the contracts will be very attractive. Accordingly, it finds that Mich Con can realistically expect to attract at least 50% of these additional sales; therefore, one-half of these additional revenues should be included in the revenue determination in this proceeding.

The Commission is aware of developments in the federal arena which may impact special contract sales, e.g., Maryland People's Counsel v FERC, Docket No. 84-1019, and Notice of Proposed Rulemaking, Docket No. RM85-1-00 (Parts A and D), 31 FERC §61,230. Since the developments are so recent, they could not have been considered by the parties to this proceeding. The Commission, therefore, invites comments from the parties regarding any new issues presented by these federal pronouncements within 60 days of the date of this order.

### Depreciation

In its exceptions, the Staff pointed out that while the ALJ found that it was reasonable and appropriate to reduce net plant projections by \$504,000 to reflect the disposition of the Tawas and Eureka stations, he failed to adopt a corresponding reduction in depreciation expense. The Staff maintains that recognition of the retirement of the plant reduces depreciable plant balances and, therefore, the annual depreciation expense.

The Commission agrees that it is appropriate to recognize this lower depreciation expense for the projected test year. Therefore, it adopts the \$15,000 reduction in depreciation resulting from the retirement of the Tawas and Eureka stations.

### O&M Expense

In its exceptions, Mich Con requests an allowance for O&M expense of \$192,153,000. The Staff, in its exceptions, proposes that O&M expense be allowed up to \$181,628,000. ABATE and the Attorney General generally support the Staff's position regarding O&M expense.

Mich Con based its O&M request on an analysis of historical test year and 1984 budgeted O&M expense. To this base, specific inflation factors for each specific type of expense were applied to estimate the 12 months' ended June 1986 expense levels (10 Tr. 1008). The Staff used only 1983 actual expenses adjusted for non-utility operations, disallowances and permanent changes in recurring expenses as adjusted for inflation on the basis of one overall inflation rate for all O&M expense (20 Tr. 2539).

The Staff argued that an historical calendar year is the appropriate basis and that the use of budget levels is inappropriate because the Staff cannot audit budget proposals. The Staff also states that it has audited the calendar year

results. It contends that it analyzed each category and expense incurred in 1983 to determine whether or not it would be representative of the future and made appropriate adjustments, in addition to the application of inflation factors.

Mich Con contends that the use of a base historical period is inappropriate because Mich Con's priorities change over time, and 1983 results are not necessarily representative of the expense levels in each category for the projected period. If the Staff's method were to be adopted, Mich Con argues, a number of adjustments would have to be made to correct the Staff's O&M base prior to the application of inflation factors.

The ALJ believed that the method employed by the Staff, i.e., examining 1983 recorded expenses and adjusting them to the projected test period, had the advantage of enabling the Staff to audit actual expenditures. That method afforded Mich Con an opportunity to propose appropriate adjustments and provide the necessary justification. The ALJ believed that it was Mich Con's responsibility and burden to justify any significant changes in the various categories of O&M expense beyond the application of inflation factors. Its mere presentation of budget estimates did not satisfy this burden. Accordingly, the ALJ determined that the level of O&M expense should be based on appropriate adjustments to recorded results for calendar year 1983.

Mich Con excepted to the ALJ's failure to recommend what it termed a reasonable level of O&M expense. Its primary position was that Mich Con's method should be adopted. It argued that its O&M allowance represented a projection of the reasonable O&M expense levels which will likely exist during the period for which rates set in this proceeding will be in effect. Under its method, all major areas of O&M expense were analyzed to determine levels for the future test year (Exhibit A-9 Schedule C-92B). In some instances, recorded expense levels for the 12 months ended June 30, 1983 were found to be representative and were

merely adjusted for inflation; while in other cases, 1984 budget expectations were substituted for recorded levels because of known expected operational changes.

As part of its item-by-item analysis, the forecast was reviewed with the appropriate company activities for accuracy. This resulted, according to Mich Con, in a comprehensive forecast of the O&M expense for 1984 based on current and expected operations. Specific indices of inflation were then applied to projected costs for the future test year.

Mich Con does not dispute the accuracy of the historical cost used by the Staff. It maintains, however, that in the absence of a real analysis of exact O&M levels, the relationship of historical cost to costs to be incurred by Mich Con in the future remains unexplained. In that regard, the Staff's derivation of the base O&M levels fails to relate recorded costs to expected costs. Just because the historical cost is verifiable, Mich Con argues, that does not mean that it is in any way representative of costs to be incurred when the rate set in the proceeding will be in effect.

Finally, Mich Con argues that the historical approach used by the Staff provides the wrong incentives. If historically recorded expenses are too low relative to future legitimate requirements, needed programs will not be instituted; or if such programs are unavoidable, shareholders will bear the cost. If recorded expenses are high relative to future expectations, shareholders could receive a windfall. Neither situation, Mich Con asserts, should exist.

The Commission is not persuaded that Mich Con's item-by-item analysis is the appropriate method to utilize in determining O&M expense for the projected year. Although it represents Mich Con's best guess of what O&M expense will be, the method provides no effective opportunity for the Staff and intervenors to contest the reasonableness and prudence of the expense. Mich Con's method

also suffers from its dependence on estimates. Estimates represent only best guesses. They do not have the reliability which can be obtained from using actual expenses whenever possible. Rather than adopt Mich Con's speculative approach, the Commission finds that expenses should be developed by using appropriate adjustments to historical O&M costs.

The Commission also rejects Mich Con's recommendation that various inflation indices should be used in forecasting projected year O&M expense. Mich Con's method employs 31 separate expense categories and approximately 30 different indices. Although the use of the indices may be possible for this proceeding, the Commission believes that the burden imposed by the use of so many factors does not justify the minimal benefit. Moreover, the adoption of such a method in this proceeding might set a precedent for future rate cases in which even more categories and indices would be necessary. The Commission does not believe that the additional complication in an already complex rate case is desirable.

#### Energy Assurance Program Expense

In its brief, Mich Con contended that compliance with the Energy Assurance Program (EAP) produces an annual incremental cost of \$581,440 (22 Tr. 2781). This incremental cost was calculated by estimating the effect of the increased workload on customer service activity. Specifically, Mich Con anticipates increased contacts at customer offices, increased phone contacts and additional processing workload for energy drafts.

The Staff, in its brief, did not challenge Mich Con's assumption that additional costs would be incurred as a result of the EAP. It did, however, contest the figures on the basis that Mich Con's witness did not account for potential increased productivity among Mich Con's employees. ABATE, in its brief, generally agreed with the Staff's position.

The ALJ was convinced that additional cost would be incurred as a result of the EAP and that Mich Con's method for determining such cost was reasonable. Accordingly, he recommended the addition of \$641,000 to the Staff's recommended O&M allowance for EAP costs.

The Staff and ABATE excepted to the ALJ's determination. The Staff argues that the ALJ's approach fails to take into consideration the basic premise underlying the Staff's methodology. According to the Staff, it is incorrect to add the cost of this or any new program without allowing offsets for the cost of old programs discarded or cost-saving programs anticipated in the future. The use of historical actual expenses without attempting to reflect numerous changes allows management the flexibility to budget its programs to take into account the ever-changing circumstances and still recover the appropriate O&M expense in its rates. Adjusting the Staff's recommended allowance for one isolated change without reflection of all the changes would, according to the Staff, be incorrect and should be rejected. Finally, the Staff argues that Mich Con's method for determining the cost of EAP was unreasonable. Mich Con made no attempt to calculate the actual incremental expenses of the program, nor did it offset the expenses with increases in productivity or reduced costs associated with a decline in customer collection problems.

ABATE also argues that Mich Con's estimates are inherently suspect. It maintains that Mich Con incorrectly assumed that a customer who received an energy draft would visit the branch office as well as make two telephone calls. According to ABATE, there is no basis for this assumption. ABATE also maintains that there was no basis for Mich Con's assumption that senior citizens are more likely to want a direct receipt for payment than the majority of customers. In fact, only 60% of energy draft recipients would be seniors. ABATE also points out that Mich Con is incorrect in assuming that additional telephone calls will

be made to clarify energy draft questions. These conclusions are incorrect, according to ABATE, because most questions should have already been answered prior to the projected test period. Finally, ABATE cites major problems with Mich Con's incremental cost calculations.

The Commission is persuaded that Mich Con will incur additional expenses relative to the EAP. However, the Commission agrees with the Staff that the historical approach presumes a balance wherein new programs are developed which increase costs and other programs are discarded which decrease costs.

The Commission also shares the Staff's concern that Mich Con has failed to account for an increase in productivity. Mich Con should have assigned a value to that potential. The Commission is also persuaded by arguments presented by ABATE. It is troubled by the assumptions made by Mich Con's witness, John E. Von Rosen, regarding the number of visits that would be made relative to the energy draft program due to the number of seniors involved in that program. Therefore, the Commission determines that the \$641,000 net adjustment recommended by the ALJ should be rejected.

#### Injuries and Damages Reserve

In its brief, Mich Con sought to increase the Staff's O&M allowance by \$454,700 on the basis that the Staff had understated the liabilities for injuries and damages. The Staff contends, on the other hand, that the increase in Mich Con's insurance deductible from \$100,000 to \$250,000 in 1982 has been factored into the Staff's allowance.

Mich Con's witness, Gilbert L. Lavey, testified that there were four claims paid in 1983 which would have resulted in an additional \$407,500 in recorded payments had the new deductible been in effect in the year of the claim (23 Tr. 3023). According to Mich Con's argument, it would be patently unfair to reflect the benefit of the reduced premium booked in 1983 as a result of the higher deductible

without recognizing the belated higher cash settlements required in the future.

In its brief, the Staff recommended that this adjustment be rejected for two reasons. First, the actual claim settlements that may be paid out in the projected test year may still be under the \$100,000 because it is unknown what length of time it takes to settle claims (23 Tr. 3079). Secondly, it is unknown what the severity (or cost) of claims per incident will be or what number of claims will be settled in the projected test year. The best policy, according to the Staff, is to use the Commission-ordered method of actual cash settlements without introducing speculative situations which may or may not occur.

The ALJ found that Mich Con's proposed adjustment to the Staff's O&M expense allowance was not supportable because there was no evidence of the extent to which ratepayers would have benefited by the lower premiums. In fact, Mich Con's witness could not determine an amount of savings when requested to do so on the record. The ALJ also believed that the number of claims projected to be settled in the projected test year was highly speculative. He therefore recommended rejection of the adjustment.

The Commission agrees with the Staff's analysis that actual claim settlements in the projected test year may still be covered by the \$100,000 deductible due to the lag in settling claims and the fact that the amount and number of claims in the projected test year is unknown and cannot be accurately estimated. Since the company's proposed adjustment is without foundation and is entirely speculative, the Commission rejects it.

#### Executive Life Insurance and Supplemental Retirement Costs

The Staff excluded expenses associated with executive life insurance and supplemental retirement costs in the amount of \$131,000, adjusted for inflation, for a total of \$146,000. The Staff maintains that expenses associated with



these benefit plans should be excluded since the plans are available only to certain key executives who are also participants in the regular employee pension plan. The Staff believes that ratepayers should not be required to pay for two retirement programs.

The ALJ determined that the executive life insurance and supplemental retirement plans are part of the total compensation package. He concluded that the Staff failed to show that the overall compensation package for these employees was unreasonable, and the costs should therefore appropriately be considered as part of O&M expense.

The Commission agrees with the ALJ that executive life insurance and supplemental retirement benefits are part of the compensation package offered to Mich Con's executives. There is nothing on the record to substantiate that elements of the compensation package are unreasonable. Further, there is no logic or rationale that dictates that all employees should receive the same forms and amounts of compensation. Accordingly, the Staff's arguments and the \$146,000 disallowance proposed by the Staff are rejected.

#### Recreation Expense

The Staff also excluded one half of the total 1983 expenses associated with Mich Con's recreational programs and facility. The Staff believed that although some benefit may be derived from these programs, they also pose several disadvantages. For example, the nature of several of the programs was such that the funding by Mich Con actually resulted in charitable contributions. In addition, the Staff believed that some of the funding was excessive. Because it was difficult to measure the relative advantages versus the disadvantages, the Staff believed a sharing of cost between the ratepayer and the shareholder was appropriate.

The ALJ agreed with the Staff that there were potential benefits for shareholders regarding community involvement aspects of the recreation program and that it was appropriate to divide the cost of the recreation program between the ratepayer and the shareholder. Therefore, he accepted the Staff's \$100,000 disallowance in O&M expense.

Mich Con excepted to the ALJ's recommendation of the Staff's disallowance of what Mich Con terms actual, legitimate recreation program expenses. Mich Con maintains that employee costs are costs of service just like other O&M expenses. The company's recreation program is part of the total employee compensation. In that respect, it is no different than wages or benefits. Thus, absent any showing that employee compensation is unreasonable, there is no basis for disallowing any particular element of employee cost.

Mich Con also argues that the Staff's claim that recreation expenses are charitable contributions is a bald, unquantified allegation and cannot be a justification for arbitrarily halving reasonable expenses. Finally, Mich Con maintains that this recommended disallowance is no different from that which was proposed in regard to Mich Con's Detroit cafeteria and its Employee Appliance Purchase Program. In Case No. U-5955, the Commission specifically rejected these recommendations for disallowance and it should therefore, for the same reasons, reject the Staff's recommendation in this proceeding.

The Commission agrees with the ALJ's recommendation. It believes that there are, in fact, potential benefits for shareholders regarding the community involvement aspects of the recreation program. It further believes that, in addition to providing a form of employee compensation, the program also benefits the public in the charitable sense. Since this program is not entirely one designed for employee compensation or for community involvement, the Commission agrees that the cost should be divided between the ratepayer and the shareholder.

It, therefore, adopts the ALJ's and Staff's adjustment of \$100,000 to O&M expense.

### Contributions

In its brief, Mich Con sought to restore all of the Staff's \$553,000 disallowance for contributions. Of these costs, \$95,000 was attributable to area development costs, which are contributions to community groups such as New Detroit, Detroit Renaissance, Chamber of Commerce, etc. Mich Con pointed out that in Case No. U-5955 the Commission had allowed contributions to the Detroit Urban Progress Fund, Detroit Renaissance and the Metropolitan Fund. It also cited the Commission's allowance of contributions to the "Say Yes to Michigan" Program. The remaining contributions expense represented donations to various community groups, and Mich Con contended that the ratepayers would benefit from such contributions because they would enhance Mich Con's ability to deal with its customers in a harmonious fashion by improving the public's perception of Mich Con. Mich Con further contended that such costs have not been excessive and are legitimate business expenses.

The Staff contended that contributions to businesses, associations, and charitable, social and civic groups do not directly benefit ratepayers and impose an additional economic burden on Mich Con's customers. The Staff pointed out that contributions have traditionally been disallowed by the Commission. The Staff takes the position that Mich Con's obligation to improve the viability of its service area and the overall business and social climate should be financed by shareholders, and not ratepayers.

The ALJ believed that the benefit to ratepayers of contributions is both indirect and remote. He noted that the Commission has consistently in the past denied Mich Con such expenses with few exceptions. Accordingly, he recommended that Mich Con's proposed adjustment be rejected.

Mich Con excepted to that recommendation and, essentially, repeats the arguments presented in its brief and reply brief. It maintains that there are extensive policy reasons for allowing legitimate and reasonable business expenses in rates. It admitted that it was aware that such an allowance was wholly discretionary with the Commission and that the Commission had not generally been sympathetic in the past. Nevertheless, it pointed out that, contrary to the ALJ's conclusion, Mich Con's contributions program is directly beneficial to ratepayers. Given Mich Con's high residential heating market saturation and the fact that almost all the contributions are to groups in the company service area, Mich Con argues that it is apparent that contributions are likely to directly benefit many ratepayers. It maintains further that benefits accrue to ratepayers with the establishment of working relationships which lead to resolution of ratepayer problems and thus better quality service.

Mich Con rejects the ALJ's argument that a private sector company must take dollars from earnings to support a contributions program and Mich Con should do the same. Although it believes that 100% of the contributions it proposes should be allowable in the cost of service, it suggests that an allowance of 50% of contributions in rates would be a reasonable method for ensuring that Mich Con's shareholders have a stake in the contributions program.

The Commission has, in the past, expressed its opinion regarding the inclusion of charitable contributions in O&M expense. There is no evidence in this proceeding that would alter the Commission's prior position. There is absolutely no reason why ratepayers should be required to pay the expense of public relations efforts that are directed at the ratepayers themselves. To the extent that Mich Con desires to enhance its image by fulfilling social obligations and making charitable contributions, those dollars should come from the shareholders. Mich Con and the shareholders, after all, gain directly from an enhanced image. All

that Mich Con's customers can expect to gain from the contributions is increased rates. Since the benefit lies with the shareholders, the Commission concludes that it would be grossly unfair to burden the ratepayer with this cost. Accordingly, the Commission adopts the Staff's charitable contribution disallowance of \$553,000.

#### Advertising Expense

In its testimony and briefs, the Staff calculated a disallowance of \$792,000 for advertising expense. Mich Con sought the restoration of \$762,000 to this expense. The Staff, in turn, conceded the propriety of \$58,000 of this advertising expense related to participation in two home builder shows and \$10,000 associated with miscellaneous conservation ads. Therefore, the amount which continues in dispute is \$694,000.

The Staff's remaining disallowances include \$168,776 applicable to the Residential Conservation Service (RCS) Program. The Staff excluded this expense because it pertains to the RCS and such expenses are required to be collected through the surcharge for those programs.

The Staff next disallowed \$26,206 related to cooperative advertising. This type of advertising is that in which the company joins with a retailer or manufacturer of a conservation-related device to share the expenses of promoting that device. In this instance, the devices are high-efficiency gas furnaces and Mich Con joined with the manufacturer of one of those furnaces to share advertising expense. The Staff opposed the inclusion of these expenses on the basis that it amounts to a subsidization of the advertising campaigns of appliance manufacturers, and ratepayers should not be required to provide such subsidization. ABATE and the Attorney General also opposed this type of expense for the same reasons.

The Staff also disputes the \$498,810 advertising expense related to Mich Con's "Helping Is Our Job" campaign. Mich Con had characterized the "Helping Is Our Job" campaign as corporate advertising, which was intended to lay the foundation for and make more effective the specific advertising programs of Mich Con, such as the Energy Assistance, Winter Protection and Conservation Programs. ABATE joined the Staff's position and called for the disallowance of corporate advertising expenses. ABATE contends that if this advertising does improve Mich Con's image among its customers, there is no real customer benefit associated with this, since Mich Con's residential customers do not have an alternative source for the purchase of gas. Moreover, it complains, these programs do not benefit the industrial class of customers and, in fact, by selling less gas, the unit cost of gas to Mich Con's customers must rise.

Mich Con contends that the advertising expenses applicable to the RCS Program are better considered in the context of this rate case. It contends that it is administratively more efficient to allow Mich Con the flexibility to apply this conservation-related advertising expense as it sees fit, rather than to recover the expenses in specific program-related surcharges. Mich Con argues that there will always be conservation advertising, whether or not the RCS Program continues or requires additional advertising. Mich Con maintains that cooperative advertising should be allowed because these expenses do directly promote conservation.

Finally, Mich Con maintains that the advertising expense associated with its "Helping Is Our Job" campaign should be allowed because the advertising serves to make other advertising programs more effective due to an enhanced image of the company which is created among the company's customers. Based on market opinion research studies of customers' perceptions of Mich Con, the campaign did, according to Mich Con's witness, Richard Zimmen, improve Mich Con's image

among its customers. Mich Con concedes that this type of expense has been traditionally disallowed by the Commission, but it requests that the Commission reconsider the area on the basis of Mr. Zimmen's testimony.

The ALJ agreed with the Staff's recommendations as to each of the contested advertising expenses. First, the ALJ determined that expenses associated with the RCS Program should be recovered under that program's surcharge. Next, the ALJ disallowed cooperative advertising, not because it concerned conservation, nor because it was cooperative, but because nowhere in the advertisement was the name of Mich Con mentioned. Finally, the ALJ concluded that Mich Con had not presented a convincing case to warrant the Commission's overturning its long-term policy of disallowing promotional advertising.

The Commission agrees with the ALJ and the Staff in all respects on the issue of advertising expenses. Mich Con's RCS advertising is specifically set up to be recovered through program-related surcharges. There is absolutely no reason for complicating this rate case proceeding with an advertising expense that is properly the subject of a separate proceeding.

The Commission likewise rejects Mich Con's proposed adjustment for cooperative advertising. The idea behind cooperative advertising is that it will benefit both of the parties. This advertisement, however, was for a Bryant furnace and did not even mention Mich Con. Although Mich Con claims that cooperative advertising is cost effective to the company because of the sharing of the cost with another company, in this situation it amounted to nothing more than cost subsidization. Bryant, as the manufacturer of the furnace, paid less for its advertising costs because Mich Con paid a portion. Ratepayers of Mich Con should not be required to subsidize the advertising campaign of appliance manufacturers or any other such business.

Finally, the Commission is not persuaded by the arguments presented by Mich

Con that the Commission should modify its position on promotional advertising. Although Mich Con presented testimony on the Yankalovich study and argued that this study supported the proposition that promotional advertising increases the effectiveness of other types of advertising, the Commission disagrees. The Commission notes that Mich Con's situation is different from the situation evident in the study. First, Mich Con does not sell a traditional product. Second, the Yankalovich study targeted people who were all at least college graduates having incomes above \$30,000, who were primarily executives, administrators and professionals. Finally, Mich Con spends approximately one-third of its advertising budget on corporate advertising, while the typical corporation in the Yankalovich study spent 16% of its advertising budget on corporate advertising. Accordingly, the study is of little value for comparative purposes.

The Commission is also unconvinced by Mich Con's market opinion research study. The Commission notes that Exhibit A-92 indicates that perceptions of Mich Con by its customers were worse after the campaign than before. This is clearly shown in the percentage of customers with favorable attitudes in August 1983, compared to the total customers with favorable attitudes in February 1984, after the campaign. Mich Con states that the survey also shows that Mich Con's customers had better attitudes if they saw more corporate ads. The significance of the percentages by group, however, cannot be ascertained without knowing the number of respondents in each group. Mich Con's market opinion research study is also unpersuasive on the basis that it did not provide any empirical or theoretical evidence which would tend to prove that Mich Con's customers take action more readily on the public service advertisements as a result of the corporate image-building advertising. Even if Mich Con had been able to show an improved image preception as a result of the ads, without proof of some concrete change in customer behavior, the Commission is not inclined to pass along promotional



advertising costs to ratepayers.

Finally, the Commission agrees with the ALJ that the issues involved in corporate advertising tend to be similar to the issues of contributions. Contributions, like corporate advertising, tend to enhance the image of Mich Con and to portray Mich Con as "the good guy." The goal is to persuade Mich Con's customers, both subtly through advertising and directly through contributions, that Mich Con is a trustworthy and civic-minded organization that has the best interests of its customers in mind. Essentially, what Mich Con is seeking is to have its customers pay Mich Con to demonstrate to themselves Mich Con's virtuosity. The incongruity of seeking over \$1,000,000 of expense from ratepayers for advertising and contributions directed at Mich Con's image enhancement far overshadows the potential that the by-product of this image enhancement might, in some way, benefit the customers. This possibility is simply insufficient to warrant the Commission's altering its long-held policy of disallowing promotional advertising.

#### Joint Expenses

Joint expenses are expenses related to distribution which must be allocated between construction accounts and O&M accounts. In 1984, Mich Con changed its allocation method so that it began allocating its expenses based on the percentage of direct labor included in each category. Mich Con's witness, Gilbert R. Lavey, testified that Mich Con changed its procedure because it viewed the new allocation methodology as an improvement over the old one, which was based on both direct and contract labor costs. Mr. Lavey recalculated the amount of joint expense which would have been charged to O&M expenses in 1983 under the new allocation methodology and testified that this would add \$1,120,000 to O&M expense after adjusting for inflation.

In its brief, the Staff opposed Mich Con's suggestion on the basis that it

does not reliably predict the amount of joint expense charged to O&M in the projected test period. The Staff pointed to Exhibit A-80 which provided an estimate of the 1984 joint expenses charged to O&M expenses, as compared to the 1983 amount of joint expenses charged to O&M expenses. The exhibit reflected in 1984 the new allocation methodology and was based upon the estimated mix between direct and contract labor costs during 1984. The result was that the 1984 joint expense charge to O&M exceeded 1983's by \$586,000. The wide variation in the results caused the Staff to question the reliability of projecting this change and the associated mix of expenses into the projected test year.

In its brief, ABATE also opposed the adjustment for joint expenses on the basis that the prior methodology had been employed for many years and was, in fact, the basis upon which 1983 joint expenses were allocated. ABATE contended that, in light of these facts and the magnitude of the item, the additional O&M expense adjustment should be denied.

The ALJ concluded that there was no basis upon which to determine the effect of the new allocation methodology in the projected test year. Accordingly, he found that Mich Con's proposed adjustment for a change in the allocation methodology for joint expenses had not been substantiated and should be rejected.

Mich Con excepted to the ALJ's rejection of the joint expenses adjustment. Mich Con argues that the ALJ's rejection of the joint expense adjustment was based on the same erroneous rationale as the Staff's -- that because different amounts of joint expense would have been charged to O&M for two different periods under the new methodology, there is something wrong with the calculation. According to Mich Con, accounting periods virtually always produced different results; that different results would have occurred in this instance is of no significance. Mich Con stresses that none of the parties presented a direct challenge to the accuracy of Mich Con's calculation or the new methodology.

Mich Con also maintained that the ALJ's concern with the question of whether the expense mix is representative of the future test year is misplaced in view of his adoption of the Staff's O&M methodology. The Staff was not concerned with projected costs. Its theory was that some costs will go up, others will go down, and everything will balance out. Under that approach, actual projected cost is irrelevant -- only the starting point or base matters. Mich Con maintains that its adjustment merely attempts to make the Staff's base more representative of a fair starting point.

The Commission does not believe that Mich Con's new methodology should be used in this particular proceeding. While nothing is inherently suspect about the methodology, the initial results of its application in the projection are unknown. Since there is no indication in the record as to what mix of expenses to expect for the projected test period, the Staff's projected allowance should be more representative of the costs expected to be incurred in the projected period. Thus, Mich Con's proposed adjustment should be rejected.

The Commission adopts all of the other O&M findings made by the ALJ inasmuch as the parties have filed no exceptions in that regard. The Commission also takes this opportunity to address Mich Con's implementation of the Home Heating Maintenance Plan (also known as the Appliance Maintenance Contract Program). While the Commission is not opposed to this program per se, it cautions Mich Con that it must operate this program in a manner which strictly isolates expenses and revenues to assure that ratepayers, other than those participating in the program, are not assessed the costs of the program.

Based on the discussion above, the Commission adopts an O&M expense allowance of \$182,116,000. This results in a reduction to net operating income of \$3,241,000 from the historical test period.

### Commitment Fees

In its reply brief, the Staff opposed Mich Con's request to include \$341,000 in commitment fees, arguing that Mich Con would be able to borrow through commercial paper and, therefore, would have no need for substantial lines of credit. The ALJ disagreed, concluding that it was prudent for Mich Con to maintain its lines of credit. While no exceptions were filed, the Commission nevertheless believes the Staff's analysis should be given some measure of support. In light of Mich Con's financial strength and lowered interest rates, it is reasonable to conclude that the company will pursue much of its borrowing through readily available and attractive commercial paper. Its commitment fees will thus be minimized. Since the degree of that minimization is unknown, the Commission believes that Mich Con should be allowed to recover one-half of its commitment fee request, for a net adjustment of \$90,000.

### Provision for Uncollectibles

In its brief, Mich Con sought to adjust the test period provision for uncollectibles downward by \$2,978,000 based on a total allowance for uncollectibles of about \$36,500,000. The Staff reduced the provision for uncollectibles by \$8,014,000 based on a total provision of uncollectibles of approximately \$31,500,000. Of the difference between the Staff and Mich Con, \$2,600,000 is related to the cost of gas consumption which has already been resolved. Accordingly, the Commission reduces uncollectibles by \$2,600,000.

### Energy Assurance Program

In its testimony and brief, Mich Con acknowledges savings of \$4,900,000 related to the implementation of the EAP and its impact on uncollectibles. The Staff, on the other, would deduct \$360,000 because Mich Con did not implement the program within 30 days after the Commission's order approving the program.

It would also reduce uncollectibles by \$396,000 on the basis that the EAP will increase the number of customers who will have to pay a deposit in order to get service from Mich Con. The Staff next decreased the provision for uncollectibles by \$800,000 based on Mich Con's stated goal, discovered in an internal memorandum, to increase agency collections from 10% to 12%. Finally, the Staff proposed to recognize \$900,000 to account for the effect of pipeline refunds on uncollectibles, based on an historical five-year average of such refunds.

In its brief, Mich Con contests the \$360,000 adjustment on the basis that Mich Con could not have implemented the program within 30 days after the Commission's order due to the need to train employees with respect to the new rules governing the program. Mich Con contends that once the rules were finalized, it had to meet with members of the Staff to interpret certain provisions and then pass those interpretations on to involved employees. Consequently, it was unable to implement the program for a period of about 90 days.

With respect to the \$396,000 related to customer deposits, Mich Con maintains that there is no basis upon which this adjustment was calculated and it should be rejected as arbitrary.

With regard to increases in bad debt recoveries, Mich Con maintains that the 12% collection agency rate was a goal stated by an employee of Mich Con, but was probably unobtainable. Further, if an adjustment were permitted, Mich Con maintains that it should be reduced by \$240,000 to account for agency fees of 30%.

Finally, Mich Con contends that the use of an historical five-year average of pipeline refunds is misleading and should not form the basis for projecting the amount of pipeline refunds which will be received in the projected test period. It maintains that refunds during the historical five-year period were unusually large and therefore unreliable for purposes of establishing the figure

in this proceeding.

The ALJ agreed that Mich Con had acted reasonably in taking up to 90 days to implement the EAP. He also agreed with Mich Con that the 12% goal of bad debt recoveries was probably unrealistic. He did recommend, however, a 1% increase in the 10% historical experience and offset that increase by 30% for associated agency fees. The ALJ did not accept the Staff's estimate of the reduction of customers who would not have to pay a deposit on the basis that the Staff had not provided a sound analysis or method for its calculation. Finally, the ALJ accepted all of Mich Con's arguments regarding the effect of pipeline refunds. Accordingly, he rejected the Staff's reduction of \$900,000 associated with increased refunds. The results of the ALJ's recommendations produced an addition to net operating income of \$3,079,000 based on a gross adjustment of \$5,838,000. (Both figures include the \$2,600,000 adjustment related to cost of gas and its effect on the provision of uncollectibles.)

The Staff excepted to the ALJ's findings relative to the EAP recoveries of accounts written off and customer refunds. It did not, however, except to the ALJ's approval of a 90-day EAP implementation schedule. As to the EAP, the Staff maintains that the Commission should adopt its adjustment to the uncollectible accounts expense of \$396,000 to reflect a lower number of projected test-year customers charged off who will not have paid a deposit when they obtained new service. The Staff believed that its 7.5% estimate in the number of customers was more appropriate than Mich Con's 15%. According to the Staff, Mich Con's methodology in determining the appropriate percentage overstated the percentage of new customers who will not pay a deposit and who will become a bad debt in the projected test year. The Staff maintains that this is because the study, a 1978 market opinion research survey relied upon by Mich Con, is based on gas customers in arrears with their gas bills who maintain good credit with

their electric or telephone utilities. The Staff argues that it is unreasonable to assume that new customers who had good credit when they applied for gas service will be the same customers who will become bad debts in the future. It is more reasonable to assume that those customers with bad credit ratings, who therefore will be required to pay a deposit when they apply for gas service, are likely to be the customers written off in the projected test year.

The Commission does not accept Mich Con's premise that because 15% of its new customers who eventually go into arrears have good credit ratings, likewise, 15% of all the uncollectible new customers will also have good credit ratings. Customers in arrears with proven good credit ratings will obviously be much more likely to eventually pay their gas bills and, therefore, not even be in the population of charge-off customers than the 85% who do not have good credit ratings. For that reason alone, the Commission cannot reasonably accept Mich Con's figure of 15%. Although the ALJ had rejected the Staff's estimate for want of a sound analysis for the calculation of the percentage, the Commission determines that the Staff's method is better than that used by Mich Con. Accordingly, the Commission rejects Mich Con's overstatement and adopts the Staff's position, that 7.5% of Mich Con's new customers charged off in the projected test year will not have paid deposits, and adopts the Staff's adjustment of \$396,000.

In its second exception, the Staff disagreed with the ALJ's recommendation that additional collection agency fees be allowed because the Staff did not reference any document in the record where the inclusion of such additional fees is found in the Staff's O&M expense. The Staff maintains that its Exhibit S-76, Schedule C, line 16, as well as the cross-examination of its witness at 20 Tr. 2646-47, and the additional information in the base level of collection agency fees given at 20 Tr. 2765, demonstrate that the Staff has allowed ample expense for the projected test year collection agency fees.

The Commission has reviewed the cross-examination of the Staff's witness, as well as Exhibit S-76, and concludes that the Staff has allowed ample expense for the projected test year collection agency fees. As reflected in the record, the Staff has allowed over \$2,033,000 for such fees compared with an historical test year allowance of \$1,822,000. The difference of \$211,000 provides collection agencies a return on their recoveries which the Commission finds is sufficient.

Finally, with regard to the Staff's adjustment to reflect the effect of customer refunds on bad debts, the Staff maintains that the ALJ erred in agreeing with Mich Con that no reduction should be recognized because the refunds during the historical five-year period were unusually large. It maintains that the ALJ failed to recognize that Mich Con continues to generate large refunds. In fact, according to the Staff, Mich Con's 1983 GCR refund was \$21,000,000. In addition, the Staff maintains that the ALJ was mistaken in his belief that the Staff's adjustment was based, in part, on anticipation of future pipeline increases which the Staff's witness, Roger Lamb, had indicated would not occur. The Staff pointed out that pipeline refunds can occur for various reasons besides pipeline rate increases. Examples would include court rulings, as in the recent ruling on the proper measurement of Btu content of gas sales, as well as changes in rate design, etc. In addition, Mich Con generates refunds in its own operations through the GCR process and the 90-10 plan.

The Commission agrees that refunds will continue to have an effect on bad debt recovery. Mich Con's 90-10 plan, as well as its GCR Plan, will continue to operate during the projected test year. Both of these plans have the potential of providing significant refunds. It is unreasonable and unfair to Mich Con's customers to ignore the effect of reduced uncollectibles which result from these customer refunds. Since the Staff's method of using the five-year average



is the only method on the record and since it appears reasonable and is supported by historical data, the Commission concludes that it should be adopted. Adoption of this recommendation results in a \$900,000 reduction of the provision for uncollectibles.

#### Gas Research Institute Funding

In its brief, the Staff reduced Mich Con's request for Gas Research Institute (GRI) funding. Mich Con had requested that the Commission allow \$750,000 for this item of expense. In its brief, Mich Con did not contest the Staff's adjustment. The Attorney General contended that no allowance for GRI funding should be made since no direct benefit is given to Mich Con's customers as a result of the GRI activities.

The ALJ believed that the GRI activities were, in the long run, beneficial to Mich Con's customers and, given the fact that Mich Con had not contested the Staff's adjustments to its request, the ALJ recommended a reduction of net operating income of \$250,000, as proposed by the Staff.

The Attorney General excepted to the ALJ's recommendation. He maintained that there was no showing or support in the record whatsoever that the GRI research would directly benefit Mich Con's customers. He also pointed out that Mich Con has not contributed the amount allowed in the past by the Commission (20 Tr. 2545).

The Commission disagrees with the Attorney General's position. It believes that the research that is undertaken by GRI was designed to benefit customers in the long run, as well as gas companies such as Mich Con. Since there is a benefit to both the ratepayer and the company, it is appropriate that they share in this cost.

#### Job Development Investment Tax Credit

None of the parties disputed including the Job Development Investment Tax

Credit (JDITC) in the calculation of the overall rate of return. Further, no one disputed the Staff's amortization of JDITC in calculating net operating income. The only issue raised was the Attorney General's recommendation that an interest component at the overall rate of return assigned to JDITC be imputed and that the associated tax consequences be reflected as an increase in net operating income of \$219,000.

The ALJ found that long-standing Commission policy precludes treatment of JDITC as recommended by the Attorney General. He therefore rejected the adjustment.

The Attorney General excepted to the ALJ's recommendation on the basis of the same arguments set forth in his brief. Specifically, he argues that the adjustment he proposed is necessary because if JDITC were not included in the capital structure, it would be replaced with equity and long-term or short-term borrowing. If such were the case, there would be an interest deduction associated with additional debt and the capital structure. He maintains that his adjustment will provide to ratepayers the tax benefits of the interest deduction whether or not JDITC is included in the capital structure.

The Commission has considered the treatment of JDITC before and remains unpersuaded by the Attorney General that his treatment of JDITC should be adopted.

#### Campaign Expenses Penalty

In its Opinion and Order in Cases Nos. U-7395 and U-7397 dated April 9, 1985, the Commission determined that Mich Con, together with The Detroit Edison Company and Consumers Power Company, had improperly expended funds collected from their ratepayers for the purpose of defeating Ballot Proposal D. The Commission therefore ordered the utilities to reflect in their next respective rate cases a one-time penalty equal to their individual expenses for payroll and

overhead, plus their pro rata share of the campaign contributions solicited. Mich Con's total penalty was set at \$958,950. The Attorney General has filed Motion I to reopen the record in this proceeding to afford the parties an opportunity to introduce the Commission's order and to argue for the disallowance of an amount equal to Mich Con's share in the campaign expenses.

The Commission does not believe it is necessary to reopen the record for the simple reason that there are no evidentiary questions to resolve. The questions of whether Mich Con should be assessed a penalty and, if so, what amount, already have been resolved. Additional argument on these questions would be a waste of both the Commission's and the parties' resources. Furthermore, the Commission notes that neither Mich Con nor any other party has appealed the ballot proposal decision. The underlying findings in the April 9, 1985 order may therefore be incorporated in this case.

The Commission also believes that it is appropriate to assess the ballot proposal penalty against Mich Con at this time rather than waiting until the next round of rate hearings. Although the Commission did not address the issue of assessing the penalty in pending cases, there are no factors to counter imposing the penalty at this time. The fact that Mich Con continues to benefit from funds that properly belong to the ratepayers, in fact, persuades the Commission that the penalty in the net amount of \$506,000 should be applied at this time.

#### Summary of Adjustments to Net Operating Income

| <u>Description</u>            | <u>Net</u> |
|-------------------------------|------------|
| Recorded Net Operating Income | \$54,048   |
| AFUDC                         | <u>788</u> |
| Subtotal                      | \$54,836   |

Summary continues . . .

|  |            |
|--|------------|
| Revenue and Cost of Gas, including Company Use<br>and Lost and Unaccounted For Gas | \$22,291   |
| Revenue from Special Contract Sales  | 13,142     |
| Depreciation   | (6,339)    |
| Amortization of Michigan Income Tax  | (531)      |
| Depreciation - 26th Floor  | 31         |
| Exempt Vacation Accrual  | (254)      |
| Elimination of Utility Storage Revenue   | (1,821)    |
| Elimination of Cost of Produced Gas  | 3,388      |
| Discounts on Reacquired Debt   | 944        |
| AFUDC  | 251        |
| Stand-By Revenues  | 243        |
| Utility Transportation Revenue   | (56)       |
| ISD - Revenue  | (134)      |
| Late Payment Revenue   | (147)      |
| Oil and Extracted Products   | (526)      |
| Miscellaneous Revenues   | 461        |
| O&M Expense  | (3,241)    |
| Commitment Fees  | (90)       |
| Provision for Uncollectible Accounts   | 3,825      |
| Elimination of Heat Bank & S.U.R.E.  | 1,055      |
| Property Taxes   | (1,821)    |
| Michigan SBT   | 154        |
| Employment Taxes   | (766)      |
| Schedule M Adjustment  | 818        |
| Deferred Taxes on Indirect Construction Costs                                      | (261)      |
| Amortization of ITC  | 895        |
| City Income Tax  | (230)      |
| ESCOR Operating Income   | 686        |
| Income Tax Effect Due to Change in<br>Rate Base and Capital Structure              | (5,009)    |
| Gas Research Institute   | (250)      |
| Campaign Expense Penalty   | <u>506</u> |
| Adjusted Net Operating Income  | \$82,050   |

## VII.

### REVENUE DEFICIENCY

The revenue deficiency, given the findings above, is calculated as follows:

| <u>Description</u>            | <u>Amount</u>     |
|-------------------------------|-------------------|
| Rate Base                     | \$886,198,000     |
| Overall Return                | <u>9.26%</u>      |
| Income Required               | \$ 82,062,000     |
| Adjusted Net Operating Income | <u>82,050,000</u> |
| Income Deficiency             | \$ 12,000         |
| Revenue Multiplier            | <u>1.896%</u>     |
| Revenue Deficiency            | \$ 23,000         |

The revenue deficiency is de minimus. The Commission concludes, therefore, that no rate increase is warranted.

### VIII.

#### RATE DESIGN

Since the Commission has determined that no rate increase or decrease is appropriate in this proceeding, various cost-of-service arguments set forth by the parties are irrelevant. The Commission, nevertheless, takes this opportunity to reassert its commitment to continue to close the gap between rates as they are currently set and rates set purely on the basis of cost of service.

Several other rate design issues remain despite the absence of a revenue deficiency distribution. Mich Con has proposed increases in its monthly customer charges. It proposes to increase Rate 1 from \$15 to \$30; Rate 2 from \$7.50 to \$15; Rate 2a, Class I, from \$7.50 to \$15; Rate 2a, Class II, from \$15 to \$30; Rate 2a, Class III, from \$40 to \$50; Rate 2a, Class IV, from \$80 to \$100; and Rate 10 from \$200 to \$250. All other customer charges would remain unchanged. Mich Con maintains that the above changes are justified by its cost-of-service study and that with the proposed increases the customer charges would not be as much as the cost-of-service study would dictate they should be. It argues that higher customer charges decrease the hardship on customers in times of harsh weather because of the reduced commodity charge. Similarly, a higher customer charge benefits higher-consumption customers, who tend to have the greatest difficulty in paying their gas bills. Moreover, Mich Con maintains that its revenue stability would be greatly enhanced should the monthly charges be increased.

The Staff maintains that increasing the customer charges would improve revenue stability just as surely as increases of this magnitude would destabilize

Mich Con's and the Commission's public relations. The adverse impact of increasing Mich Con's customer charge so soon after its last increase was one of several reasons cited by the Staff for recommending no increase. The Staff further argues that uncollectibles should not be allocated to the monthly customer charges proposed by Mich Con. The Staff maintains that uncollectibles are related to revenues and their recovery should be reasonably coincident with their incurrence.

MBUUC also opposed the increase in monthly customer charges on the basis that some classes would receive a 100% increase in such charges, while other classes would receive no increase under Mich Con's proposal. MBUUC viewed this as an inequitable proposal.

The Commission finds that the 100% increase in customer charges proposed by Mich Con would result in substantial inequities to very small volume customers. Noting that Mich Con has not presented a record which provides a cost justification for a 100% increase in customer charges, and mindful of the fact that Mich Con was allowed to raise its customer charges by 50% in its last rate proceeding, the Commission concludes a customer charge increase at this time is unwarranted.

#### Rate 3A

In connection with the EAP, Mich Con proposed a new senior citizen discount Rate 3A. Eligibility for the new rate would be limited to those senior citizens who met a maximum income test (Exhibit A-14). The customer charge and distribution charge for Rate 3A would be identical to those applicable to the existing residential Rate 2, but bills for such customers would be reduced by winter credits in an amount equal to a 5% discount on the bill of a residential customer using 150 Mcf per year. The credit would be applied during the four winter months of December through March. Net revenue loss resulting from the discount would be recovered from all residential customers in the residential customer

service charge (12 Tr. 1237). To avoid an adverse impact on existing Rate 3 customers who do not qualify for Rate 3A, Mich Con proposed a grandfathering provision.

The Staff opposed the replacement of the current Rate 3 with Rate 3A on the basis that it would be a savings of only an additional \$33 per year for the typical customer. In the Staff's opinion, this savings is not enough to warrant the proposed change. The Staff further takes the position that the cost of the program, if implemented, should be recovered from all customers, not simply from residential customers. ABATE, on the other hand, opposed spreading the cost of the program beyond the residential customers on cost-of-service grounds.

The ALJ concluded that Rate 3A would provide an appreciable benefit to eligible senior citizens. He proposed adoption of the rate. The ALJ also reasoned that the residential class should be responsible for the cost of the program since it is only residential customers who can become eligible to benefit from the program, and all residential customers would ultimately have an opportunity to become eligible for the program.

The Staff reiterates its opposition to Rate 3A in its exceptions.

The Commission finds that Mich Con's proposed Rate 3A is reasonable and appropriate. The current Rate 3 saves all senior citizens approximately \$15 per year whether they have adequate financial resources or not. Rate 3A, on the other hand, concentrates more savings where they are most needed. Rate 3A thus directly addresses the underlying purpose of a senior citizen rate. Since Mich Con has agreed to grandfather the current Rate 3 customers into the Rate 3A program, disruption among the senior customers will be minimized.

The Commission also finds that the costs of the Rate 3A program should be recovered only from the residential class as only residential customers may become eligible for the Rate 3A program.

### Standby Service

In Case No. U-7298, the Commission included a standby service provision in the interruptible Rate 7. In that case, the standby provision was made applicable to those customers who do not wish to take gas from Mich Con but who wished to have gas service available on a standby basis. The charge for interruptible standby service was \$50 per MMBtu of nameplate capacity, while the standby charge for other rate schedules was \$65 per MMBtu of nameplate capacity.

Traverse City argued that it is not appropriate to recover capacity costs from interruptible customers who receive service only if capacity is available after all firm customers receive service. Traverse City maintains that the payment of the charge does not entitle the customer to any service and, therefore, sharing of capacity costs is inappropriate. As an alternative to the elimination of the standby service provision and the related \$50 per MMBtu of nameplate capacity charge, Traverse City argues that the standby service provision should be modified to establish a separate standby service provision for interruptible customers. These customers should be charged \$35 per MMBtu of nameplate capacity plus a commodity charge equal to the cost of gas. As a third alternative, Traverse City contends that, rather than adopting an MMBtu of nameplate capacity charge, interruptible standby customers should be charged a minimum bill amount. Traverse City argues that \$35, based on a \$.47 spread for interruptible customers, is a reasonable charge. On the other hand, the \$50 charge is arbitrary and not the result of cost-of-service studies.

Both Mich Con and the Staff oppose any changes to the current interruptible standby service provisions. The Staff contends that, except during periods of interruption, standby service must be available on demand and that the necessary capacity must be made available to provide such service. Thus, according to the Staff, capacity costs should be assessed to Rate 7 standby customers. The Staff



further contends that the \$50 charge is not arbitrary and is based on the historical difference between Rate 6 firm service distribution charges and Rate 7 interruptible service.

Mich Con contends that the Staff's recommended spread in this case is \$1.05 and application of that spread to the standby service provision would produce a \$75 charge. Alternatively, Mich Con's recommended spread of \$.97 would produce a \$70 charge. In any event, Mich Con contends that the \$50 charge assessed to the interruptible customer for standby service is reasonable by comparison.

The ALJ agreed with the Staff and Mich Con that it was appropriate to assess capacity costs to interruptible customers who are on standby service. He further recommended that the \$50 charge was reasonable and should be adopted.

In its exceptions, Traverse City argues that the ALJ erred in retaining the standby service provision in the interruptible Rate 7. It also maintains that the ALJ failed to address and consider Traverse City's proposal to treat the standby service charges as a minimum billing amount or to create a separate interruptible standby service rate. Finally, it argues that the ALJ erred in rejecting its proposal that the standby charge be set at \$35 per MMBtu of contracted nameplate capacity.

The Commission believes that it is appropriate to assess capacity costs to interruptible customers who are on the standby service provision. Although Traverse City maintains that interruptible customers should be excluded from a standby service charge, this argument is without merit. The justification for exclusion of interruptible customers is that they impose no demand upon a utility. In a theoretical sense, this arguably could be true. However, in Mich Con's real-life situation, interruptible customers are quite different from the theoretical ideal. In considering the theoretical ideal, the idea of having interruptible customers is to give Mich Con the flexibility of flattening its load growth.

However, flattening the load growth is achieved by interruptions of service and Mich Con has not interrupted any customers in the past seven years. Therefore, Mich Con is incurring a demand-related cost to serve interruptible customers and, consequently, these customers should not be exempted from the standby charge.

The Commission is also persuaded that the \$50 per MMBtu of nameplate capacity charge should be retained. The Commission determined in Case No. U-7298 that a \$50 per MMBtu surcharge established in Case No. U-7298 was justified for the type of service Rate 7 customers demanded. The surcharge, further, is consistent with the rate established for large-volume therm customers in Case No. U-6939.

The Commission is also fully convinced that the \$50 surcharge should be retained because calculation of Traverse City's \$35 proposed charge is flawed. Traverse City's witness's charge was based on a 10.22% return for Rate 7 customers (18 Tr. 2141, Exhibit A-63). This return applied a spread for Rate 7 of only about \$.47 per MMBtu (18 Tr. 2142). In contrast, the Staff's proposed spread for Rate 7 was about \$1.05 per MMBtu (Exhibit S-70, Schedule F-5). Thus, Traverse City's reduced standby charge was calculated on the basis of a significant change in Rate 7 cost responsibility, cutting the allocation of cost of service to Rate 7 by over 50%. This cut in the allocation of cost is entirely unrealistic.

In its exceptions, Traverse City also included 12 proposed findings of fact (which are set forth in Appendix A). The Commission has addressed proposed findings nos. 1, 2, 4, 9 and 11 in the context of the discussion above. With respect to proposed findings nos. 3, 5 and 7, the Commission finds that to the extent that there is double recovery of capacity-related costs, such double recovery is minimal. The \$50 surcharge provides a substantial discount from the rate charged for standby service customers. This is despite the fact that firm and

interruptible service customers in Mich Con's service territory receive virtually the same service. Additionally, the Commission is not convinced that a double recovery actually occurs because there has been no accurate showing of where a double recovery results.

Traverse City's proposed findings nos. 6 and 8 propose alternatives to the current method of determining the standby service surcharge. The Commission is unpersuaded that the standby service charge should be treated as either a minimum billing amount or as a separate service rate. The current surcharge of \$50 per MMBtu of nameplate capacity is rationally related to the charge imposed on firm customers who are provided standby service. There is nothing in the record that would convince the Commission that the current surcharge approach is improper or unreasonable. Accordingly, there is no justification for establishing a separate rate or a minimum bill approach.

#### Miscellaneous

The Commission notes the Attorney General's Motion II which seeks to reopen the record for the purpose of considering 1984 actual operating results. It is unpersuaded that such a reopening is appropriate. Proceedings must have a definite ending point; otherwise, parties would continually seek reopenings to introduce more recent data. Only for exceptional circumstances, therefore, will the Commission reopen a record.

The Attorney General cites no exceptional circumstances. The parties to this proceeding, including the Attorney General, agreed to the use of the 1983 historical test year. That the Attorney General now thinks 1984 would be a more representative test year is not a sufficient reason to set aside the parties' agreement and reopen the record. This, essentially, would start this proceeding over from the very beginning. Accordingly, the Commission denies Motion II.

The Commission has considered all arguments and exceptions of the parties. It is neither practical nor useful for the Commission to attempt to detail every reason in support of each decision. The arguments and exceptions not discussed above and that are inconsistent with the Commission's decision have been considered and rejected. Also, where the Commission agreed with the rationale and recommendations of the ALJ, no further explanation was deemed necessary. The Commission, therefore, accepted those recommendations without comment.

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. The test year July 1, 1985 to June 30, 1986 is reasonable and appropriate for the purpose of establishing rates in this proceeding.
- c. A rate base for Mich Con of \$886,198,000 is reasonable and just for the purpose of establishing rates in this proceeding.
- d. An overall rate of return of 9.26%, including a 14.82% return on common equity, is just and reasonable for the purpose of establishing rates in this proceeding.
- e. The adjusted net operating income for the test year for the purpose of establishing rates in this proceeding is \$82,050,000.
- f. Mich Con's expected deficiency is \$23,000.
- g. Mich Con's revenue deficiency is insufficient to warrant a change in rates.
- h. The gas rate schedules, attached hereto as Exhibit A, will result in just and reasonable rates and charges for the sale of gas energy, and should be made effective for service rendered on and after July 1, 1985.

i. The Attorney General's Motions to Reopen Record should be denied.

j. All contentions of the parties not specifically determined should be rejected, the Commission having given full consideration to all evidence of record and arguments made in arriving at the findings and conclusions set forth in this Opinion and Order.

THEREFORE, IT IS ORDERED that:

A. The rate schedules of Michigan Consolidated Gas Company, attached as Exhibit A, are hereby approved for service rendered on and after July 1, 1985.

B. In conformance with the Commission's order in Case No. U-6300, Filing Procedures, Michigan Consolidated Gas Company shall, within 30 days of the date of this order, file with the Commission rate schedules and tariffs in substantial conformity with Exhibit A.

C. The Attorney General's Motions to Reopen Record are denied.

D. All contentions of the parties not specifically determined are hereby rejected, the Commission having given full consideration to all evidence of record and arguments made in arriving at the findings and conclusions set forth in this Opinion and Order.

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 30 days after issuance and notice of this order, pursuant to MCLA 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

/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 June 26, 1985.

/s/ Bruce R. Maughan  
Its Secretary

TRAVERSE CITY BOARD OF LIGHT AND POWER

PROPOSED FINDINGS OF FACT

1. Capacity costs, except costs of local delivery and metering, are not incurred by Michigan Consolidated Gas Company to serve interruptible customers.

2. Capacity costs, except costs of local delivery and metering, should not be incurred by Michigan Consolidated to serve interruptible customers.

3. The current Standby Service provision in Interruptible Rate 7 results in the double-recovery of the same capacity-related costs.

4. There is no evidence on the record to support continuation of the current Standby Service provision. The Standby Service provision in Interruptible Rate 7 should be eliminated.

5. Treating the Standby Service charge as a minimum billing amount, as proposed by the Light and Power Board, avoids the double-recovery of the same capacity-related costs.

6. The Standby Service charge for an interruptible customer should be treated as a minimum billing amount.

7. Creating a separate Interruptible Standby Service Rate, as proposed by the Light and Power Board, avoids the double-recovery of the same capacity-related costs.

8. A separate Interruptible Standby Service Rate should be created.

9. The current Standby Service charge of \$50.00 per MMBtu of nameplate capacity is unsupported by any cost-of-service study or other competent, material and substantial evidence on the record in this case.

10. The \$35.00 per MMBtu of contracted nameplate capacity charge proposed by Mr. Herz is based on the cost of service.

11. The \$35.00 charge proposed by Mr. Herz will permit the full recovery of any capacity-related costs incurred by Michigan Consolidated Gas Company to serve an interruptible standby service customer.

12. The \$35.00 charge proposed by Mr. Herz is supported by the competent, material and substantial evidence on the record and should be adopted.

MICHIGAN CONSOLIDATED GAS COMPANY

Rules and Regulations

15. Service Restoration and Meter Relocation Charges:

A. Charges to offset the costs of restoring service and costs of meter relocation, if applicable, to customers whose previous service has been discontinued for nonpayment of bills or for any other breach by customers of the Company's Rates, Rules and Regulations, will be collected by the Company as follows:

- (1) Where service has been discontinued as a result of theft, a charge of \$500.00 will be collected if service was terminated by cutting and capping the service line. In all other cases where service has been discontinued as a result of theft, a charge of \$15.00 will be collected.
- (2) Where service has been discontinued as a result of non-payment, a charge of \$100.00 will be collected if service was terminated by cutting and capping the service.
- (3) In all other circumstances where service has been discontinued, a single service restoration charge of \$15.00 will be collected.
- (4) As provided under Rule 55 of the Consumer Standards and Billing Practices where a meter has been relocated, a charge of \$250.00 will be collected in addition to the applicable service restoration charge payable under this rule.

All service restoration charges are charges for gas service and are subject to the same payment requirements applicable thereto.

B. No service restoration charge shall be collected where the customer is receiving State or Federal assistance or a State or Federal agency determines that the customer is eligible to receive assistance, and the agency agrees to pay all or a satisfactory part of the customer's arrearage in accordance with the standards set forth in Rule 34 of these Rules.



# Michigan Consolidated Gas Company

Rate Schedule No. 2

Applicable to All Districts

## RESIDENTIAL RATE

**Character of Service:**

**Who May Take Service:**

Subject to limitations and restrictions contained in orders of the Michigan Public Service Commission in effect from time to time and in the Rules and Regulations of the Company, service is available under this rate schedule to any residential customer for residential service as hereinafter defined. As used in this rate schedule "residential service" means service to any residential customer for any purpose, including space heating, by individual meter in a single family dwelling or building; or in an individual flat or apartment, or to not over four households served by a single meter (one customer) in a multiple family dwelling, or portion thereof. Residential premises also used regularly for professional or business purposes (such as doctor's office in a home, or where a small store is integral with the living space) are considered as residential where the residential use is half or more of the total gas volume; otherwise, these will be provided service under Rate Schedule No. 1.

For purposes of rate application "residential usage" shall be usage consumed within an individual household, or reasonably appurtenant and related to, and normally with such a household, for such applications as space conditioning, cooking, water heating, refrigeration, clothes drying, incineration, lighting and other similar household applications.

**Hours of Service:**

Twenty-four hours per day.

**Rate:**

Customer Charge: \$7.50 per customer per month, plus  
Distribution Charge: \$0.11294 per 100 cubic feet  
Gas Cost Recovery Charge: as set forth on Surcharge Sheet No. S-2

**Surcharges:**

This rate is subject to surcharges as set forth on Surcharge Sheet No. S-1 of the Rules and Regulations of the Company.

**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 the due date shown thereon. The due date shall be 21 days following the date of mailing. A late payment charge will not be assessed against customers participating in the Winter Protection Plan described in Rule 34 F(3).

(Continued on Sheet No. R-2-a)

# Michigan Consolidated Gas Company

## Rate Schedule No. 2A (Continued)

Applicable to All Districts

### Rate:

#### Customer Charge:

One of the following charges per customer per month will be applied:

|                           |   |                        |
|---------------------------|---|------------------------|
| Meter Class I             | \$7.50                                  | per customer per month |
| Meter Class II            | \$15.00                                 | per customer per month |
| Meter Class III           | \$40.00                                 | per customer per month |
| Meter Class IV            | \$80.00                                 | per customer per month |
| Distribution Charge:      | \$0.11294                               | per 100 cubic feet     |
| Gas Cost Recovery Charge: | as set forth on Surcharge Sheet No. S-2 |                        |

### Surcharges:

This rate is subject to surcharges as set forth on Surcharge Sheet No. S-1 of the Rules and Regulations of the Company.

### 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 the due date shown thereon. The due date shall be 21 days following 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.

### Gas Cost Recovery:

This rate is subject to adjustments for fluctuations in the cost of gas as stated in Rule No. 30 of the applicable Rules and Regulations of the Company.

### Customer Contract:

Applications for Gas Service shall be in writing upon application forms to be supplied by the Company. Existing customers who wish to connect spaceheating equipment must make written application for such service on forms to be provided by the Company.

### Rules Applicable:

Service under this schedule shall be subject to the Rules and Regulations of the Company, but not by the Case No. U-4240 billing practices.

### Controlled Service:

This rate is subject to all provisions contained in Rule No. 31 of the Rules and Regulations of the Company which are applicable to priority of service hereunder.

(Continued on Sheet No. R-2A-b)

MICHIGAN CONSOLIDATED GAS COMPANY

Rate Schedule No. 3

Applicable to All Districts

OPTIONAL RESIDENTIAL RATE  
Senior Citizen Rate

Character of Service:

Who May Take Service:

Subject to limitations and restrictions contained in orders of the Michigan Public Service Commission in effect from time to time and in the Rules and Regulations of the Company, service is available under this rate schedule to residential customers for residential service as hereinafter defined. As used in this rate schedule "residential service" means service to qualified residential customers for domestic purposes, including spaceheating, by individually metered single-family dwelling or building; or in an individual flat or apartment, served by a single meter (one customer) in a multiple-family dwelling.

To qualify for this rate, the customer must be 65 years of age and the head of household. The rate is not available for an alternate or seasonal home.

This rate is no longer available to residential customers not currently taking service under Rate 3 or to existing Rate 3 customers when: (i) there is a change in the customer of record, except where the customer's spouse aged 65 or older requests service in his or her name in which case existing Rate 3 shall continue to apply, or (ii) the customer of record relocates.

For purposes of rate application "residential service" shall be usage consumed within an individual household, or reasonably appurtenant and related to, and normally with such a household, for such applications as spaceheating, cooking, water heating, refrigeration, clothes drying, incineration and other similar household applications. "Residential usage" does not include usage for lighting, air conditioning or swimming pool heating.

Hours of Service:

Twenty-four hours per day.

Rate:            Customer Charge: \$7.50            per customer per month, plus  
                 Distribution Charge: \$0.10248 per 100 cubic feet  
                 Gas Cost Recovery Charge: as set forth on Surcharge Sheet No. S-2

Surcharges:

This rate is subject to surcharges as set forth on Surcharge Sheet No. S-1 of the Rules and Regulations of the Company.

MICHIGAN CONSOLIDATED GAS COMPANY

Rate Schedule No. 3A

Applicable to All Districts

LOW INCOME RESIDENTIAL RATE

Low Income Senior Citizen Spaceheating Rate

Character of Service:

Who May Take Service:

Subject to limitations and restrictions contained in orders of the Michigan Public Service Commission in effect from time to time and in the Rules and Regulations of the Company, service is available under this rate schedule to residential customers for residential service as hereinafter defined. As used in this rate schedule "residential service" means service to qualified residential customers for domestic and spaceheating purposes, provided that such consumer's premises are heated solely by gas, by individually metered single-family dwelling or building; or in an individual flat or apartment, served by a single meter (one customer) in a multiple-family dwelling.

To qualify for this rate, the customer must be 65 years of age or older and have a household income that does not exceed 125% of the federal income poverty level, as stated in Rule 34 of this Company's Rules and Regulations. Upon request of the Company, a customer shall provide information sufficient for the Company to verify that the customer is qualified for new or continued service under this rate. The rate is not available for an alternate or seasonal home.

Customers qualifying for this rate shall not be subject to discontinuation of gas service during the spaceheating season (October 1 through April 30).

For purposes of rate application "residential service" shall be usage consumed within an individual household, or reasonably appurtenant and related to, and normally with such a household, for such applications as spaceheating, cooking, water heating, refrigeration, clothes drying, incineration and other similar household applications. "Residential usage" does not include usage for lighting, air conditioning or swimming pool heating.

Hours of Service:

Twenty-four hours per day.

|       |                                |                                 |
|-------|--------------------------------|---------------------------------|
| Rate: | Customer Charge: \$7.50        | per customer per month, plus    |
|       | Winter Credit: \$12.00         | per month during billing months |
|       |                                | December through March          |
|       | Distribution Charge: \$0.11294 | per 100 cubic feet              |

Gas Cost Recovery Charge: As set forth on Surcharge Sheet No. S-2

Surcharges:

This rate is subject to surcharges as set forth on Surcharge Sheet No. S-1 of the Rules and Regulations of the Company.

# Michigan Consolidated Gas Company

## Rate Schedule No. 3A (Continued)

Applicable to All Districts

### Late Payment Charge and Due Date:

The due date shall be 21 days following the date of mailing. A late payment charge will not be assessed against customers served under this rate.

### 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.

### Gas Cost Recovery:

This rate is subject to adjustments for fluctuations in the cost of gas as stated in Rule No. 30 of the applicable Rules and Regulations of the Company.

### Customer Contract:

Applications for Gas Service shall be in writing upon application forms to be supplied by the Company. Existing customers who wish to connect spaceheating equipment must make written application for such service on forms to be provided by the Company.

### Rules Applicable:

Service under this schedule shall be subject to the Rules and Regulations of the Company.

### Controlled Service:

This rate is subject to all provisions contained in Rule No. 31 of the Rules and Regulations of the Company which are applicable to priority of service hereunder.

### Conservation of Natural Gas — Insulation:

- (1) Any customer after January 30, 1981 requesting natural gas service for spaceheating purposes in a residential structure which is not currently being heated with natural gas shall meet one of the following insulation standards:
  - (a) ceiling or attic insulation with a value of R-19 or greater, or
  - (b) as much insulation as space permits with adequate ventilation and other energy conservation methods as approved by the Company so that the total energy conservation will be equivalent to that obtained by a level of R-19 ceiling insulation.
- (2) Gas service rendered under this rate may be subject to Rule No. 32.

### Territory Served:

This rate applies in the territory served by the Company, comprising the cities, villages and townships in All Districts as stated in Rule No. 1 of the applicable Rules and Regulations of the Company.