STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter, on the Commission's own motion, of the rates and tariffs of MICHIGAN CONSOLIDATED GAS COMPANY regarding gas transportation service and related matters.	Case No. U-8635
In the matter of the application of MICHIGAN CONSOLIDATED GAS COMPANY for authority to file revised rate schedules.	Case No. U-8812
In the matter of the application of MICHIGAN CONSOLIDATED GAS COMPANY for approval of long-term special gas transportation agreements.	Case No. U-8854

At a session of the Michigan Public Service Commission held at its offices in the city of Lansing, Michigan, on the 22nd day of December, 1988.

PRESENT: Hon. William E. Long, Chairperson
Hon. Steven M. Fetter, Commissioner
Hon. Ronald E. Russell, Commissioner

OPINION AND ORDER ESTABLISHING RATES

I.

BACKGROUND

Pursuant to the Commission's order and notice of hearing dated December 17, 1986 in Case No. U-8635, a contested case proceeding was begun regarding gas transportation service and related matters on the Michigan Consolidated Gas Company (Mich Con) system. Administrative Law Judge Robert L. Shankland presided over this contested case, which began on March 17, 1987 and continued for approximately six months.

Pursuant to its order dated May 27, 1987 in Cases Nos. U-8565, U-8684, U-8793 and U-8794, the Commission approved a settlement agreement that reduced Mich Con's rates and required the company to file a general rate case application. Mich Con filed the general rate case application, Case No. U-8812, on August 14, 1987, requesting a $35.5 million annual increase in the rates projected to be effective as of September 1, 1988. Administrative Law Judge James N. Rigas (ALJ) presided over this proceeding. The Association of Businesses Advocating Tariff Equity (ABATE) moved for consolidation of the gas transportation case with the general rate case, which was granted by Administrative Law Judge Shankland on September 25, 1987.

Concurrently with the general rate case application, Mich Con filed an application for approval of certain long-term gas transportation agreements, Case No. U-8854. ABATE also moved for consolidation of that proceeding with the gas transportation and general rate cases, which was granted by the ALJ on October 19, 1987.

Pursuant to due notice, hearings continued before the ALJ in the now combined cases.

The following participated in the proceedings: Mich Con; the Commission Staff (Staff); ABATE; Attorney General Frank J. Kelley (Attorney General); Hadson Gas Systems, Inc. (Hadson); Amoco Production Company; Kent County; Grace Petroleum, Inc., PPG Oil & Gas Company, Inc. (now a division of PPG Industries, Inc.), Peninsular Oil & Gas Company-Michigan Basin Venture No. 2 and Wolverine Gas & Oil Company, Inc. (collectively, Grace); Traverse City Light & Power Board; Michigan Gas Utilities Company; the Michigan School Gas Consortium; Shell Western E&P, Inc.; the Residential Ratepayer Consortium; Wisconsin Public Service Corporation; Keith M. Sappenfield, II; ANR Pipeline Company; Thomas C.

Pangborn, d/b/a Pangborn Exploration; Preston Oil Company and Federated Natural Resources Corporation; Southeastern Michigan Gas Company; Consumers Power Company (Consumers); The Detroit Edison Company (Detroit Edison); H&H Star Energy, Inc., d/b/a PetroStar Energy (PetroStar); H&H Energy Services (now Unicorp Energy, Inc.) (Unicorp); Michigan Power Company (now Michigan Gas Company); the Michigan Business Utility Users Committee; and the Apartment Association of Michigan. Grand Valley State College and C. Patrick Babcock, Director, Michigan Department of Social Services, filed statements of position pursuant to Rule 16 of the Rules of Practice and Procedure Before the Commission, R 460.26.

The ALJ issued his proposal for decision (PFD) on July 1, 1988. Mich Con, the Staff, Hadson, Kent County, ABATE, Grace, the Attorney General, PetroStar and Unicorp filed exceptions. Replies were not provided for. On July 23, 1988, Mich Con filed a motion to strike portions of ABATE's exceptions. On August 2, 1988, ABATE filed a reply to that motion. The record consists of 4,626 pages of transcript in 34 volumes. The ALJ received 123 exhibits into the record. Hadson, Grace, PetroStar and Unicorp will be referred to collectively as the producer/broker intervenors.

II.

DESCRIPTION OF MICH CON

Mich Con, a Michigan corporation with principal offices at 500 Griswold Street, Detroit, is an investor-owned public utility engaged in the distribution, transportation and sale of natural gas throughout the state of Michigan. The company serves approximately one million customers in its Detroit, northern and western districts. At the time of hearing, Mich Con was a subsidiary of Primark Corporation.

III.

ORAL ARGUMENT REQUEST

Grace requests oral argument before the Commission, stating that the ALJ did not provide for replies to exceptions and that the gas transportation issues to be decided are important matters.

Rule 40(1) of the Rules of Practice and Procedure Before the Commission, R 460.50(1), gives this Commission the discretion to hear oral argument. In deciding whether to exercise this discretion, the Commission must determine whether a full hearing has occurred on the record, as required by the Administrative Procedures Act of 1969, 1969 PA 306, as amended, MCL 24.201 et seq. (APA).

The APA requires that parties in a contested case be given an opportunity for a prompt hearing, an opportunity to present oral and written arguments on issues of law and policy, and an opportunity to present evidence and argument on issues of fact. Further, the APA provides for the rights to cross-examine witnesses and to submit rebuttal evidence. However, once the parties have been granted a fair and impartial hearing in accordance with the full panoply of procedural safeguards guaranteed by the APA, a party does not have the right to demand oral argument. Rochester Community Schools, Board of Education v State Board of Education, 104 Mich App 569 (1981).

The record in this proceeding is complete. The Commission does not require additional information to render a decision. To grant Grace's request when the Commission has before it a full record of evidence, arguments and exhibits received at the hearing is unnecessary. Grace has not requested oral argument to supplement the record; rather Grace seeks to debate the issues raised by the

parties in their briefs, reply briefs and exceptions. We find oral argument unnecessary for our review of this record and, therefore, deny Grace's request.

IV.

TEST YEAR

In each rate case, a test year must be selected and appropriate adjustments made so that the operating results of the test year will be representative of the future and thus afford a reasonable basis upon which to predicate rates that will be in effect in the future. In this proceeding, Mich Con and the Staff have based their presentations upon a projected test year of the 12 months ending June 30, 1989. The Commission's order dated May 27, 1987 in Cases Nos. U-8565, U-8684, U-8793 and U-8794 permitted use of that test period and the remaining parties did not object. The record does not contain evidence supporting the use of any other period. The Commission adopts as reasonable the projected 12-month period ending June 30, 1989 as the test year.

V.

RATE BASE

Net Utility Plant

Mich Con's rate base consists of two elements: net utility plant and working capital. Mich Con proposed net utility plant of $813,984,000; the Staff proposed $813,904,000. The ALJ, noting that Mich Con accepted the Staff's calculation, recommended a net utility plant of $813,904,000. Exceptions were not filed and the Commission adopts as reasonable a net utility plant of $813,904,000.

Working Capital

Mich Con proposed a working capital requirement of $4,368,000. The Staff proposed a negative $3,833,000, but on brief developed a working capital requirement of a negative $10,582,000. Mich Con took issue with a number of the Staff's adjustments. The ALJ recommended a working capital requirement of $4,234,000. Mich Con, the Staff, ABATE and the Attorney General except.

Initially, the Commission must address the method to be used to establish the working capital requirement. While all parties agree that the Commission has directed that the balance sheet method is to be used to compute the working capital requirement, Mich Con and the Staff differ as to how the computation should be made. The Staff argued that a mathematical approach should be used, as discussed in the Commission's order dated June 11, 1985, in Case No. U-7350, the generic working capital case. Mich Con, on the other hand, argued that the Commission recognized in the company's last rate case, Case No. U-7895, order dated June 26, 1985, that the working capital components must also recognize the need to bridge the gap between the time of payment of expenses and the receipt of revenue. After reviewing the generic working capital case and the Commission's statements in Mich Con's last rate case, the ALJ concluded that the Staff's approach was the more appropriate, but recommended that the Commission clarify its intention.

The Commission has consistently striven to simplify the ratemaking process. Case No. U-7350 was begun to provide an easier, less complicated standardized method to compute a working capital allowance. While in the most general sense for any business, working capital comprises the more liquid assets necessary for the day-to-day running of the business, i.e., that necessary for the business to operate before accounts receivable are realized, the issue before the Commission

is not the definition of working capital; rather, it is a reasonable method to approximate that working capital requirement. We resolved that issue in Case No. U-7350 by adopting the balance sheet approach.

The Commission reaffirms its choice of methods and rejects Mich Con's attempt to again inject uncertainty into the computation. We again support the Staff's mathematical approach, finding it a simple and effective way to compute a working capital allowance. The method is straightforward and easy to comprehend, and it will reduce the controversy within a rate case. Moreover, the computational nature of the method permits the Commission to make adjustments to elements of the computation and thereby revise the calculation within a final order.

For this reason, we must also reject ABATE's contention, along with the ALJ's subsequent recommendation, that the Commission cannot compute a balance sheet working capital amount from evidence within the record. ABATE would require a separate witness to sponsor each complete calculation, thus limiting the Commission to accepting the presentation of one party or another. This is not a proper reading of our role as an administrative fact-finder. We have stated previously our intention to use a mathematical balance sheet method to compute a working capital allowance, and record evidence exists to permit that calculation. We find that no party is prejudiced by our exercise of judgment and use of experience to compute an appropriate working capital allowance.

Mich Con includes within working capital an allowance for funds expended to redeem the company's 15 5/8% series first mortgage bonds and its $3.19 series preference stock. As discussed later, these redemptions were appropriately expensed and a working capital allowance is unnecessary.

The Staff proposed that the environmental impairment reserve be reflected

in working capital. The ALJ recommended use of the reserve. Mich Con states that a reserve for an expense item, such as the environmental impairment expense, can offset working capital only if ratepayers fund the expense prior to its payment. Therefore, the environmental impairment reserve cannot be used as an offset to working capital.

As discussed later, the environmental impairment costs were properly expensed in 1984. We find that the reserve maintained on the company's books is appropriately used as a working capital offset. We reject the company's theory that only those reserves that are "prepaid" by ratepayers may be appropriately used as offsets. In the Commission's view, all Mich Con's expenses are paid by ratepayers, inasmuch as the company's major products are sold at regulated rates. Therefore, all the company's revenues are provided by ratepayers.

Because the ALJ recommended adoption of the Staff's negative pension expense, Mich Con requests a working capital allowance for the negative expense. Because as later discussed the Commission adopts a zero pension expense, a working capital allowance is unnecessary.

As part of its working capital requirement, Mich Con includes a negative amount that accounts for the difference between the average value of gas in inventory and the average balance within the company's inventory equalization account. Mich Con witness Mark Cieslak and ABATE witness Mark Drazen described the operation of these accounts.

Inventory gas is held in Mich Con's storage fields. Gas is normally withdrawn during the winter and replenished at a later time. In the normal course of a year, gas withdrawn from inventory offsets that placed into inventory. Because a significant portion of inventory gas was purchased many years ago, that gas is carried at a very low cost. However, gas withdrawn from inventory

must be replaced at a significantly higher cost. Under Mich Con's accounting system, inventory gas is valued on a last-in, first-out basis.

In order to arrive at a yearly account balance, an account is created during the year that reflects the gas taken from storage at current market costs inasmuch as market cost gas will replace the inventory gas removed, in effect cancelling out the removal of the low-cost gas. In this way, the inventory cost is maintained at a lower level and more current gas costs are recovered from ratepayers. It is the interplay between the inventory and inventory equalization accounts that produces the negative working capital requirement. The two accounts are related and the size of the negative adjustment is a function of the value of the gas in storage and the market replacement cost of gas taken from and returned to inventory. A change in any of these may have a significant impact on the negative working capital requirement.

The Staff, and eventually Mich Con, proposed use of the actual 1987 inventory equalization and inventory account balances because that year reflected the first full year of transportation activity. (The historical 1986 base that was used to project the test year did not contain a full year of transportation activity.) The Staff and Mich Con argued that the reduction of system-supply gas sales due to the great increase in transportion activity caused changes in the amount of gas sold from, carried in, and returned to inventory. The Staff's proposal reduces the negative working capital requirement that would be arrived at using the 1986 base year.

ABATE proposed using a three-year (1984, 1985 and 1986) historical relationship between gas sales and inventory withdrawals to project the working capital requirement. ABATE argued that the three-year approach is more reliable than the use of only 1987 data, suggesting that its approach ties the inventory

level to the level of gas sales. ABATE acknowledged that a lower level of sales withdrawals will increase the average balance in the inventory equalization account, but stated that Mich Con has not explained why withdrawals would be lower.

The ALJ recommended using the Staff's proposed adjustment. ABATE excepts.

The Commission finds the use of the three-year historical average relationship inappropriate. At the least, such an average should include 1987, the first full year of transportation activity. However, we find that the period of 1984 through 1986 cannot be compared to 1987 or the 1989 test year simply because that three-year period does not reflect transportation activity. Gas sales have decreased, and the need to use pipeline supplies reduces the need to withdraw inventory gas from storage. We are persuaded that ABATE's proposal does not appropriately recognize this fact and that the use of 1987 data, which reflects the first full year of transportation activity, provides a reasonable basis for projecting the probable occurrences during the 1989 test year.

Based on the foregoing, the Commission finds appropriate a working capital requirement of a negative $10,267,000, computed as follows:

Michigan Consolidated Gas Company
Mathematical Working Capital Computation
Projected June 1989 Test Year
$(000)

Description		
Capital Structure:		
Long-term debt (includes current portion)	$267,425	
Short-term debt (includes customer deposits)	67,979	
Preferred stock	19,297	
Common equity	254,008	
Deferred investment tax credit	4,200	
Net deferred income taxes	160,000	
Job development investment tax credit	43,200	
Total investor supplied capital	$816,109	
Less non-utility investment	(12,472)	
Investor supplied capital devoted to utility operations		$803,637
Less Net Utility Plant--Investor Supplied:		
Net plant	$820,115	
Less Non-investor supplied funds		
1. customer advances	4,933	
2. estimated contract liability	1,272	
3. retained by contractors	6	($813,904)
Mathematical balance sheet working capital		($ 10,267)

This negative working capital requirement, together with net utility plant of $813,904,000, results in a rate base of $803,637,000.

VI.

RATE OF RETURN

Capital Structure

A rate of return must be established. To do so requires a review of each element of the company's capital structure.

Preferred Stock

The ALJ recommended an 8.70% rate for preferred stock. Exceptions were not filed, and the Commission finds the 8.70% rate reasonable.

Common Equity

The ALJ recommended a 13.50% rate for common equity. Mich Con and the Staff had both proposed that rate, pursuant to the settlement agreement approved in Cases Nos. U-8565, U-8684, U-8793 and U-8794, order dated May 27, 1987. Exceptions were not filed, and the Commission finds the 13.50% rate reasonable.

Short Term Debt

The ALJ recommended a 6.70% rate for bank loans and commercial paper, and a short-term investment rate of 6.15%. These two rates, combined with a 9.00% customer deposit rate, resulted in a recommended overall 7.52% short-term debt cost rate. The Attorney General excepts, stating that the ALJ's calculations contain two inadvertent errors. The Attorney General states that the amount of bank loans and commercial paper should be $50,315,000, not rounded to $50 million, and that Exhibit SC-30 lists the correct cost for bank loans and commercial paper at 7.00%. The Attorney General then computes an overall short-term debt cost rate of 7.30% and a capital amount of $67,979,000.

The Commission has reviewed the Attorney General's exception, and finds

that his short-term debt cost rate is correctly stated as 7.30%. However, the $50 million figure used was taken from the Staff exhibits and is not incorrect; it merely reflects rounding. Nevertheless, the Commission's use of the mathematical balance sheet method for computing working capital permits an easy adjustment to use the Attorney General's more accurate $50,315,000 figure, and we have used that figure in our final computations.

Long-Term Debt

The ALJ recommended a 8.66% rate for long-term debt, which did not include Mich Con's adjustments for its 15 5/8% series first mortgage bonds or its $3.19 series preference stock.

Peter L. Verardi, Mich Con's treasurer, testified regarding the company's capital structure, including its costs of capital, its debt structure and its related financial activities. He stated that in 1985 there was a build-up of cash caused by sudden changes in the business environment that permitted Mich Con to reduce its capitalization without affecting the company's operations or the level of service to its customers. At that time, the two highest cost capital instruments in their respective categories were the company's 15 5/8% series first mortgage bonds and its $3.19 preference stock. Mr. Verardi testified that the two issues could be redeemed in accordance with the legal documents governing the instruments.

The mortgage bonds were redeemed at a premium of $5,268,000. The bonds had an unamortized debt discount of $94,375 and an unamortized debt expense of $432,191 remaining. Other costs of $76,074 were incurred. Total redemption costs were $5,870,640, which were charged to income in 1986. The mortgage bonds were redeemed and not refunded with a new, lower cost issue. Mr. Verardi stated

that the $3.19 preference stock was called during 1985 at a $3,164,684 premium. The preference stock had an unamortized stock expense of $1,022,335 remaining. Other costs of $31,417 were incurred. Total redemption costs for the preference stock were $4,218,436. Appropriate adjustments were made in Mich Con's capital accounts to reflect the redemption.

Mich Con proposed to defer and to amortize both redemption costs over a number of years. The company requested an annual expense of $287,000 for the mortgage bonds and $206,000 for the preference stock. The company stated that retiring this debt and capital reduced interest expense, directly benefiting ratepayers. In the company's view, unless it is permitted to recover the expense, the company will not redeem high cost debt in the future because to do so will penalize its shareholders as all benefits of a redemption will flow only to ratepayers.

The company admitted that it earned sufficient revenues in 1985 and 1986 to recover the redemption costs, but stated that its revenues in those years are unrelated to whether the expense is appropriate for the test year. In the company's view, to consider its prior earnings is to engage in retroactive ratemaking. The company acknowledged that for a time it collected rates based upon these high-cost instruments, but insisted that any regulatory lag in recognizing the redemptions was short-lived and insufficient to recover the redemption costs. Mich Con also argued that the Commission has routinely used discounts on reacquired securities for the benefit of ratepayers, Case No. U-3740, order dated March 25, 1971.

The Staff and the Attorney General would disallow both expenses. In their view, the Uniform System of Accounts (USOA) governs the redemptions and prescribes the appropriate treatment. They argued that general instruction 15(B)

of the USOA provides that expenses associated with a long-term debt that is redeemed without refunding must be recognized in current income, not deferred and amortized. Moreover, they stated, the reacquistion of a capital stock does not result in a loss reflected on the income statement; rather, the USOA requires that any loss on redemption of the preference stock must be charged to retained earnings. In the Attorney General's view, the redemption of capital stock is fundamentally different than the redemption of long-term debt and rests on an entirely different accounting principle. A capital stock redemption may only result in a redistribution of assets among the shareholders of the company.

Both the Staff and the Attorney General noted that Mich Con had sufficient earnings in 1985 and 1986 to recover the redemption costs and that the company's rates, for short intervals, had been set using these high-cost instruments even after they had been retired. The Staff agreed with Mich Con regarding the past treatment of discounts on reaquired securities and proposed that any such discounts now benefit shareholders, not ratepayers.

The ALJ found that the expenses should be disallowed and Mich Con excepts.

The Commission has reviewed Mich Con's statements regarding the consequences of the ALJ's recommendation. The Commission disagrees that ratepayers will be harmed because Mich Con will not redeem high cost debt in the future. Mich Con must take all appropriate steps to maintain a proper capital structure as well as to pay only suitable interest rates. If the company does not take steps to create that appropriate debt and capital structure, then the Commission will, if necessary, impute an appropriate structure for rate-setting purposes. On the other hand, the Commission does agree with Mich Con that its earnings during 1985 and 1986 do not bear upon whether the redemption costs are an appropriate test year expense.

The Commission has reviewed the USOA and agrees with the Staff and the Attorney General that the USOA prevents recognition of the mortgage bond or preference stock redemption costs as an expense in the test year. The mortgage bonds were redeemed without refunding. Consequently, that cost should have been charged to current income, which the company did in 1986. The redemption of capital stock did not result in a charge to income, but rather resulted in a redistribution of capital among the company's shareholders. While it is true that preference stock is not identical to common stock and that many stock instruments have attributes of debt, a basic, conceptual difference exists between stock and debt instruments predicated on an ownership interest in the company. We find the distinction appropriate and well-recognized by the USOA, generally accepted accounting principles, and the witnesses who testified at hearing.

For these reasons, the Commission finds that the mortgage bond redemption costs were appropriately charged to income in 1986 and that the preference stock redemption costs did not result in a loss that may be recognized for rate setting purposes. Accordingly, the Commission finds that the redemption costs for the 15 5/8% series first mortgage bonds and the $3.19 preference stock should not be deferred and amortized nor recognized as an expense in the test year.

The Staff and Mich Con argued that the Commission has previously used discounts on reacquired securities for the ratepayers' benefit, and that now, to be consistent with the proposed treatment of the mortgage bond and preference stock redemption costs, the Commission must revise its treatment of those discounts. We agree.

No other exceptions to the ALJ's long-term debt rate of 8.66% were filed. Accordingly, the Commission adopts a long-term debt rate of 8.66%.

Based on the foregoing discussion, the Commission finds the following capital structure reasonable and appropriate:

Michigan Consolidated Gas Company
Rate of Return Summary
Projected June 1989 Test Year
$(000)

Description	Amount	Portion of Capital Structure	Cost Rate	Weighted Cost	Computation of Cost of JDITC Percent	Computation of Cost of JDITC Weighted Cost
Long-term debt	$267,425	32.77%	8.66%	2.84%	49.46	4.28%
Short-term debt	67,979	8.33%	7.30%	.61%	-	
Preferred stock	19,297	2.36%	8.70%	.21%	3.57	.31%
Common equity	254,008	31.12%	13.50%	4.20%	46.97	6.34%
Deferred investment tax credit	4,200	.52%	0.00	0.00	-	-
Net deferred income taxes	160,000	19.61%	0.00	0.00	-	-
Job development investment tax credit	43,200	5.29%	10.93%	.58%		
Total	$816,109	100.00%	-	8.44%	100.00	10.93%

VII.

ADJUSTED NET OPERATING INCOME

When reviewing the projected net operating income for the test year to determine the extent of any revenue excess or deficiency, the Commission must establish a reasonable level for projected sales and transportation volumes. Once set, these levels will yield projected revenues. Then, expenses must be projected. Subtracting the projected expenses from the projected revenues will yield the income excess or deficiency.

Sales and Transportation Volumes

Mich Con projected sales for the test year at 201,659 million cubic feet

(MMcf). The Staff supported the figure and the ALJ recommended its use. Exceptions were not filed, and the Commission finds reasonable and appropriate projected sales of 201,659 MMcf for the test year.

The Staff projected transportation volumes at 99,728 MMcf. Mich Con projected lower levels, but accepted the Staff's position. Mich Con cautioned that approximately 13,800 MMcf is subject to potential by-pass and requested a downward adjustment if the National Steel by-pass case[1] was decided against Mich Con's interest.

ABATE witness Mark Drazen opposed Mich Con's lower projected transportation volumes, and ABATE argued that transportation volumes should be set no lower than 89,300 MMcf.

The ALJ, noting that the National Steel by-pass case had been decided against Mich Con's interest, recommended adoption of the Staff's 99,728 MMcf figure, reduced by the 9,000 MMcf projected to be transported for National Steel. ABATE agrees with the ALJ's recommendation, but excepts to what it states is his failure to discuss its transportation volume projection.

The Commission has reviewed ABATE's exception and finds it inappropriate. ABATE proposed that transportation volumes be set no lower than 89,300 MMcf. Because the ALJ set the volume at 90,728 MMcf, ABATE did not take exception to the ALJ's finding. The Commission acknowledges the ABATE witnesses' testimony regarding the austerity of Mich Con's projections. However, having recommended a transportation volume above ABATE's minimum level, we do not find it error for

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[1]National Steel Corp v Michigan Public Service Commission, Case No. L 87-30-CA5, and Michigan Consolidated Gas Co v Panhandle Eastern Pipe Line Co, Case No. L 87-46-CA5, United States District Court, Western District of Michigan, Southern Division.

the ALJ to have passed over ABATE's arguments supporting that minimum level.

The Commission has reviewed the transportation volume projections. While we are concerned with the threat of by-pass, we find that a projected transportation volume of 90,728 MMcf provides a reasonable and appropriate estimate of transportation volume for the test year. The sales and transportation projections approved result in a total volume of 292,387 MMcf.

Other Revenues

In addition to revenue from sales and transportation volumes, Mich Con receives revenue from other sources that is utilized to establish its jurisdictional revenue. The Staff made adjustments in a number of areas (including Utility Division storage revenue, collection fee income, subsidiary revenues, reconnect charge income, and temporary cash investment earnings), and the ALJ recommended use of the Staff's adjustments. With the exception of Mich Con Trading Company (MTC) profits and the GT Energy Concepts Incorporated (G-Tec) profit interest, the company has acquiesced in the adjustments and the Commission finds the adjusted revenues appropriate.

MTC is a wholly-owned subsidiary of Mich Con Investment Company, which in turn is a wholly-owned subsidiary of Mich Con. Gary A. Luke, Mich Con's executive director of Michigan regulatory affairs, described the operations of MTC, which engages in the business of brokering natural gas. MTC has no separate employees and uses Mich Con employees to operate its business. Rai P. Bhargava, Mich Con's director of marketing, is also president of MTC. Accounting records are kept to separate the employees' Mich Con- and MTC-related time and expenses. Many of MTC's employees also have marketing duties within Mich Con. Attorney General witness Bradley Lewis testified that MTC generated approximately $1.7

million in profits during the first eight months of 1987 and that losses are not likely due to the subsidiary's method of operation.

Mich Con initially proposed to use all MTC's profits to purchase and to install high efficiency gas furnaces for low-income families or to weatherize low-income housing. The Staff proposed that MTC profits be included within the yearly Gas Cost Recovery (GCR) reconciliations in which the company's 90/10 refunds are reviewed. Mich Con supported the Staff's proposal as an alternative to its proposal. The company noted that the $1.7 million MTC profit was not adjusted for income taxes nor was it established exactly how the profit had been computed, i.e., whether all expenses and return on investment had been subtracted when arriving at the $1.7 million figure. ABATE and the Attorney General would use the MTC profits when computing Mich Con's revenue deficiency, as is done with other subsidiaries' profits.

The ALJ recommended including MTC's profits when computing the company's revenue deficiency. Mich Con and the Staff except.

The Commission has reviewed the record, and Mich Con is correct that evidence was not presented indicating whether the $1.7 million in MTC profits was typical of a full year's operations, whether the figure was net of taxes, and what, if any, expenses had been removed from that figure. Mich Con states that MTC's $1.7 million profit should be reduced to $938,000 to reflect the profit net of taxes. We agree with the company that any profit figure used for MTC should be net of taxes. The Commission also agrees with the ALJ that MTC's projected profits should be included within Mich Con's projected revenues, not placed within the 90/10 refund mechanism. The Commission is concerned, however, that the $1.7 million profit figure covers only an eight-month period. Because of this, the Commission finds that the $1.7 million profit should be annualized

to $2,550,000 and then netted of tax as Mich Con proposed for the $1.7 million figure. This calculation results in an annualized figure, net of taxes, of $1,643,000, which we find reasonable as a projection of MTC's income during the test year.

Mich Con Investment Corporation (MTC's parent corporation) has another subsidiary, G-Tec, which is developing and marketing a gas torch and related equipment. The gas torch may be used in industrial applications in a manner similar to an acetylene metal welding torch, but it uses compressed natural gas rather than acetylene gas. The G-Tec torch was initially developed by Mich Con and will be further developed and marketed by G-Tec. Alan M. Cody of Arthur D. Little, Incorporated, testified in support of Mich Con's proposal to use 10% of G-Tec's net profits when computing Mich Con's revenues. Mr. Cody stated that a 10% profit interest in G-Tec's operations, without time limit, was appropriate given the saturated market for metal welding torchs and the entrenched nature of acetylene gas usage. Mr. Cody stated that the Staff's proposal to use one-sixth of G-Tec's gross revenue was inappropriate because it did not take into account G-Tec's expenses and was a royalty figure that was only prevalent in the oil and natural gas production industry.

The Staff initially proposed that one-sixth of G-Tec's gross revenues be used when computing Mich Con's revenues. Later, the Staff indicated that the proposal was merely a response to Mich Con's 10% proposal, which the Staff believed inadequate. The Staff then proposed that a division of G-Tec's profits be deferred to a later proceeding when more information is available on the subsidiary's operations.

ABATE supported the Staff's proposal, but stated that Mich Con should maintain records of all revenues, expenses and costs received or incurred by G-Tec

so that the subsidiary's operations can be easily segregated and analyzed. ABATE argued that expenses associated with G-Tec should not be included in rates set in this case, and if those expenses are included then they must be refunded to all ratepayers when the appropriate treatment of G-Tec is established.

The ALJ agreed with the Staff, and proposed deferring the G-Tec issue to a future rate case. Mich Con acquiesces in the ALJ's recommendation, but notes that the issue of delineating utility and non-utility operations should likewise be deferred.

G-Tec is a viable subsidiary of Mich Con, one to which a technology developed and nurtured by Mich Con's ratepayer-supplied funds was transferred. We find it more than appropriate that ratepayers should benefit from the future profits of that enterprise, and we find the 10% profit interest proposed by Mich Con to be inadequate to recompense ratepayers for their support of the gas torch technology's development. Because the record does not contain adequate information for the Commission to establish the proper profit interest, we agree with the Staff, and now Mich Con, that the issue should be deferred to Mich Con's next rate case. At that time, Mich Con shall submit a specific proposal on how G-Tec's profits will be determined and how the ratepayers' profit interest will be applied. In the meantime, the company shall maintain records that segregate all revenues and expenses of G-Tec, both those actually incurred or received by the subsidiary and those indirectly incurred or received by Mich Con on the subsidiary's behalf. The question of how the ratepayers' profit interest will be applied may then be completely reviewed in the next rate case.

The issue of the proper treatment of MTC's and G-Tec's profits points out an important circumstance. Mich Con has begun to diversify and it becomes increasingly difficult for the Commission to sift through the company's opera-

tions. Gary A. Luke, Mich Con's executive director of Michigan regulatory affairs, testified that Mich Con has interests in Michigan Consolidated Homes Limited Dividend Housing Corporation, Mich Con Development Corporation and Energrid, in addition to MTC and G-Tec. He proposed three criteria for use by the Commission when reviewing whether these separate businesses are utility-related and should be included within jurisdictional revenue computations. The company later agreed with the Staff's proposal that specific criteria should not be adopted, but should await further Staff development. The ALJ agreed with the Staff's deferral of the issue.

While the Commission agrees that Mich Con's criteria are a step in the appropriate direction, they are not the final criteria that should be adopted. We are greatly concerned that criteria must be developed and that information must be created and maintained by Mich Con to enable the Staff, and intervenors when appropriate, to quickly review the activities and operations of the entire organization. To do less greatly hampers our ability to set appropriate rates which will benefit both the utility's shareholders and ratepayers.

Accordingly, in this period before final criteria are proposed and adopted, the Commission finds that Mich Con must utilize accounting procedures and controls to fully and completely separate the activities of its subsidiaries and its related companies into easily indentifiable and auditable accounts. To facilitate Commission review, we direct that Mich Con shall make all its books and records, and those of its subsidiaries and its related companies, accessible and available to the Staff at the company's offices for reasonable review upon the Staff's request. We direct that Mich Con shall keep its books and records, and those of its subsidiaries and its related companies, in accordance with generally accepted accounting principles and the Commission's Uniform System of

Accounts, where appropriate. We find these interim directives necessary, appropriate and reasonable to permit our future review of Mich Con's business operations to enable the Commission to set just and reasonable rates for the company's regulated services.

Operation and Maintenance Expenses

Having established projected revenues, expenses for the test year must be ascertained. Howard L. Dow, III, Mich Con's executive director of corporate planning, explained the company's calculation of its projected operation and maintenance (O&M) expenses. He testified that the company forecasted an inflation level using information from Data Resources, Inc. and that Mich Con projected varying levels of change for different O&M expenses, such as medical benefit costs, which he stated will increase substantially faster than the Consumer Price Index (CPI). In prior rate cases, all base O&M expenses have been uniformly increased by the Personal Consumption Expenditure (PCE) deflator, which is an index related to the CPI.

Larry Bak, an auditor in the Commission's gas division, testified that the Staff proposed use of a general inflation index to project O&M expenses; that use of such an index has been established past practice; and that the Staff had not received direction from the Commission to change the procedure. He stated that the Staff substituted the CPI for its past use of the PCE deflator because the CPI was more appropriate as an indicator of future events.

Under the Staff's proposal, historical O&M expenses are established and then increased uniformly by a CPI inflator. In the Staff's view, the CPI itself represents an average of a number of varying indicators, some higher, some lower. The Staff acknowledged that when the CPI is applied, some costs are

increased above, and some below, what separate, specific projections might require. Nonetheless, the Staff stated that on balance Mich Con would be reasonably compensated. Moreover, use of the CPI provides an additional regulatory incentive for the company to control costs, because specific projections for each O&M expense result in a "cost-plus" type of regulation with no countervailing inducement to control costs. The Staff stated that the Commission rejected a similar request to separately project O&M expenses in the company's Case No. U-7895, order dated June 26, 1985.

The company did not dispute the Staff's proposed change from the PCE deflator to the CPI, but argued that mere use of a CPI inflator cannot compensate the company for the inevitable increase in many costs above the CPI. Mich Con stated that a proper projection of O&M expenses now requires review of each major expense and the separate economic factors having an impact upon that expense. The company argued that many expenses increase at a rate different from the CPI--some at a higher level, others at a lower level. In the company's view, advanced techniques now exist for projecting expenses and these techniques should be utilized. Mich Con acknowledged that the Commission rejected a similar proposal in Case No. U-7895, but the company argued that the Commission's action was based upon a lack of record evidence supporting the projections, not a rejection of the concept. Mich Con noted that the Commission recognized an unusual increase in medical benefit costs in Consumers' Case No. U-7830, Step 2, order dated July 16, 1987.

The ALJ agreed with the Staff's position. Mich Con excepts.

The Commission has reviewed Mich Con's proposed O&M expense projection method. We disagree with the company's statement of our reason for rejecting a similar proposal in Case No. U-7895. There, the Commission rejected the com-

pany's proposal, not because of a lack of record support, but because of the method's complexity. It required separate projection of 31 expense categories (Mich Con now proposes almost 40 categories). We also held that the burden imposed by the use of such a complex proposal did not justify the minimal benefit achieved through production of potentially slightly more accurate projections. (Order, p. 37).

In judging the validity of a projection, the question to be asked is whether the method and result are reasonable, not whether a more accurate or more complex method can be created. In Case No. U-7895, the Commission stated its belief that additional complications in an already complex rate case should be avoided. We continue to believe that additional complexity must be avoided and that the use of historical expenses adjusted by a general, uniform inflation index is a reasonable, rational and even-handed method to project O&M expenses. Therefore, the Commission finds appropriate the Staff's method, and because parties have not objected to use of the CPI in lieu of the PCE deflator, we use the CPI.

The ALJ recommended adoption of the following O&M expense projections: the Staff's trust and management fees adjustment; the Staff's injuries and damages projection; the Staff's disallowance of economic development advertising expenses; the Staff's clearing account adjustment; the Staff's adjustment for historical uncollectible accounts expense; the Staff's disallowance of cogeneration feasibility study costs; the Staff's disallowance of labor expenses for employees assigned to charitable organizations; the Staff's adjustment for officers' and directors' salaries, charitable donations, lobbying costs, and costs chargeable to non-utility operations; the Staff's treatment of commitment fees; the reclassification of the separate Mich Con annual report; the Staff's

disallowance of 50% of Primark board of directors fees; the Staff's adjustment to the Massachusetts formula for assigning Primark costs; and the Staff's normalization of a 13-month affiliated company billing. Exceptions to the ALJ's recommendation were not filed. The Commission has reviewed the expense levels, and finds them reasonable and appropriate. Thus, they have been used to compute the revenue deficiency.

We now turn to the contested O&M expense issues.

Federal Affairs Expense

Mich Con's parent company, Primark, maintained a governmental affairs office in Washington, D.C. Mich Con witness Howard Dow testified that most of the office's expenses were allocated to Mich Con, with the few remaining expenses allocated to other Primark subsidiaries. Mr. Dow stated that the governmental affairs office operates only at the federal level, to expedite matters at the Federal Energy Regulatory Commission (FERC) and to work with Congress to pass or to defeat legislation. The expenses allocated to Mich Con were $672,000. Mr. Dow stated that prior to 1986, these expenses were routinely recorded below-the-line, i.e., the costs were not treated as a jurisdictional expense for ratemaking purposes; that during 1986, the company's allocation techniques were re-evaluated; and that the company subsequently determined that these governmental affairs expenses are jurisdictional.

Mich Con argued that, although the Washington office engages in significant administrative and legislative lobbying, the expense should be treated as jurisdictional because at the federal level the interests of Mich Con's shareholders and its ratepayers are the same: to lower gas costs. The company stated that a distinction can, and should, be made between lobbying activities at the state

and federal levels, and that 1982 PA 304 (Act 304) directs the company to take appropriate regulatory action to reduce its cost of gas.

The Staff, supported by the Attorney General, argued that the governmental affairs expense comprises significant lobbying activity and, therefore, should not be permitted as a jurisdictional expense. The Staff noted that the Commission has historically denied lobbying expenses, citing Michigan Gas Utilities Company's Case No. U-7976, order dated March 11, 1986.

The ALJ agreed with the Staff, recommending disallowance of the costs as a jurisdictional expense. Mich Con excepts.

The Commission has reviewed Mr. Dow's testimony regarding the activities of the governmental affairs office. We find that its activities to influence the FERC and to pass or to modify congressional legislation are lobbying. While the Commission recognizes Mich Con's efforts to accelerate the elimination of ANR Pipeline Company's fixed-cost minimum bill, as well as its work on Order 436, Order 500 and the federal Tax Reform Act of 1986, the Commission does not agree that at the federal level the political interests of the company's ratepayers and its shareholders will always be the same. Their interests can easily diverge on tax matters or ratemaking principles.

Moreover, Section 6h(6) of Act 304, MCL 460.6h(6), does not direct Mich Con to engage in lobbying activities. Rather, that section directs the Commission to determine whether the company has taken all appropriate legal and regulatory actions to minimize the company's cost of purchased gas. We find that section specifically directed to our review of the company's legal and regulatory actions to reduce its cost of gas, not the company's congressional lobbying regarding its interests. Therefore, Act 304 does not compel allowance of Mich Con's federal lobbying expenses.

A disallowance relating to lobbying must be implemented on an even-handed basis, and cannot turn on whether the Commission approves or disapproves of the position taken by the utility. For these reasons, the Commission finds that the federal governmental affairs office expense should not be allowed as a jurisdictional expense.

Work Force Reduction Litigation Expenses

Mich Con witness Howard Dow described the company's actions in 1983 to reduce its workforce. He stated that 299 employees were terminated and that 65 law suits had been commenced contesting the severances, arguing breach of implied contract and age discrimination, among other legal theories. Mr. Dow testified that adverse judgments totaling $315,000 had been issued in two cases; that seven cases had been settled for $441,000; and that the net cost of these judgments and settlements, after a 60% insurance reimbursement, was $310,000. The company proposed to include the expense within the test year, arguing that the costs were an appropriate business expense; that the work force reduction was handled appropriately; that if the costs had been paid directly to an employee at severence, the costs would have been allowed as an appropriate expense; and that in today's society, employees can be expected to litigate, no matter how carefully planned the employer's actions.

The Staff stated that the judgment costs should be disallowed and that 50% of settlement costs should be disallowed. In the Staff's view, the judgment costs reflect adverse verdicts on age discrimination claims, and to approve such an expense requires the Commission and the ratepayers to condone Mich Con's actions. The Staff stated that claim settlement should be encouraged; however, to permit complete recovery of settlement costs while denying recovery of all

judgment costs encourages the company to settle all cases. Therefore, the Staff proposed that only 50% of settlement costs be allowed.

The ALJ agreed with the Staff. Mich Con excepts.

The Commission has reviewed Mich Con's arguments. The record presented does not show that Mich Con was imprudent in pursuing these cases and reaching the settlements. In the Commission's view, these costs reflect appropriate costs and should be allowed.

Pension Expense

In the recent past, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) 87, which changed the method of pension expense determination. Mich Con witness Howard Dow testified that under SFAS 87 pension expense will consist of five specific components:

1. The present value of benefits earned during the year.
2. The increase in projected pension obligation due to the passage of time.
3. The expected return on the funded assets.
4. The amortization of gains and losses arising from the differences between the actual and expected return on assets and changes in the projected pension obligation and plan assets due to: 1) the actual return differing from expected return, or 2) changes in assumptions.
5. The amortization of any excess or deficiency between the plan's assets and the projected obligation upon adoption of SFAS 87.

He stated that under SFAS 87, pension expense is likely to be more volatile than at present because a significant factor in determining the expense is the interest rate received on the pension plan's funded assets. In his opinion, a 1% change in long-term interest rates would increase the company's annual pension expense by over $4 million.

Mr. Dow calculated Mich Con's pension expense under SFAS 87, which resulted in a negative expense due to the then-existing plan assets and expected return. He proposed setting pension expense at zero because use of a negative expense would, in effect, require the company to refund prior pension costs to ratepayers and the company could not withdraw funds from the plan's trust to compensate the company for this refunding. Moreover, he stated, the negative expense would require an increase in working capital as an offset.

The Staff, supported by the Attorney General, argued that the SFAS 87 calculation should be used, resulting in a negative $666,000 pension expense for the test year. In the Staff's view, SFAS 87 is appropriate for use and should be used. While the Staff acknowledged that minor interest rate changes may cause variances in pension expense, the Staff noted that SFAS 87 is a relatively new standard and any significant variances can be ameliorated as more experience with the method is obtained.

The ALJ agreed with the Staff. Mich Con excepts and states that, if the ALJ's recommendation is followed, the company's working capital allowance must be increased to reflect the effect of the negative pension expense.

Although SFAS 87 is fairly new, the Commission finds that it should be implemented for financial accounting purposes, subject to review in future cases. However, we note the company's argument that use of a negative pension expense for ratemaking purposes will require the company to refund previous pension costs and that the company cannot remove funds from the pension trust. Moreover, SFAS 87 is a recent development. The Commission finds, therefore, that pension expense should be set at zero for this rate case. We note that pension expense may vary significantly over time due to the increased influence of interest rates under SFAS 87. Thus, as more experience is gained, averaging

can be developed, if necessary. Moreover, the rates set in this proceeding will not be used indefinitely, and the Staff may present a differing treatment in future cases based on actual experience under SFAS 87.

Environmental Impairment Costs

Mich Con witnesses Mark Cieslak and Steven Kurmas, its manager of engineering and construction planning, testified regarding $11.7 million that Mich Con expensed during 1984 for removal and remediation of environmental contamination at certain gas manufacturing sites throughout the state. Mr. Cieslak regarded the costs as significant and unique. Mich Con is the successor to a number of companies that manufactured gas for distribution and sale beginning in the late 19th century. Prior to widespread use of natural gas, lighting and heating gas was manufactured from coal by a number of different processes, many of which resulted in by-products that are now recognized as environmentally harmful, unless disposed of properly. Manufacturing of gas ceased at one site in the early 1900s, others were used up to the 1950s.

Mich Con became aware that 14 sites throughout the state (some no longer owned by the company) contained significant amounts of coal tar and other items that required remediation. After study, the company estimated clean-up expenses at $11.7 million and expensed that amount in 1984. The company now estimates the expenses at $11.4 million and seeks to reverse its 1984 actions.

The company requested deferral of the $11.4 million amount and a six-year amortization of it, which will place a $1.9 million expense within the test year. The company argued that these costs are comparable to typical O&M expenses; are a valid cost of doing business; and are similar to the storm damage expenses deferred and amortized in Detroit Edison's Case No. U-6569, order dated

August 19, 1981. The company acknowledged that it earned sufficient revenues in 1984 to cover the expenses charged off, but stated that consideration of its previous revenues is inappropriate retroactive ratemaking.

The Staff and the Attorney General, while acknowledging that the environmental impairment costs would be a valid expense if projected to be incurred during the test year, argued that the company made its choice of treatment in 1984 when it expensed the amount and did not request deferral and amortization. They argued that it is now too late to revise that action and to request a more favorable treatment. Moreover, they stated, the company earned more than its authorized rate of return during 1984, even after the expense had been taken. The Staff and the Attorney General acknowledged the similarity to Detroit Edison's storm damage situation, but argued that the cases are distinguishable because Detroit Edison requested and received deferral and amortized in a timely manner, not well after the event and after one method of expensing the cost had been used.

The ALJ denied Mich Con's request, and the company excepts.

We have reviewed Mich Con's, the Staff's and the Attorney General's arguments and agree that the environmental impairment costs would be a valid expense if incurred within the test year. However, the Commission agrees with the Staff and the Attorney General that the method previously chosen by the company to expense the cost should prevail, with the result that an expense for environmental remediation does not occur within the test year.

As noted earlier, the company is correct that its previous profits are not a measure of whether an expense is appropriately recognized within a test year. We also find the Detroit Edison storm damage case distinguishable precisely because that company chose to request deferral and amortization in a timely

manner, not well after the fact when it appeared that amortization of the expense could benefit the company in the context of a rate case.

Uncollectibles Expense

Mich Con presented its position on uncollectibles expense through James A. Brewer, its vice-president of customer and account services, and John E. vonRosen, its senior vice-president of customer service. The company projects an uncollectibles expense of $21.8 million, which includes $3.4 million to reflect a projected decline in employment within the company's service area. As support, the company presented a University of Michigan (U of M) study that projected higher levels of unemployment in Michigan. Mich Con noted that its service areas include the core cities of Detroit, Grand Rapids and Muskegon and not the heavily populated counties immediately north of the city of Detroit. In the company's view, its service areas contain a high proportion of the state's poor and working poor, who will be most affected by increases in the unemployment level.

Mich Con argued that, although all the projections in the U of M study have not proven accurate, the study's overall projection is remarkably close to actual results, i.e., actual unemployment levels in mid-1988 were very comparable with the study's projected year-end 1988 level. The company acknowledged that in recent years its projected uncollectibles expense has been consistently above its actual experience. However, the company stated that much of the difference is attributable to unplanned increases in assistance payments and arrearage payments by the Michigan Department of Social Services (DSS). The company, citing DSS director C. Patrick Babcock's statement, argued that federal and state assistance sources are dwindling and that the present levels of

spending may not be maintained.

Cornell D. Pettiford, an auditor in the Commission's gas division, adjusted Mich Con's uncollectibles expense to reflect a lower, $3.84 per thousand cubic feet (Mcf) cost of gas. Mr. Pettiford also reduced Mich Con's projection by $3.4 million, reflecting a disallowance of the company's projected higher unemployment levels. The Staff argued that the U of M study has not proven accurate and that Michigan Employment Security Commission data shows unemployment levels lower than those projected by U of M. Moreover, the Staff stated, Mich Con routinely projects a pessimistic, gloomy picture of unemployment levels, which has not proven accurate in the recent past.

The ALJ agreed with the Staff, noting that uncollectibles expense has been overestimated for a number of years and that the U of M study has not proven accurate. Mich Con excepts.

The Commission has reviewed Mich Con's and the Staff's arguments. Mich Con accepts the Staff's use of the $3.84 per Mcf cost of gas, but argues that the company's projection of increased unemployment is appropriate. Rather than determine whether uncollectibles expense has been overestimated in the recent past, the Commission must establish a reasonable projection of uncollectibles expense for the test year. The Commission notes that while segments of the U of M study have proved correct, many have not. We simply disagree with Mich Con that unusual or excessive unemployment levels will occur during the test year or that the unemployment that does occur will have a disproportionate effect on Mich Con's service areas. The Commission, therefore, adopts the Staff's uncollectibles expense projection.

A number of the Staff's revenue and cost of service adjustments are undisputed: amortization of exempt vacation costs, elimination of the cost of

company-produced gas, elimination of conservation programs costs, elimination of royalties, elimination of the amortization of the ballot proposal penalty, elimination of the tax adjustment for leased facilities, the federal Tax Reform Act of 1986 adjustment, standby revenues, north slope transportation revenue, Interstate Storage Division storage and transportation revenues, late payment revenue, the oil and extracted products adjustment, property taxes, single business tax, Schedule M of the federal income tax, the allowance for funds used during construction, the projected depreciation expense of $55,538,000, the payroll tax adjustment, the investment tax credit adjustment, and the commitment fee adjustment. The Commission has reviewed these undisputed items, and finds them reasonable and appropriate. Thus, they have been used to compute the revenue deficiency.

Based upon the foregoing discussion and the exhibits, the Commission finds appropriate the following revenue and cost of service adjustments:

Michigan Consolidated Gas Company
Revenue and Cost of Service Adjustments
Projected June 1989 Test Year

Description	Net
Revenue/Cost of gas	($22,162,000)
Company-use and lost-and-unaccounted-for	2,097,000
Utility division storage revenue	(251,000)
Cost of produced gas	1,752,000
Conservation programs	188,000
Royalties	2,055,000
Amortization of the ballot proposal penalty	(412,000)
Tax adjustment for leased facilities	(1,127,000)
Tax Reform Act of 1986	13,158,000
Depreciation	(5,373,000)

Unit of production depreciation	1,388,000
Allowance for funds used during construction	122,000
Standby revenues	(385,000)
MTC profits	1,644,000
North slope transportation revenue	(387,000)
Interstate Storage Division revenue	(1,370,000)
Late payment revenue	(303,000)
Oil & extracted products	69,000
Miscellaneous revenues	258,000
O & M expenses	486,000
Pension expense	0
Uncollectibles expense	(1,163,000)
Property taxes	(1,973,000)
Single business tax	761,000
Employment taxes	(232,000)
Federal income tax - Schedule M	3,213,000
Amortization of investment tax credit	(122,000)
Revenues from re-connect charge	55,000
Interest from temporary cash investments	458,000
Commitment fees	(181,000)
Total revenue and cost of service adjustments	($7,738,000)

Based upon the findings in this order, the Commission finds Mich Con's adjusted net operating income to be $59,348,000, computed as follows:

Net utility income	$67,641,000
Allowance for funds used during construction	335,000
Discount on reacquired securities	-0-
Subtotal	$67,976,000
Revenue and cost of service adjustments	(7,738,000)
Adjusted tax effect of interest	(1,509,000)
Interest synchronization	619,000
Adjusted net operating income	$59,348,000

Revenue Deficiency

The Commission finds a revenue deficiency of $13,159,000 based upon the findings in this order, computed as follows:

Rate base	$803,637,000
Overall rate of return	8.44%
Income required	$ 67,827,000
Adjusted net operating income	(59,348,000)
Income deficiency	8,479,000
Revenue multiplier	1.552
Revenue deficiency	$ 13,159,000

VIII.

RATE DESIGN

Having established Mich Con's revenue deficiency, the Commission must now design rates for the company's customers, both sales and transportation. We have repeatedly stated our intention to move toward cost-of-service-based rates.

To do so requires establishment of the cost of service. The starting point for that determination is a cost-of-service study. Mich Con, the Staff and ABATE presented cost-of-service studies, which varied in many respects. The ALJ recommended many adjustments. Mich Con, the Staff, ABATE and the Attorney General except.

In any cost-of-service study, some cost for the company's administration of the transportation program must be established and then allocated to the transportation program. The Staff initially set those costs at $600,000 and allocated that amount to the transportation class. On brief, the Staff revised the amount to $2,350,800, based upon ABATE's monthly $300 administration fee multiplied by the number of transportation customers, multiplied by 12 to annualize that monthly amount.

ABATE argued that its rebuttal witness adopted the Staff's initial $600,000 proposal and that record evidence did not support the $2,350,800 figure.

The ALJ was persuaded by ABATE's argument, finding little record support for the Staff's increased figure. The Staff excepts.

As was indicated earlier regarding the balance sheet working capital method, the Commission is not constrained to choosing one party's position over another. Rather, the Commission must, based upon appropriate evidence, establish just and reasonable utility rates in furtherance of the public interest.

We have reviewed the record cited by the Staff. ABATE witness Alan Rosenberg proposed use of a Consumers' study regarding the increased cost to the company of administering a transportation program. Consumers' study provides an estimate of $300 per month for the additional cost to administer the account of a transportation customer. Mich Con had initially proposed a $1,000 per month transportation customer charge, but admitted that it had never quantified the

actual underlying increased cost to administer a transportation account. ABATE proposed use of Consumer's $300 figure as Mich Con's monthly transportation customer charge, arguing that it was the best approximation of the actual increased cost to Mich Con to administer a transportation account. However, ABATE would now not use that figure to allocate costs.

We agree with ABATE's initial argument, and find it credible and better supported than the Staff's initial proposal. Because the $300 figure is a monthly amount, it is easily annualized to $3,600. The Staff's cost-of-service study assumes that Mich Con will have approximately 653 transportation customers during the test year, well within the 620 to 700 customer range noted by Mich Con's witnesses as the number of transportation customers during 1986 and 1987. It is a simple calculation to multiply the $3,600 yearly increased administrative cost by the 653 estimated transportation customers to arrive at a $2,350,800 figure for the projected additional expense attributable to administering transportation accounts. We do not find that the Staff relied on extra-record evidence to arrive at that expense figure, and we find it a reasonable and appropriate estimate of the actual cost.

Exceptions were not filed to the ALJ's recommendation regarding the allocation of uncollectibles expense, corrected to include the cost of purchased gas. We, therefore, find that allocation appropriate.

Peak Day Projection

When allocating capacity costs for the projected test year, a peak day must be used when calculating the various rate classes' share of the peak day send-out. The Staff and Mich Con used actual January 1987 data for the peak day sendout. The Staff argued that use of actual 1987 numbers is appropriate and

that no significant volume changes are expected to occur between 1987 and the projected 1989 test year, with the exception of many large-volume customers moving from sales to transportation service.

ABATE proposed use of a projected peak day. ABATE argued that little evidence was presented that peak volumes had not changed from 1987. In any event, ABATE stated, because all other data are projected within the cost-of-service study, projected data should be used for the peak.

The ALJ agreed with ABATE, finding it reasonable to use projected January 1989 data to allocate peak usage. He noted that the remaining data used within the cost-of-service study were projected. The Staff excepts.

Use of a projected January 1989 peak is consistent with the use of projected data for the remaining portions of the cost-of-service study. The Commission, therefore, finds the use of a projected peak reasonable and appropriate.

Capacity Cost Allocation Method

In assigning capacity costs, the allocation method used has a significant impact upon the costs assigned to a particular customer class. ABATE proposed use of the average and excess demand (AED) method, which attempts to allocate capacity costs based upon two components: 1) the average use of the distribution system (system average demand), and 2) the excess use of the system (which is the difference between each class's peak demand and average demand). The system average demand component is allocated to each customer class in proportion to its average demand. The excess use component is allocated to each customer class in proportion to the amount that the class's peak demand exceeds its average demand. ABATE stated that the AED method is included in numerous utility ratemaking texts, such as the American Gas Association's Gas Rate

Fundamentals. ABATE argued that the Staff's method does not so appear. In ABATE's view, the Staff's method does not reflect the realistic demands customers place upon the distribution system. Moreover, ABATE stated that the Staff's method assigns more costs to large-volume users than a stand-alone system would require.

The Staff allocated capacity costs using the average and peak (A&P) method, which allocates costs based upon two components: 1) the average demand, and 2) the peak demand. A weighted average is developed comprising a capacity (peak) allocation factor and a commodity (average usage) factor. In the Staff's view, the A&P method takes into account both customers' average demand and peak demand, which is necessary because, while Mich Con's distribution system is designed for peak day usage, that system could not be maintained if adequate annual system usage did not occur. The Staff acknowledged that its proposed method is not listed in Gas Rate Fundamentals, but noted that the text does state that other allocation methods exist. The Staff stated that its proposal is similar to that used in past Mich Con rate cases. The Staff argued that, because of the pattern of usage on Mich Con's system, ABATE's AED method results in a cost allocation similar, if not identical, to the use of a peak-only allocation.

The ALJ was persuaded that ABATE's proposal was more fully supported by utility texts and that the Staff's method assigned too much capacity to large-volume users--more than a stand-alone system would require.

The AED method is treated in both Gas Rate Fundamentals and Prof. James C. Bonbright's recognized treatise on utility ratemaking, Principles of Public Utility Rates. The Commission has reviewed the treatises and finds that, while some allocation methods are fully explained, both texts note that other methods

do exist. We have reviewed the AED method and, although that method does provide for use of a system average demand component, the Commission finds that, because of the peculiarities of Mich Con's system and its customers' usage patterns, the AED method results in a cost allocation similar in result to a peak-only method. We hold that a peak-only cost allocation is inappropriate for use when allocating capacity costs.

During at least the last two decades, the Commission has routinely used a cost allocation method in Mich Con's rate cases that allocates costs using both an average factor and a peak factor. We find the Staff's A&P method to be the method that the Commission has utilized in prior cases and one that properly accounts for the various rate classes' average demand on the system as well as their peak usage needs. We, therefore, reject ABATE's AED capacity cost allocation method.

We also reject ABATE's argument that large-volume customers must be assigned costs based upon a stand-alone system comparison. To do so requires constructing a hypothetical system for every rate class--systems that, in the Commission's view, would never actually have been constructed.

Storage Cost Allocations

Mich Con maintains storage facilities that supplement its ability to deliver a constant flow of gas throughout its distribution system. A portion of the costs of the storage facilities are allocated to transportation services under the Staff's and ABATE's cost-of-service studies.

The Staff, consistent with its treatment of capacity costs, allocated storage facilities using its A&P method. As a result, the Staff assigned 29% of storage costs to transportation customers. The Staff argued that transportation

volumes represent 33% of Mich Con's deliveries; hence, the 29% allocation is appropriate.

ABATE allocated storage costs based upon the AED method, which assigns 23% of the storage facility costs to transportation customers. ABATE noted that transportation customers are high load-factor customers and, in consequence, use less storage service. ABATE stated that transportation customers use less than 7 billion cubic feet (Bcf) of storage services during the winter peak, while ABATE's allocation provides for 22 Bcf.

The ALJ was persuaded by the lower actual usage of storage services by transportation customers and recommended use of ABATE's AED method. The Staff excepts.

As indicated in our discussion regarding capacity cost allocation, ABATE's AED method, when placed in the context of Mich Con's entire distribution system, results in an allocation of costs similar, if not identical, to a peak-only allocation. While in the case of system capacity costs, the Commission finds the AED method inappropriate, a peak-type method is appropriate in the storage cost area because the facilities are not heavily utilized by the larger volume customers whose draw on the system is more consistent. Accordingly, the Commission finds the AED method proposed by ABATE appropriate for allocating storage cost allocation.

Main Expense

A substantial portion of Mich Con's distribution system is composed of underground piping (mains) that serves its customers. The mains vary greatly in size from large, high-pressure transmission mains, to low-pressure distribution mains, to the smaller pipes that connect to the residential distribution system.

The Staff, pursuant to past practice and supported by Mich Con, allocated mains based upon demand. This has the effect of allocating a higher proportion of piping to those customers that consume larger quantities of gas. The Staff argued that this allocation is an accepted, long-standing method that achieves reasonable results.

ABATE initially proposed, through its witness Alan Rosenberg of Drazen-Brubaker & Associates, Inc., that approximately 25% of Mich Con's mains should be allocated based upon the number of customers. This proposal assumed that all mains with a diameter greater than 10 inches are completely demand-related. ABATE later revised its proposal to allocate approximately 16% of Mich Con's mains based upon the number of customers. This proposal assumes that only mains with a 2-inch or less diameter are customer-related.

ABATE stated that the cost of a main does not increase in direct proportion to its diameter, i.e., the cost of installing ten feet of four-inch piping is not twice the cost of installing ten feet of two-inch piping. In ABATE's view, more in-ground piping is used to serve the residential classes and, therefore, more costs should be allocated to those customers--more customers, more pipes. ABATE stated that the Staff's demand method allocates 106 miles of mains to Mich Con's largest customer and only 11 feet of mains to a residential customer. ABATE stated that most, if not all, large-volume users do not require extensive piping for their distribution needs. It argued that its witness Rosenberg's study of distribution systems demonstrates that his method, which uses a customer number and demand component, yields a higher correlation to the actual number of inch-feet of main per customer than does the Staff's demand-only method.

The ALJ agreed with the Staff's proposal. ABATE excepts.

Over the recent past, ABATE and other industrial intervenors have argued for use of a customer component in the method used to allocate mains among the various classes. We have been, and remain, unpersuaded by their arguments. Any allocation method is arbitrary in some manner. In the broad sense, no customer should be assessed more than the exact cost of serving that customer. Carried to its logical extreme, each customer should have a separate computation based upon its precise geographic location, or the Commission could return to establishing geographic sub-areas within Mich Con's service territories. Those closer to major pipelines or production supply would be assigned fewer costs, or those served by older, lower cost mains would be assigned lower costs. The permutations are unending.

In the final judgment, the question is not whether a more exact method can be constructed; rather, the question is whether the method and result are reasonable. We find the demand method proffered by the Staff and Mich Con to be that used in prior cases and an accepted and reasonable way to distribute the costs of Mich Con's state-wide system (with its concomitant piping), which was built to serve the entire state, not one small geographic area in southeastern Michigan. We will not begin down a path that will again lead to the establishment of geographic rate zones within Mich Con's service territory.

Production and Gathering Expenses

Mich Con's statewide system was constructed prior to the advent of gas transportation. The system was not built with the intention of separating facilities into gas transmission service and gas sales service. Rather, the system was constructed to further Mich Con's general sales business and, in a number of ways, provide for system load balancing, system supply and system

security. Given the use to which the entire system was placed, a number of system costs, rather than directly assigned to the cost of gas, have historically been recovered through base rates as a general cost of Mich Con's business. Production and gathering expenses are of this type.

Production and gathering expenses relate, in substantial part, to the costs of the wetheader pipeline system in northern lower Michigan, but also include a not insignificant amount of costs related to other production or gas gathering facilities throughout Mich Con's service territory. Thus, it would be extremely impractical to separate these expenses based upon the record before us.

ABATE argued strongly that production and gathering expenses, by their very nature, relate only to the use and sale of gas as a commodity. Consequently, because transportation customers do not purchase Mich Con's gas they logically cannot be assessed production and gathering activity costs. ABATE noted that the company's Michigan-produced gas, or any sales gas for that matter, will only be available for sale to transportation customers upon payment of a separate, system-supply entitlement charge.

The Staff proposed assessing a portion of production and gathering expenses to transportation customers. The Staff stated that transportation customers benefit from these facilities through load balancing, i.e., Mich Con can provide consistent, uninterrupted service to transportation customers even though the transportation customers' gas may not be delivered into Mich Con's system in synchronization with their usage. Moreover, the Staff noted, gas from Michigan production will be available for sale to transportation customers.

The ALJ agreed with the Staff, recommending that a portion of the production and gathering expenses should be assessed to transportation customers. ABATE excepts.

It must be remembered that the gas distribution industry is dividing into distinct functions: sales and transportation. However, the simple fact remains that Mich Con's system, as well as its operations, were not constructed or established to meet that eventuality and must be adapted to these new circumstances. Much, if not all, of the sunk costs of Mich Con's production and gathering facilities have historically been recovered through base rates while the commodity cost of Michigan-produced gas has been recovered through the old purchased gas adjustment clause and now the GCR clause. Under the present scheme, if transportation customers do not bear a portion of these base system costs, then only sales customers will shoulder those costs. Transportation customers who purchase Michigan-produced gas through the GCR system or who transport Michigan-produced gas will not bear those costs because they are not contained within either the GCR gas commodity price or the transportation rate.

The solution is to place these costs into a separate category and assess them to customers in proportion to their use of the company's production and gathering system. Because sales customers are currently using the production and gathering system for the purchase of Michigan-produced gas, all production and gathering expenses will be initially allocated to them and reflected in base rates. For transportation customers, a separate per-Mcf production and gathering charge will be assessed on any gas transported on their behalf through the company's production and gathering system. The Commission has calculated this charge by computing the level of production and gathering expenses and dividing that amount by the volume of Michigan-produced gas included in Mich Con's 1988 GCR plan, Case No. U-8870, order dated November 10, 1988. The calculation results in a $0.2269 per Mcf charge, as shown in the chart below:

Production plant	$127,327,000
Construction work in progress--production	4,403,000
Accumulated depreciation production	(69,944,000)
Depletion	(12,764,000)
Rate base	49,022,000
Overall rate of return	8.44%
Income effect	4,137,000
Revenue multiplier	1.552
Revenue effect	6,421,000
O & M--production	6,192,000
Depreciation--production	4,967,000
Property taxes	3,133,000
Tax effect of interest	(950,000)
Total	$ 19,763,000
Volume (Case No. U-8870)	87,103,000 Mcf
Cost per Mcf	22.69¢ per Mcf

All revenues collected through this per-Mcf charge will be credited to sales customers in the yearly GCR reconciliation which will compensate them for the transportation customers' use of the production and gathering system, and the charge will apply to all Michigan-produced volumes transported through any portion of the company's production and gathering system, including the wetheader. As more information becomes available regarding transportation customers' use of the production and gathering system, parties to future rate cases should suggest appropriate refinements or alternatives to this procedure.

System-Supply Entitlement Charge

If a transportation customer may at any time switch to sales status and

require Mich Con to supply it gas, then Mich Con must plan for that customer's potential supply needs, and it can be assumed that, should the price of transportation gas rise unexpectedly above the cost of system-supply gas, transportation customers would shift to lower-cost system-supply sales gas. In order to meet this increased demand, Mich Con would need to purchase higher cost gas. While the average system-supply gas price would increase because of this higher cost gas, that price would never increase to the cost level of the additional gas because of the effect of averaging: the lower cost, earlier planned supply would be blended with the higher cost, additional supply. Thus, core sales customers would see a price increase and former transportation (now sales) customers would receive a lower price than that available elsewhere. The result is fundamentally unfair to core sales customers, who do not or cannot play the market but seek a sure supply at a fair price.

Because of this, we strongly agree with the Staff's proposal that a limitation must be placed upon a switch from transportation to firm sales status. The Staff would permit a transportation customer to request firm sales status, and then require a five-year period before another firm sales request could be made. However, the Commission finds that the five-year period should be implemented with the customer's choice of transportation service--if a customer becomes a transportation customer in 1990, that customer cannot return to firm sales status until 1995 or beyond. At that time, the transportation customer would have the same standing as a new customer, i.e., if gas is available for sale, then Mich Con will supply gas to the new customer. For these reasons, we find that this five-year limitation proposal should be adopted.

In a similar way, both the Staff and Mich Con argued that some penalty should exist for transportation customers who use system-supply gas without

authorization. Because a transportation customer is attached to Mich Con's integrated system, that customer may, at any time, draw gas, and it cannot be known whether the gas drawn exceeds the amount agreed to be transported until the monthly meter is read. If the amount drawn exceeds that transported for or maintained in storage by the transportation customer, then that customer has received the benefit of Mich Con's planned system-supply purchases. Consequently, if this unauthorized usage is billed at the GCR rate, the transportation customer, without cost, has received a back-up supply.

Mich Con and the Staff proposed a $10 per Mcf charge in addition to the GCR rate for each Mcf of unauthorized usage. The ALJ agreed.

The Commission also agrees with the proposal. Transportation customers choose to secure their own gas supply and must manage the quantity of that supply to meet their overall needs. They cannot rely upon Mich Con to do so without compensation. We therefore find the penalty charge appropriate to discourage unauthorized gas takes by transportation customers.

While unauthorized takes should be discouraged, the Staff and Mich Con also proposed a system-supply entitlement charge (SSEC), which would permit a transportation customer at any time to draw system-supply gas at the GCR rate or to change from transportation status to sales status at will, without the five-year limitation or the need to qualify as a new customer. The charge would be in addition to the transportation rate and would be based upon the level of average system D1 and D2 demand charges, minimum commodity bills and supply reservation charges.[2] In consideration of the payment of the SSEC, Mich Con, in effect, would continue to plan for the transportation customer's supply needs.

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[2]These charges relate to Mich Con's pipeline supplier rates and tariffs.

The Staff proposed that the SSEC for gas transported be set at $2 per Mcf, with permitted reductions to a floor of 30¢ per Mcf, depending upon the current projection of system average D1 and D2 demand charges, minimum commodity bills and supply reservation charges. In future GCR reconciliation cases, the actual cost of providing system-supply back-up for transportation customers would be deducted from the GCR cost of gas, and the SSEC revenue collected, net of system-supply backup costs, would be included within the 90/10 refund mechanism.

Mich Con and ABATE support the concept. ABATE, however, argued that curtailment category I transportation customers[3] should be required to pay the SSEC because political realities are such that this class of customer will never be denied system-supply gas due to the nature of their gas usage.

The ALJ recommended that an SSEC be established and that it be made mandatory for curtailment category I transportation customers. The Staff and Mich Con except to the imposition of the mandatory requirement, arguing that this required extra charge may make transportation uneconomic for those customers.

We agree that the SSEC should be established to give transportation customers the option of using system-supply gas as a back-up, if they so choose. The charge reflects the costs to Mich Con of providing and planning for the contingency service. The Commission nevertheless in concerned that the charge should reflect the current costs of the contingent supply as proposed by Staff witnesses William Aldrich and William Bokram.

Rather than set a rate in this proceeding, the Staff proposed to establish

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[3]Mich Con's Rule B 4 provides that curtailment category I customers are those with: residential gas requirements, commercial gas requirements having a maximum day requirement of less than 50 Mcf (notably smaller educational institution uses), requirements for services essential for public health and safety, and requirements for plant protection.

a range between $2 and 30¢ per Mcf of gas transported. Mich Con would establish the rate consistent with Mr. Bokram's Exhibit AC-52. The charge would be the same for GCR customers and transportation customers. During the GCR reconciliation, the actual cost of providing system-supply back-up for transportation customers would be deducted from the GCR cost of gas. The SSEC collected for that same GCR period, net of system-supply back-up costs, would be added to or deducted from revenues subject to the 90/10 refund plan.

The proposal appears workable and would provide for a yearly review of the SSEC, thus ensuring that the charge remains current, and we find use of the 90/10 refund plan a proper method to assure collection of appropriate revenue. The Commission therefore will implement the Staff's proposal.

While we agree that an SSEC is appropriate, we find that rather than apply it to all gas transported by a customer, it should apply only to those amounts chosen by a customer, i.e., if a customer transports 1000 Mcf monthly, it may choose to pay an SSEC covering only 500 Mcf. The choice should be the customer's.

Moreover, the Commission does not agree with the ALJ that the SSEC should be mandatory for curtailment category I customers. We are unpersuaded by ABATE's argument, and agree with the Staff that the decision to switch to transportation service should not be constrained by the mandatory imposition of the charge.

All parties agree that Mich Con may have excess gas supplies that may be advantageously sold to transportation customers. ABATE argued that such sales should be encouraged and that requiring a Commission order to authorize those sales may prevent the sales due to the processing time for an order. The Staff proposed that the sale of system-supply gas, other than under the SSEC or the

unauthorized usage charge, should be reviewed annually in the GCR reconciliation. Mich Con would need to demonstrate that these sales provided a benefit to the GCR customers; if the company could not, then it would bear any loss. ABATE argued that this mechanism is sufficient incentive to Mich Con to ensure that it does not engage in inappropriate sales to transportation customers.

The Staff did not oppose any sale of excess supply, but argued that the sales already may be made pursuant to an interruptible sales contract (which could be granted at any time) or under a special contract that could be quickly approved by the Commission on an ex parte basis.

The Attorney General did not oppose the sales, if beneficial to the GCR customers. He stated, however, that in his view, Mich Con may only make sales pursuant to a Commission-approved tariff or a Commission-approved special contract; therefore, an approval of each sale is necessary.

The ALJ agreed with ABATE. The Staff and the Attorney General except.

Initially, we agree with the parties that a sale of excess system-supply gas should be made when that sale will benefit the GCR customers or when the GCR customers are not disadvantaged by the sale. The Commission agrees that placing Mich Con at risk for any loss occassioned by these sales will assure the company's complete review of the sales proposals, but we are constrained by our statutory authority as pointed out by the Attorney General. We therefore find that sales of system-supply gas to transportation customers shall be made in accordance with the authorized gas usage provisions of the T-1 and T-2 tariffs. This tariff will permit appropriate gas sales to transportation customers. Any non-tariff sales must be approved by the Commission. Every effort will be made to expedite the review and processing of any application filed.

Take-or-pay and Excess Pipeline Costs

Due to a change in the natural gas market, it is undisputed that Mich Con faces considerable costs reflecting gas contracted for, but not taken (take-or-pay costs), and excess pipeline fixed costs, which reflect lower demand on Mich Con's supplying pipelines. There is, however, considerable speculation over the amount of these costs. Prior to the advent of a substantial transportation program, the Commission treated these costs as part of the booked cost of gas sold, and therefore collectible through the GCR system. ABATE insisted that these costs strictly relate to gas as a commodity, in effect relating only to Mich Con's sales function. It argued that it is illogical to force transportation customers to shoulder sales-related costs.

The Staff, on the other hand, views these take-or-pay and excess pipeline costs as a phenomenon arising from conservation, plant closings, shifts to other fuels and gas transportation; in short, a consequence of the changes in the gas market. In the Staff's view, these costs result in part from Mich Con's attempt to assure a gas supply to sales customers that are now transportation customers. The Staff would allocate these costs to all of Mich Con's customers, including the transportation customers. The Staff argued that these costs are not long-term and will disappear in the short run as Mich Con brings its supply requirements in line with its sales and transportation needs. The Staff acknowledged that the amounts of the costs are speculative, but argued that the Commission must now determine how such costs will be recovered.

The ALJ agreed with the Staff and, because of the speculative nature of the costs, recommended that they be set within future GCR proceedings. ABATE, the Staff and the Attorney General except. ABATE argues that these costs are inappropriate for transportation customers to bear. The Staff requests the Commis-

sion to affirmatively state that transportation customers must bear a portion of these costs. The Attorney General agrees that transportation customers must bear a portion of the costs and that the costs are speculative. He argues that the GCR proceedings may be an inappropriate vehicle to set a rate for the recovery of take-or-pay or excess pipeline costs because Act 304 provides for GCR proceedings to recover the booked cost of gas sold, not a transportation customer's share of take-or-pay costs or excess pipeline costs.

The gas industry has changed dramatically in the recent past. Due to these changes, significant take-or-pay and excess pipeline costs face Mich Con, and the blame cannot be laid at the doorstep of any single customer or group of customers. Conservation, fuel shifts, plant closings and transportation have all contributed to the situation. The costs face Mich Con and, if appropriate, the costs will be allowed to be recovered.

While we recognize that transportation customers now purchase their own gas, the Commission simply does not agree with ABATE that transportation customers need not bear some of these costs. The costs are legitimate costs of the service provided by Mich Con to the transportation customers. In the case of sales customers, we find these costs appropriately booked as a cost of gas sold. In the case of transportation customers, we find these costs to be a cost of providing transportation service. Nothing improper exists in this dichotomy precisely because pipeline costs and take-or-pay costs, reflecting both the gas commodity and its transportation, have been viewed in the past as a cost of gas sold, not reflective of separate services. Thus, for sales customers this treatment carries on prior practice. However, in the case of transportation customers, these valid costs cannot be included within a combined commodity/service cost as has been done in the past; and another method of recovery must

be established. Therefore, we find that take-or-pay costs and excess pipeline costs shall be apportioned pursuant to the Staff's proposal, which is a reasonable method to assure recovery of those costs.

Nevertheless, we are mindful of the Attorney General's reading of Act 304 and the limitations of a GCR proceeding. Therefore, the Commission finds in this proceeding that take-or-pay costs and excess pipeline costs shall be apportioned between, and collected from, sales and transportation customers. We also find that the cost levels are speculative and, therefore, that when those costs are known, Mich Con shall file in conjunction with a GCR plan case a calculation of those costs in substantial conformance with Exhibit AC-52 to this proceeding. In addition to the GCR case number, the notice for the GCR proceeding shall also bear the Case No. U-8812 number and shall state that the proceeding will, in addition to a GCR plan, also review the calculation of the take-or-pay costs and excess pipeline costs to be assessed. The scope of this Case No. U-8812 portion of the proceeding shall be limited to a review of the calculation of the costs to be assessed, including the amount, its reasonableness, and other related factors. This specific authorization within this proceeding and the future notice and hearing should meet the Attorney General's concerns. Attorney General v Public Service Commission, 157 Mich App 198 (1986).

Monthly Administrative Fee

The ALJ recommended use of ABATE's proposed $300 monthly administrative fee (which the Commission used earlier to establish the costs allocated to the transportation program). The ALJ also recommended that transportation customers be permitted to aggregate accounts similar to the way in which sales customers may aggregate accounts. The aggregation proposal is contained in ABATE's pro-

posed Rule D 2.6 (now Rule D 3.2). Exceptions to the ALJ's recommendations were not filed and the Commission finds his recommendations reasonable and appropriate.

Stand-by Service Charges

Mich Con and the Staff proposed a stand-by transportation charge of 6.5¢ per cubic foot (cf) ($65 per million British thermal units (MMBtu)) for each cf (or MMBtu) of name-plate rating of the facility or equipment taking stand-by service. The charge reflects the cost of holding Mich Con's distribution system in readiness to provide transportation service; it does not contain any charge for access to gas as a commodity. The proposal was unopposed and the ALJ recommended its adoption. Exceptions were not filed and the Commission finds the proposal reasonable and appropriate.

The Staff also proposed a change in stand-by sales service charges. Stand-by sales service provides use of Mich Con's distribution system as well as access to Mich Con's system-supply gas. The Staff proposed increasing the stand-by sales charge from $65 per MMBtu to $250 per MMBtu of name-plate rating of the facility or equipment taking the service. The Staff would also eliminate the 50 MMBtu threshold to be subject to the charge. The Staff's charge includes a $65 per MMBTu stand-by distribution fee plus a gas supply charge roughly equal to the SSEC multiplied by the hours in the day and the days of the month, with a .41 load factor applied. In the Staff's view, few sales customers will opt for this service.

ABATE opposed the form of the charge. ABATE stated that the $250 per MMBtu charge is composed of a $65 per MMBtu charge for holding the distribution system in ready (similar to the stand-by transportation charge) and a cost for securing

a gas supply for the stand-by customer (similar to the SSEC paid by transportation customers who seek access to Mich Con's system-supply gas as a back-up), computed on an MMBtu-per-hour-of-name-plate-rating basis. ABATE stated that the SSEC will vary as the costs of securing gas supply vary and, therefore, that the stand-by sales charge's gas supply component should also vary. ABATE argued that the stand-by sales charge should remain at $65 per MMBtu of name-plate rating (representing a stand-by distribution charge), but that an additional charge should be added equivalent to the SSEC, but converted to an MMBtu-per-hour charge in the same manner in which the Staff computed its $250 per MMBtu charge.

The ALJ recommended the Staff's position, finding that a fixed stand-by sales rate provides customers and Mich Con with certainty and is administratively convenient. ABATE excepts, arguing that if the SSEC can be calculated easily, its proposed charge should be similarly easy to calculate and to administer.

The Commission does not agree with ABATE. The SSEC may be applied to a significant number of transportation customers and, therefore, must closely track the costs incurred to provide the service to enable more market-sensitive transportation customers to react to changing gas prices. To be used in the stand-by charge as ABATE proposes, the SSEC calculation must be converted to a per-MMBtu-of-name-plate-rating basis, adding more administrative duties. We are not in favor of increasing Mich Con's administrative duties. While certain charges, like the SSEC or take-or-pay costs, need to be set more frequently to keep pace with rapidly changing economic factors or are speculative at this time, the Commission sees no reason to carry that practice over to all aspects of rate setting, especially in this instance where the Staff has indicated that few customers are likely to avail themselves of the service. Accordingly, the

Commission rejects ABATE's exception and finds that the Staff's proposed $250 per MMBtu charge should be approved.

Lost-and-Unaccounted-for Gas

Mich Con's lost-and-unaccounted-for (lost) gas level has historically been set using an average of the most recent five-year period. Mich Con witness Mark Cieslak testified that lost gas levels for the five-year period 1982 through 1986, after adjustment for the elevated pressure complaint case, Case No. U-8415, were:

1982	1.31%
1983	1.38%
1984	.56%
1985	.36%
1986	1.08%

He stated that the 1984 and 1985 levels had been abnormally low and that in Case No. U-8406 the company refunded to its ratepayers the difference between the actual lost gas levels for 1984 and 1985 and the average level used to establish the company's rates. Because Mich Con had refunded the difference to its ratepayers, the company adjusted the 1984 and 1985 lost gas levels to 1.68% and 1.60%, respectively. Mr. Cieslak stated that the 1984 and 1985 levels were highly unusual and that the company had not experienced such low levels of lost gas within the past 25 years. The company cited Consumers' Case No. U-291, order dated May 4, 1961, in which the Commission adjusted an aberrant lost gas level through use of a long-term averaging method, stating that the Commission has acknowledged that use of aberrant data is an inappropriate ratemaking base.

Robert G. Ozar, a public utilities engineer in the Commission's gas division, testified that the lost gas level should be based upon an average of the five-year period of 1983 through 1987 because that period was more recent than

the 1982-1986 period proposed by Mich Con. Mr. Ozar stated that Mich Con improperly adjusted the 1983, 1984 and 1985 years when reflecting the elevated pressure complaint case. Mr. Ozar supported a .85% lost gas level, which is an average of the following adjusted levels for the five-year period of 1983 through 1987:

1983	1.29%
1984	.48%
1985	.28%
1986	1.08%
1987	1.12%

The Staff, supported by the Attorney General and ABATE, argued that the 1984 and 1985 levels should not be adjusted to reflect the Case No. U-8406 refund because Mich Con was not required to refund the amount and, thus, voluntarily refunded the difference between the actual and allowed lost gas levels. Moreover, the Staff stated, the purpose of the averaging method itself is to smooth out abnormalities.

The ALJ agreed with the Staff, recommending use of the actual, pressure adjusted lost gas levels for the most recent five-year period, 1983 through 1987. Mich Con excepts, arguing that unless the 1984 and 1985 levels are adjusted upward, the company will be penalized for its prior actions.

The Commission has reviewed Mich Con's argument, but does not entirely agree with it. The Commission does find Case No. U-291 instructive. The averaging method was used because the one-year figure was abnormal; the average of a significant number of previous years smoothed out that abnormality. In a similar manner, the 1984 and 1985 figures are highly unusual. The company had not experienced similar levels within the previous 25 years, nor since. We, therefore, find that those years must be disregarded as aberrant. Given the record before us, a three-year average using 1983, 1986 and 1987 will be used.

In the future, a return to the five-year average may be appropriate. Using the Staff's adjusted 1983 figure and the Staff's 1986 and 1987 figures results in a lost gas percentage of 1.16%. We find the 1.16% figure appropriate and a reasonable approximation of the lost gas percentage during the test year.

Gas-in-Kind Provision

The cost of lost gas is allocated to sales and transportation volumes using an average cost of gas. ABATE requested that transportation customers be permitted to reimburse Mich Con for this lost gas percentage by providing gas-in-kind, i.e., if Mich Con's lost gas percentage is 1%, then for each 100 Mcf transported on Mich Con's system, the transportation customer will receive 99 Mcf. ABATE stated that transportation customers can purchase gas more cheaply than Mich Con, resulting in economic savings that cannot help but be beneficial to Michigan. ABATE noted that to adopt its proposal merely requires reducing Mich Con's projected gas purchases by the lost gas attributable to transportation customers, with a corresponding reduction in the company's revenue requirement to reflect its non-purchase of the gas. Moreover, ABATE stated, this type of provision is an appropriate unbundling of services. ABATE would also similarly reimburse Mich Con for company-use gas.

The Staff did not favor ABATE's proposal, but proposed to permit Mich Con to negotiate a gas-in-kind provision under the Staff's transportation proposal. Mich Con opposed the provision.

The ALJ recommended adopting the Staff's position, which was consistent with his recommendation regarding the Staff's transportation proposal. ABATE excepts.

The Commission has reviewed ABATE's proposal for lost gas and company-use gas, and we find it appropriate. However, rather than permit individual trans-

portation customers to choose whether to deliver gas-in-kind, we find that the provision should be mandatory for all transportation customers, which should enable Mich Con to better plan its deliveries and simplify billing.

Based on the Commission's other findings in this order, lost gas volumes will be approximately 3,453 MMcf. From the company's exhibits, company-use gas volumes will be approximately 1,847 MMcf, resulting in a combined lost and company-use gas volume of 5,300 MMcf. This order establishes volumes of 90,728 MMcf for transportation and 201,659 MMcf for sales. Therefore, the transportation customers' allocated share of lost and company-use gas is 90,728 ÷ (201,659 + 90,728), or 31.03%, times 5,300 MMcf, which is 1,645 MMcf. Thus, the appropriate gas-in-kind factor to be used by Mich Con is 1,645 MMcf ÷ (90,728 MMcf + 1,645 MMcf) or 1.78%.

Transportation Volume Classification

In many instances, Mich Con's rates vary by volume of usage with a higher minimum monthly payment compensated for by a lower per-Mcf charge. While theoretically any customer could be on what is termed a high-volume rate, use of that rate would not make economic sense if the customer's usage did not surpass the volumetric break-even point at which the higher minimum monthly payment combined with the lower per-Mcf charge yields a savings. ABATE proposed two classes of transportation customers: small volume and high volume. The small-volume customer would pay a $185 monthly service charge and a 60¢ per Mcf transportation charge. The large-volume customer would pay a $2,270 service charge and a 38¢ per Mcf transportation charge. (These figures are based upon ABATE's cost studies and would change as a result of findings in this order that differ from ABATE's assumptions.)

The Staff argued that the classifications are unnecessary given its market-based transportation proposal. Mich Con opposed the distinction because most customers will migrate to the lower cost, large-volume transportation rate, and evidence was not presented regarding what effect the migration would have on the company's revenue.

The ALJ agreed with ABATE. The Staff and Mich Con except.

The Commission finds that insufficient evidence was presented regarding the revenue effect on Mich Con of the migration of customers from the small-volume to the large-volume classification. While the Commission does not reject the concept, we find that a lack of sufficient evidence at this initial stage of development of Mich Con's transportation program prevents authorization of different small-volume and a large-volume rates.

Transportation Program

The Commission has discussed the principles underlying our allocation of costs to the various sales and transportation programs. Having set the costs to be assigned to the transportation area, the Commission must now establish the program to be implemented.

Significant controversy centers on the transportation proposals proffered by ABATE and the Staff. Mich Con submitted an initial proposal, which was cross-examined prior to the consolidation of this proceeding. The company later adopted the Staff's proposal. ABATE favored a cost-of-service-based transportation rate design, with all services unbundled. The Staff favored a market price approach that would vary from customer to customer depending on each customer's bargaining position. The ALJ recommended the Staff's approach, and ABATE, the producer/broker intervenors and the Attorney General except.

During the immediate past few years, the gas industry has undergone, and is undergoing, significant changes. Mich Con is shifting from its role as a local distribution company (LDC) that provides all gas-related services to its customers to a role as a provider of a number of unbundled, separate services. In the past, Mich Con planned its system and its gas supply purchases to meet the needs of its customers: if gas was to be purchased in Mich Con's service territory, it was purchased only from Mich Con. This situation required the company to have gas available for sale when its customers wanted to purchase gas. It also dictated the construction and configuration of Mich Con's system: an integrated transmission, distribution, storage and production system.

Mich Con's role has now changed. The company has revised its method of operation to provide for new services, which has resulted in the bifurcation of its business into the transportation of customer-owned gas and the sale of company-purchased or company-produced gas. Under a transportation program, customer-owned gas is received into and moved through Mich Con's system for delivery at the customer's premise. The company's traditional role continues under its sales program. However, while Mich Con now transports for, rather than sells to, a number of customers, the distribution system used is still that constructed for Mich Con's prior sales-only operation. Moreover, due to the intermingling of sales and transportation customers throughout Mich Con's service territory, it is, in the Commission's judgment, unlikely that a separate transportation distribution system will be developed. Accordingly, any transportation or sales program must start from Mich Con's present integrated system operation as well as the historical formation of its LDC operations.

At the outset, the Commission stresses that rather than favoring transportation over sales or vice versa, we are much more concerned with providing a

secure gas supply for the state, which is safe, reliable and economic. Thus, we find that transportation of gas is an appropriate function for Mich Con.

All parties agree that an LDC's duty to a sales customer differs from that owed to a transportation customer. When a customer leaves sales for transportation, that customer abandons future system-supply gas and extinguishes the LDC's obligation to plan for purchase of sufficient gas to meet that transportation customer's requirements. The LDC must still plan for the transportation customer's capacity needs. Should a transportation customer decide to return to sales status, that customer is in no better stead than a new customer, and under the terms of the transportation program later described may be in an inferior position.

Therefore, we find significant merit in the Staff's suggestion that all transportation customers be specifically advised by Mich Con that by electing transportation service the customer no longer may rely on the company for its gas supply. The Staff's proposed affidavit is an appropriate way to ensure that a transportation customer understands the consequences of its decision, and we direct that such an affidavit be utilized. However, the form used by the company should be revised to reflect the transportation programs authorized by this order, as well as the options open to customers to secure system-supply gas and the time limits imposed regarding a change from one transportation program to the other, or a return to sales from either.

The Staff's market-based transportation proposal is predicated on the ability of transportation customers to bargain with Mich Con, either based upon an alternate fuel capability or some other means to end their reliance on Mich Con's gas supplies. The Staff's rate would vary between $2.50 to 30¢ per Mcf, on a monthly basis, but customers could enter into longer term contracts. In

the Staff's view, all rates would vary within this zone in such a way that Mich Con would recover the total revenue requirement assigned to transportation services. The Commission would retain oversight through the 90/10 refund plan to ensure that Mich Con would recover only reasonable rates for its overall transportation services. The ALJ favored the Staff's proposal.

ABATE, the producer/broker intervenors and the Attorney General except, but on differing grounds. The Attorney General questions the wisdom of permitting Mich Con to vary rates within such a large zone, without some guidance regarding an appropriate rate or some safe harbor for customers with little bargaining power. ABATE and the producer/broker intervenors reject the Staff's basic premise that market conditions will result in appropriate rates within the preauthorized range. In their view, the only relevant factor is alternate fuel capacity, without which ratepayers will be left to the mercy of an unregulated monopoly. ABATE argues that few transportation customers presently have substantial alternate fuel capacity, and that the remaining customers will be driven to install such capacity (even if the action is uneconomic) to gain leverage in negotiations with Mich Con. Those customers without the means to install alternatives and those without other alternatives, such as customers using natural gas as a feedstock, will be charged exorbitant rates to their detriment and Mich Con's enrichment. ABATE views quick remedial action by the Commission as unlikely and, at best, an unattractive substitute for cost-of-service-based rates. ABATE's exceptions extensively treat the ALJ's rejection of its cost-of-service-based transportation proposal, and reiterate in great detail the points raised in its testimony, brief and reply brief. Because of the transportation programs authorized by this order, each lengthy exception need not be treated individually.

The Commission has reviewed the record. We find merit in the positions of all parties. Accordingly, the transportation system authorized has been designed to foster transportation, to promote business interests, to permit Michigan businesses to benefit from lessened regulation (with the concomitant increase in risks), and to promote the welfare of Mich Con's remaining sales customers.

We start from the premises that a transportation rate is necessary and appropriate for Mich Con; that many large-volume users are sophisticated purchasers of natural gas; that market-based rates, within appropriate bands, are a proper response to the emerging competition in the natural gas distribution industry; and that the interests of many, less sophisticated customers require oversight by the Commission. Neither the Staff's nor ABATE's proposals fully comport with all of these premises. The Staff's proposal permits more sophisticated customers to bargain effectively, yet leaves smaller, less astute customers unprotected. Equally so, ABATE's proposal continues the Commission's historical control of Mich Con's rate, for the benefit of those less sophisticated ratepayers, but it greatly restricts options for the more sophisticated customers--those willing to take more substantial business risks to achieve greater benefits. Thus, we find that Mich Con's transportation program must contain elements of both proposals and that two separate, but interrelated, transportation tariffs should be authorized.

Mich Con shall have two transportation tariffs: one market based along the lines of the Staff's proposal, the other cost-of-service based, similar to ABATE's proposal. The Commission is persuaded that a cost-of-service-based tariff will provide a safe harbor for less sophisticated customers, permitting a customer the ability to engage in economic gas transportation, while giving a

firmer base for planning. Although we disagree with many of ABATE's contentions, its proposal forms the basis for our T-1 tariff.

In ABATE's view, transportation is a new service, unencumbered by prior factors. In the Commission's view, transportation, while a different service, is one that must be delivered within the context of Mich Con's existing system, which was constructed for another method of business and which must be adapted, along with its peculiarities, for use in the new dual business of sales/transportation. Our earlier discussion regarding the cost-of-service adjustments has established what costs will be allocated to the transportation tariffs. The T-1 tariff rate has been computed based upon total transportation volume, as if a T-2 rate had not been authorized. Our assumptions result in a $0.4509 per Mcf charge for transportation, which must be added to the various other charges established previously in this order and adjusted as detailed in the next paragraph.

The only remaining charge that must be determined is the monthly customer charge, which is computed by subtracting the transportation commodity revenue and the total administrative fees from the cost of service allocated to transportation customers by this order:

Transportation cost of service	$51,192,000
Commodity revenue (90,728,000 Mcf x $.4509)	(40,909,000)
Administrative revenue (653 x $300 x 12)	(2,351,000)
Customer charge revenue	$ 7,932,000

Dividing this required customer charge revenue by the projected 653 transportation customers results in an annual per-customer revenue of $12,147, which is a cost-based customer charge of $1,012 on a monthly basis. For administrative convenience, customer charges are normally set at a rounded level. Thus, the Commission will adopt a monthly transportation customer charge of $1,000 and

will adjust the transportation charge to $0.452 per Mcf to account for the revenue difference. Revisions to this customer charge may be reviewed in future rate cases.

The second transportation tariff, T-2, shall be a market-based rate, under which Mich Con will negotiate a rate with each customer. The rates may be in effect on a monthly basis, or longer term contracts may be negotiated. ABATE, the Attorney General and the producer/broker intervenors argue that the Staff's proposed range of rates, 30¢ to $2.50, is excessive, permitting a wide variance in rates. Because we have authorized a cost-of-service-based rate as well, the parties' fears that all transportation rates will substantially exceed cost should be resolved.

However, we are concerned that the range of rates authorized must be within a zone of reasonableness. Therefore, the Commission finds that a narrower range of rates is appropriate. Evidence was presented that the lowest rate of $0.30 per Mcf was designed with Mich Con's present coal displacement rate in mind. However, our use of a gas-in-kind factor for company-use and lost gas results in a differential of approximately $0.07 per Mcf below the cost-of-service-based rate that would exist if gas-in-kind had not been authorized. Therefore, the $0.30 level should be adjusted to $0.23 to reflect this gas-in-kind effect. We find this $0.23 per Mcf level an appropriate lower boundary.

The cost-of-service-based rate is $0.452 per Mcf, approximately $0.22 above the $0.23 level. We find the $0.452 price an appropriate mid-point and therefore set the highest limit for the market-based rate at $0.67 per Mcf. This range permits Mich Con to negotiate its transportation rate within a 22¢ differential in either direction from the cost-of-service-based rate, and should, over time, permit the company to recover sufficient revenue to recover its costs

when serving the T-2 customers. This negotiable transportation rate shall be in addition to the various other charges established previously in this order.

Within 90 days of the date of this order or at the termination of existing or pending transportation contracts, customers shall choose either the T-1 cost-of-service-based rate or the T-2 market-based rate. Thereafter, a T-2 customer shall not be eligible for the T-1 tariff for a period of five years from the date the customer chooses the T-2 tariff.[4] This five-year period will ensure that those choosing a market-based rate cannot seek a lower initial rate, while retaining a cost-of-service-based safe harbor near at hand.

The Mich Con integrated system is designed to provide immediate gas usage: if draws are light or heavy, gas flows through the system, whether into or out of storage or to or from other pipelines. Mich Con and the Staff argued that few, if any, customers use a steady draw of gas, thereby creating a mismatch between interstate pipeline deliveries and actual customers' use. Mich Con, supported by the Staff, argued that it is more probable than not that transportation customers will make use of Mich Con's storage capabilities for load balancing and incidental storage. Thus the company and the Staff would provide storage for 10% of a transportation customer's annual contract quantity (ACQ) within the basic transportation rate, and costs related to this storage amount would be included within the rate.

Mich Con, supported by the Staff, proposed a storage charge of 10¢ per Mcf per month for a transportation customer's storage that exceeds 10% of the customer's ACQ. Mich Con stated that the 10¢ per-Mcf-per-month charge was pat-

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[4]This five year period is drawn from the five-year limitation proposed for a return to system-supply sales status after a change to a transportation tariff.

terned on its Interstate Storage Division storage contract for 100-day service. The Staff argued that transportation storage was a superior service to general storage in that it was automatic; i.e., under the rate, transportation customers could store significant quantities without prior approval because each customer's transportation volume input and actual system takes would not be known until month-end. If takes are substantially below inputs and the 10% level is exceeded, Mich Con has already stored the excess.

ABATE disputed the company's claim, arguing that pipelines or producers could provide the necessary load balancing. ABATE stated that storage services should be completely unbundled; i.e., the 10% factor engineered into the transportation rate should be eliminated and transportation customers should contract for storage on an as-needed, as-wanted basis. ABATE calculated a cost-based storage rate of 2.85¢ per Mcf per month for any volumes of gas remaining in storage at month-end, plus an additional .9% for fuel used for injection of gas into storage. ABATE stated that its cost for injection was based upon recent editions of the company's standard storage contract.

The ALJ agreed with the company's and the Staff's proposal that a 10% storage allowance be factored into the transportation rate. Later in his PFD, the ALJ also agreed with ABATE that all storage should be separately billed. ABATE excepts, arguing that the net effect of the two recommendations is to require transportation customers to pay twice for the initial 10% of storage.

The Commission is persuaded by Mich Con's and the Staff's argument that on a day-to-day basis the practicalities of balancing the load throughout Mich Con's system are such that Mich Con's storage facilities generally will be used on an incidental basis to balance load, as well as to store minor amounts of gas for transportation customers from month to month. We therefore find appropriate

inclusion of the basic storage service charge within Mich Con's transportation rate. However, records should be maintained regarding the actual month-end storage balance carried by transportation customers. In future cases, the 10% of annual contract quantity level may need to be revised should actual experience support a different conclusion. Storage above the 10% level pre-engineered into the rate shall be unbundled and set at ABATE's proposed rates of 2.85¢ per Mcf per month, plus .9% for fuel used for injection. Storage above the 10% level shall be on an as-available basis, unless the customer has signed a firm contract.

Mich Con and the Staff proposed that only end-users be permitted to contract for transportation or, in any event, that the end-user of the transportation service should determine the rate applied to the transportation services, i.e., meter charges, aggregation of accounts, etc. The producer/broker intervenors raise the issues that Mich Con's tariffs should provide one rate for transportation throughout Mich Con's system, including the wetheader system; that rates for movement of intrastate gas should be no less favorable than those for the movement of interstate gas on Mich Con's system; and that producers and brokers should be able to contract for transportation services and thereby be permitted to provide a complete package to their customers, i.e., the gas commodity and its transportation.

In the Commission's view, reasons do not exist to forbid a producer or broker from contracting for transportation services, and we find that transportation services should be available to producers and brokers. However, we are greatly concerned that producers and brokers should not be able to aggregate usage and thereby qualify for more favorable rate treatment than could an on-system end-user. Accordingly, we find that while producers and brokers may

contract for transportation services, when gas will be consumed within Michigan, the end-users' status will be imputed to the producer or broker for the computation of rates. Thus, for example, if an end-user may qualify for an aggregation of accounts, then the producer or broker may qualify for that aggregation of accounts. This treatment is appropriate because in a producer/broker situation when the commodity will be sold within this state, separate meter reading and billing will be required at each end-user's point of consumption. Therefore, the assumptions that underlie the aggregation of accounts for an end-user do not apply to a producer/broker's aggregation of a number of unrelated metering locations.

Moreover, producers and brokers should be able to contract under the T-1 and T-2 tariffs for transportation through Mich Con's system for off-system destinations. We find that the T-1 and T-2 tariffs may be used for this purpose, along with the monthly administrative fee of $300 and the $1,000 customer charge. The imposition of this customer charge is appropriate because at some point the gas provided for transportation must be metered. The producer/broker intervenors may, in future rate cases, present evidence regarding another appropriate customer charge to apply to their transportation for off-system sales.

While the T-1 and T-2 tariffs may be applied for transportation on Mich Con's system for off-system sales, we find that the T-1 and T-2 charges shall be in addition to that charge previously established for production-and-gathering expenses, which will recover transportation costs for gas transported on the wetheader system. However, the Commission also finds that neither the T-1 and T-2 tariffs, nor the production-and-gathering expense charge, shall apply to inter-utility gas transportation.

Rate Class 3A Expansion

Presently, Mich Con has a Rate Class 3, which provides a reduced rate for senior citizens (customers may no longer be added to this class), and a Rate Class 3A, which provides a reduced rate for low-income senior citizens. Mich Con proposed expanding the Rate Class 3A eligibility to include Michigan Department of Social Services (DSS) heating assistance program customers. Mich Con witnesses James Brewer and John vonRosen testified that Rate Class 3A provides a $12 per month bill credit during the months of December through March; that the credit closely parallels the normal uncollectibles expense charge-off for DSS clients; that the expansion of the rate class will assist the viability of the heating assistance program thereby preventing increases in uncollectibles expense from these customers; and that expansion of the rate class will cost rate classes 2, 2A and 3 customers very little individually. Mich Con stated that, at the very least, Rate Class 3A must be maintained in its present form.

The Staff opposed any expansion of Rate Class 3A and requested that it be eliminated along with Rate Class 3 as part of the shift to cost-of-service-based rates.

The ALJ agreed with the Staff. Mich Con excepts.

The Commission has reviewed Mich Con's exceptions regarding expansion, as well as elimination, of the two rate classes. We are persuaded that the needs of the company's customers who are least able to pay must be considered. The Rate 3 senior citizen rate has existed for some time, although new customers cannot be accepted. The Rate 3A senior citizen rate is more narrowly drawn, available only to senior citizens with incomes within 125% of the federal poverty level. We find rate classes 3 and 3A reasonable to promote the welfare of Michigan citizens. We therefore direct continuation of those rate classes.

However, we find that expansion of Rate Class 3A to include DSS heating assistance program customers is inappropriate, greatly increasing the costs of the program with no corresponding benefit to the remaining residential rate classes.

Mich Con proposed increasing the customer charge for Rate Schedule 2A, Meter Class I customers from the present level of $7.50 per month. The Staff opposed the increase, and the ALJ recommended maintaining the charge at $7.50. Exceptions to the recommendation were not filed, and the Commission finds that the customer charge should remain at its present level.

Mich Con proposed a seasonal turn-on, or reconnect, charge of $25. The Staff supported the charge, and the ALJ recommended its approval. Exceptions to the recommendation were not filed and the Commission finds the $25 seasonal turn-on charge reasonable and appropriate.

Existing Gas Transportation Contracts

Since 1986, Mich Con has entered into approximately 700 transportation contracts with varying terms. Contracts entered into on and after January 16, 1987 contained provisions that permit those contracts to be revised to be consistent with the terms and conditions for gas transportation established in this order. Mich Con requested that the pre-existent contracts be grandfathered and allowed to expire according to their terms. Moreover, Mich Con would delay the effective date of any new transportation rates by 90 to 120 days. The Staff supported 120 days. The company argued that the grandfathering and delayed effective date will permit Mich Con to effectuate a smooth administrative transition to the new transportation tariffs due to the need to deal with over 700 contracts in a short time.

ABATE proposed a delay of 30, but no more than 60, days for the implemen-

tation of new rates. It questioned the wisdom of grandfathering all contracts, noting that pre-January 16, 1987 contracts did not provide for automatic revision in the event of a final Commission transportation order. Thus, grandfathering all contracts will result in two classes of transportation customers, pre-January 16, 1987 and all others, thereby denying benefits to many simply because of the date a contract was signed. ABATE would permit all pre-January 16, 1987 contract customers the option of retaining their contract or reforming it to conform with this order.

The Attorney General argued that once the Commission has found a rate to be just and reasonable, i.e., the new transportation rate, then it is legally improper to delay implementation of that new rate.

The ALJ agreed with ABATE that, while all contracts should be grandfathered, those pre-January 16, 1987 contract customers should be given the option of retaining their contracts or taking service under conditions consistent with this order. He also recommended that any new transportation rates become effective four months from the date of the Commission's order, permitting Mich Con time to prepare for the change. Mich Con and the Attorney General except.

The Commission has reviewed the parties' arguments regarding the need to grandfather existing contracts, the delay necessary to process new market-based transportation contracts and the legality of delaying implementation of the new rates. While we understand the Attorney General's argument that new rates should be implemented as soon as practicable, we must reject his position that a new rate always becomes the only just and reasonable rate on the date of a Commission order. A number of factors enter into the determination of a just and reasonable rate, one of which is the need to implement that rate. Accord-

ingly, it is not improper for the Commission to find that existing rates are appropriately continued until a future date.

The Commission is persuaded by Mich Con's argument that all existing contracts should be grandfathered to permit a smooth administrative switch to the new transportation program. The prior contracts were freely negotiated and the parties to those contracts should be permitted the benefit of their bargains. Moreover, a substantial number of the contracts will terminate in a relatively short time. Therefore, we direct that all contracts should continue until their termination dates, including those entered into prior to January 16, 1987. By continuing all contracts, we will not, by our action, remove any benefits accruing to those parties executing contracts either before, on or after January 16, 1987.

Because we have provided for a cost-of-service-based rate and a market-based rate, and have grandfathered all pre-existent contracts, the Commission does not expect the deluge of transportation contract negotiations foreseen by Mich Con, the Staff or the ALJ. Therefore, the Commission does not find it necessary to delay authorization of new transportation rates, which will become effective with the remaining rates established in this order. Should interim problems occur through inadvertent improper charges, Mich Con can always recompute the charges at the proper rate and either refund or collect the difference.

Long-Term Gas Transportation Contracts

Mich Con entered into a number of long-term gas transportation contracts with its larger volume customers. The contracts are the subject of Case No. U-8854, one of the consolidated cases in this proceeding, and were offered to Mich Con's large-volume customers that could purchase or transport natural gas

under rate schedules nos. 6, 7, 8 and 9. Mich Con offered the contracts during the summer of 1987, withdrawing all remaining offers on September 4, 1987. Mich Con has requested approval of the contracts, arguing that the contract rates are appropriate given the customers' commitment to gas for at least five years, the threat of system by-pass, and the assurance of fixed-cost coverage on the distribution system. The company stated that the long-term contracts are a necessary part of Mich Con's orderly shift to a proper role as a sales/transportation local distribution company. Moreover, the company argued, the contracts exempt the customer from potential take-or-pay costs. Many, if not all, of the contracts contain a provision that if the transportation rates ordered in this proceeding are lower than the contract rates, then those lower rates will become the contract rates (Tr. 4148).

ABATE disputed Mich Con's statements that the contracts are necessary. It argued that Mich Con presented the long-term contracts to customers on a take-it-or-leave-it basis. In ABATE's view, Mich Con attempted to force customers to commit to a Mich Con-induced rate without knowledge of the Commission's final transportation policy. ABATE argued that Mich Con's coercive tactics should not be condoned and, in any event, that all large-volume customers should be permitted to sign similar contracts, if they choose, after those customers have been able to review the Commission's final transportation policy and rates.

The Staff argued that the long-term contracts need not be specifically approved and that the company could achieve the same results through use of the Staff's market-based transportation proposal. Moreover, the Staff stated that the contracts exempt customers from future take-or-pay costs that the Staff proposes should be spread to all sales and transportation customers.

The Attorney General argued against the contracts as contrary to the basic

idea of a tariffed transportation rate.

The ALJ, having recommended adoption of the Staff's market-based transportation proposal, found it unnecessary to specifically approve the long-term contracts because similar long-term contract results were achievable under the Staff's proposal. The ALJ also rejected ABATE's contention that Mich Con utilized coercive negotiating tactics to achieve the execution of the contracts. He acknowledged the testimony of two ABATE witnesses who complained of the negotiating process. However, he was persuaded by the fact that ABATE members had not sought to be released from the contracts: one ABATE witness declined to request cancellation of his company's contract, and one ABATE witness, whose company did not sign a long-term contract, did so primarily to await the Commission's final transportation policy. ABATE and Mich Con except.

The Commission has reviewed ABATE's testimony regarding Mich Con's negotiation of the long-term contracts. We agree with the ALJ and reject ABATE's portrayal of the negotiations as fraught with coercive utility action. The ABATE members are substantial and sophisticated companies. We find significant ABATE witness David Schultz's testimony that, while White Consolidated Industries was not satisfied with the negotiation process, the company did not want to cancel or rescind its contract (Tr. 4166). Moreover, ABATE witness David Dornbos, Sr., testified that Steelcase, Inc. would like the option of entering into a contract similar to the one previously offered, after it has reviewed the Commission's final transportation policy (Tr. 4150). Such testimony does not compel a finding of coercive behavior by Mich Con.

The long-term contracts provide a firm base for planning on the customers' part. These contracts also assure use of Mich Con's system and thereby benefit the company and its ratepayers. We therefore find that the contracts should be

approved.

However, in so doing the Commission is concerned with the exemption contained in these contracts for take-or-pay or excess pipeline cost liability, which we have earlier found to be an appropriate cost to be borne by transportation customers. Therefore, we reserve the issue of whether take-or-pay costs or excess pipeline costs should be assessed to the long-term contract customers and direct that this issue be addressed within the future proceeding, previously established, to determine the actual excess pipeline and take-or-pay charges to be assessed.

Seized Gas Tariff

ABATE stated that, while remote, a possibility exists that, during a future gas shortage, transportation gas may be seized by Mich Con to provide supply to residential customers or other curtailment category I customers. Given this possibility, ABATE proposed a tariff to cover the situation that would allow the seizure and, at the transportation customer's option, either deferral of the gas for later delivery or payment for the gas. Payment would be the greater of the total cost of alternate fuel used or the cost of the gas seized, including transportation. ABATE did not elaborate under what authority or in what situations the company could seize the gas.

Mich Con and the Staff argued that the situation hypothesized by ABATE is remote and definitely out of the ordinary. Given the unusualness of the possibility, neither would adopt the tariff.

The ALJ agreed with Mich Con and the Staff. ABATE excepts.

We agree with the ALJ. The situation posed is remote and, if such a supply situation were to arise, the Commission could institute a special proceeding to review that situation.

The 90/10 Refund Mechanism

When establishing rates, sales volumes must be set thereby providing a revenue figure. When projected volumes are inaccurate, the utility either earns below or above its return. The 90/10 refund proposal was constructed to permit Mich Con to utilize a lower projected sales level for rate setting purposes, while encouraging the company to aggressively seek increased sales. Under the plan, 90% of revenue over a pre-set level engineered into base rates is refunded while the company retains 10%.

The Staff proposed, supported by Mich Con, that transportation customers be excluded from the 90/10 refund mechanism. The Staff argued that its market-based transportation proposal would reflect a true market rate; thus, a refund mechanism for the transportation program was unnecessary.

The Attorney General, while supporting the Staff, argued that the 90/10 refund mechanism should be reduced to 95/5 for purposes of transportation-related revenues because of the wide pricing latitude proposed and the conservative nature of the transportation volumes projected. In the Attorney General's view, allowing the company to retain 10% would result in a windfall to the company.

ABATE, because it opposed the Staff's market-based approach, argued that its cost-of-service-based proposal required inclusion of transportation customers within the 90/10 refund program. In ABATE's view, when rates are based upon the cost-of-service, no logical reason exists to exclude transportation customers from a return of excess revenues.

Because the ALJ had recommended use of the Staff's market-based transportation plan, he also recommended that transportation customers be excluded from the 90/10 refund program. The ALJ did not review the Attorney General's pro-

posal. ABATE and the Attorney General except.

The Commission agrees with both ABATE's and the Staff's basic premises. When transportation rates are based upon market rates, those customers pay what they perceive as a proper, market-derived rate. Such customers should not benefit from the 90/10 program. When transportation rates are based upon the cost-of-service, those customers pay rates predicated on certain sales assumptions, which are the necessary prerequisite for the 90/10 refund program. Accordingly, excess transportation revenues will be included in the 90/10 refund mechanism. Those customers under the market-based transportation rate shall not participate in the 90/10 program. Those customers under the cost-of-service-based transportation rate shall participate in the 90/10 program along with sales customers.

On exception, the Attorney General renews his request that the company's 10% be reduced to 5% for transportation revenues. He notes that the change is a policy question, and argues that, because of the speculative nature of transportation volumes as well as the potential for excess revenues under the market-based transportation program, a 5% incentive to Mich Con is more than sufficient.

The Commission is not persuaded of the need to reduce the 90/10 refund proportions to 95/5 for transportation-related revenues. The transportation volumes are based upon reasonable projections of future occurrences, and the use of market-based and cost-of-service-based rates has reduced the potential for excessive revenue. The Commission, therefore, will continue the present 90/10 levels. Based upon the assumptions and findings in this order, the 90/10 threshold level is $52,380,746.

Offset Study

Mich Con proposed elimination of the offset study from the company's rate

case filing requirements. The proposal was unopposed; the ALJ recommended the study's elimination. Exceptions to his recommendation were not filed.

The Commission concurs and directs that the offset study shall be eliminated from Mich Con's rate case filing requirements. The Commission is continually interested in updating and revising its filing requirements, ensuring that all necessary information is available for review while eliminating redundant or unnecessary information.

Rule Revisions

The Staff proposed that Mich Con's late payment rule for rate schedules nos. 2, 2A, 3 and 3A be conformed to the present Consumer Standards and Billing Practices, Electrical and Gas Residential Service, R 460.2101 et seq., which provide that a late payment charge may be applied only to bills that are overdue by at least five days. The proposal was unopposed, the ALJ recommended its adoption, and exceptions were not filed.

The Consumer Standards and Billing Practices are validly promulgated administrative rules that supersede any of Mich Con's rules to the contrary. The company is directed to conform all of its tariffs to those billing practice rules.

The Staff proposed a revised Rule B 3 for Mich Con that would clearly define the company's obligation to serve, would establish procedures for transportation customers to switch to sales service, and would define when system-supply gas could be made available to transportation customers. The ALJ recommended implementation of the revised rule, except for the provision that required prior Commission approval for certain sales of system-supply gas to transportation customers. The ALJ earlier had found that requirement unnecessary.

As mentioned in the Commission's discussion of the basic transportation program, when a customer moves from sales to transportation service, the company's duty to plan for that customer's gas commodity needs ceases, unless the SSEC is paid. We believe this state of affairs must be clearly set forth as well as the ability of a transportation customer to return to sales service. The Commission, therefore, finds that the revised Rule B 3 should be implemented. Because we earlier held that any non-tariffed contracts permitting the sale of excess system-supply gas to transportation customers must be approved by the Commission, we direct that the entire Rule B 3 be implemented.

The Commission's use of separate cost-of-service-based and market-based transportation rates requires an addition to Mich Con's rules to reflect that once a market-based transportation rate is selected, the customer cannot select either sales service or cost-of-service-based transportation service during the five-year period immediately after that selection. After that period, the market-based transportation customer may select cost-of-service-based transportation rates, remain on market-based transportation rates, or qualify for sales service under revised Rule B 3. The attached revised Rule B 3 covers the situation.

The ALJ recommended approval of the Staff's proposed Rule B 4, concerning curtailment due to a supply deficiency, and Mich Con's proposed Rule D 2.5 (now D 3.1), concerning curtailment due to a capacity deficiency. Exceptions to the recommendation were not filed.

The Commission has reviewed the proposed rules, finds them appropriate and directs their implementation. The rules treat two related, but different, subjects: a gas supply deficiency and a system capacity deficiency. Due to the advent of transportation services, now separated from sales services, it is

necessary to establish separate curtailment rules. The proposals treat all parties fairly and are equitable.

Reporting Requirements

Under the ALJ's recommendation, Mich Con would report quarterly to the Commission the following monthly data for all transportation volumes:

1. Total transportation revenue, by rate class
2. Transportation volumes delivered, by rate class
3. Average transportation rate, by rate class
4. Transportation volumes received, by pipeline
5. Transportation volumes received from Michigan production
6. Transportation volume imbalances

Individual transportation contracts would no longer be filed with the Commission. The Staff had originally proposed that the data be compiled on a rate class basis. ABATE proposed that the report be expanded to include separate reports on each customer. The ALJ agreed with ABATE's proposed expansion. Mich Con excepts.

Mich Con argues that the separate reporting of information for each transportation customer is burdensome. Moreover, the company states, customers are entitled to confidentiality for their business negotiations, particularly transportation customers who have negotiated separate, market-based rates.

The Commission agrees with Mich Con that separate reporting of each transportation customer's data (the Staff estimates 653 transportation customers for administrative expense purposes) would be unduly burdensome. Additionally, individual customer data becomes less necessary due to the Commission's approval of separate cost-of-service-based and market-based transportation rates. In the

case of market-based rates, the Commission accepts Mich Con's assertions that market-based rate customers desire confidentiality of their sources and rates to deter competitors from obtaining that information. While we do not seek to hide competitive information from public view, the Commission is disinclined to aid a competitor's intelligence gathering. Accordingly, we find appropriate the Staff's original proposal that the previously-listed data should be provided on an aggregate rate class, not customer-specific, basis.

Mich Con's Accounting Procedures

The Staff proposed, and the ALJ recommended, that Mich Con be specifically ordered to properly account for its various costs, primarily O&M costs. In the Staff's view, Mich Con has failed to properly classify many costs as non-operating expenses and, thereby, has posted these costs to inappropriate accounts. The Staff stated that many of these postings are contrary to the Uniform System of Accounts and Commission orders. The Staff argued that an inordinate amount of Staff audit time and resources have been spent in appropriately re-classifying costs.

In this order, we have noted the need to develop and maintain necessary accounting records for Mich Con's diversified activities. No less of a need exists for the company's remaining accounting records. The Commission must have accurate information to permit it to discharge its duty to set reasonable and just rates. Mich Con, through its larger resources, significant personnel and general knowledge of its business, is in a much better position than the Staff to ensure that its accounting records are kept in proper form. The company is directed to review its procedures to ensure that its business records are maintained according to the Commission-approved Uniform System of Accounts and the Commission's orders.

MTC Brokerage Operations

MTC operates its business using, for the most part, Mich Con marketing employees. Mich Con stated that appropriate accounting records are kept to separate the time employees spend on the business of the two companies. Mich Con argued that its customers have not complained about the dual role of Mich Con's marketing employees, nor has evidence of a single specific instance of abuse or impropriety been presented.

The producer/broker intervenors argued that the relationship between Mich Con and MTC, in which the same employees serve dual functions, is intensely anti-competitive and has a great potential for abusive conduct. In their view, MTC employees are privy to substantial information that is proprietary to Mich Con: customer lists, planned pipeline purchases, pipeline capacity changes, etc., and this information is vital to competitive brokerage operations. Moreover, the producer/broker intervenors stated, customers will be intimidated by dealing with one Mich Con representative for both sales gas and transportation gas--an implied threat exists that reprisals could occur if gas is not purchased from the utility's captive broker subsidiary. The producer/broker intervenors argued that Mich Con and MTC should conduct separate operations.

The ALJ found that evidence had not been presented regarding any abusive conduct, nor had more than mere speculation been raised regarding the company's future actions. He recommended denial of the producer/broker intervenors' proposal. They except.

The Commission has reviewed Mich Con's and the producer/broker intervenors' arguments. Mich Con is correct that the record does not contain evidence of improper or anticompetitive activity by Mich Con, nor does the Commission impute that behavior to Mich Con. However, the fact does remain that MTC's employees

are privy to much information that is proprietary to Mich Con. We find it proper that Mich Con be reimbursed for use of this information as well as use of its employees' time. We, therefore, direct that Mich Con develop, and keep, detailed accounting records separating MTC's and Mich Con's business activities, which will permit the Staff to audit MTC's business operations to ensure that Mich Con receives appropriate reimbursement for services and information provided to MTC. We, however, reject the producer/broker intervenors' demands for separation of the companies, agreeing with the ALJ that evidence was not presented to justify that requirement.

Western Michigan Interconnect

Mich Con's service area extends throughout much of Michigan and these areas receive gas supplies from various sources. In the Detroit area, Mich Con receives gas from Panhandle Eastern Pipe Line Company (Panhandle), Great Lakes Gas Transmission Company and ANR Pipeline Company (ANR). On the western side of the state, Mich Con receives gas only from ANR. Because of this lack of pipeline competition on the western side of the state, ANR charges 21¢ more for transportation services there than in the Detroit area. Panhandle or Trunkline Gas Company serve the Consumers service territories adjacent to Mich Con's western area. ABATE proposed an interconnect between Mich Con and Consumers that would permit transportation customers to receive gas via Panhandle and thereby possibly reduce ANR's western Michigan rate to the same level as its Detroit area rate.

ABATE argued that the Commission should direct the Staff to investigate, along with Mich Con and Consumers, the possibility of an interconnect, its costs and its benefits. ABATE stated that this is not a FERC issue regarding pipeline

transportation; rather, this is a question of the inadequacy of Mich Con's present system. ABATE noted that the record is insufficient upon which to order an interconnect, but that an investigation of the possibility is appropriate.

Mich Con stated that the question of the interconnect is a subject that should be addressed to the FERC rather than this Commission. Moreover, the company stated, the record is inadequate as a basis for ordering an interconnect. The Staff supported Mich Con regarding the state of the record. The ALJ agreed with Mich Con and the Staff. ABATE excepts.

The Commission agrees with the ALJ that the possibility of an interconnect was not adequately reviewed on this record. However, we are concerned about the variance in price for ANR's transportation service and find that a sufficient basis has been provided to require some initial investigation. Therefore, we direct the Staff, in consultation with Mich Con and Consumers, to review whether (and how) the interconnect proposed by ABATE should be accomplished, including its costs, the legal authority by which such an interconnect could occur, and the consequences, both pro and con, that may result from the interconnection. Mich Con and Consumers shall provide complete assistance to the Staff for its review. ABATE also shall provide appropriate information as requested by the Staff. The Commission will expect a Staff report within six months of the date of this order.

Kent County Tariff Proposal

Rate Schedule 8 now provides that service under the rate is available only to customers that previously used a fuel other than natural gas or that install new equipment that does not replace natural gas-fired equipment. In general terms, the gas purchased under Rate Schedule 8 displaces alternate fuels. Mich

Con has similarly applied Rate Schedule 8 to gas transportation.

Kent County produces steam for sale by firing with natural gas. Eventually, the steam will be produced at the county's mass burn incinerator through the burning of municipal solid waste, although some supplemental gas usage may still occur. Kent County is not eligible for Rate Schedule 8 because its gas usage did not replace an alternate fuel.

Customers on Kent County's steam loop use steam, for the most part, for heating and cooling. Steam customers that have installed new gas-fired boilers have received Rate Schedule 8 treatment because the new gas usage displaces an alternate fuel: steam. Kent County argued that treating steam created by gas-fired equipment as an alternate fuel is an improper interpretation of the Rate Schedule 8 tariff. Alternatively, Kent County asked that the tariff be revised to eliminate steam created by gas-fired equipment as an alternate fuel. Kent County's proposed new tariff language provides that the alternate fuel transportation rate for a user of steam created by gas-fired equipment could never be lower than the transportation rate provided to the customer creating the gas-fired steam.

Mich Con stated that steam has always been considered an alternate fuel and that Kent County's request is more properly treated as a complaint case, not as part of a rate case. The company noted that the county did not present witnesses to support its claim but only cross-examined Mich Con's witness Rai Bhargava. Therefore, the company argued Kent County had not proven any improper action by the company. Moreover, the company stated, if a market-based transportation program is adopted, the company cannot assure that all transportation rates will be equal.

Because the ALJ recommended use of the market-based transportation pro-

gram, he found Kent County's proposed revision to the Rate Schedule 8 tariff irrelevant. Kent County excepts.

The Commission has authorized separate market-based and cost-of-service-based transportation rates. The tariff language proposed by Kent County requires the transportation rate for customers that could use steam created by gas-fired equipment to be no lower than the rate provided to the entity that provides the gas-fired steam. Such a tariff provision prohibits the steam customer from choosing to shoulder the risks of a market-based transportation rate if the steam provider instead chooses the cost-of-service-based rate. That restriction is improper because it is each customer's choice that is at issue. Should Kent County's tariff be applied only to the market-based rate then again the result would be improper because that rate will be negotiated based upon each customer's market position, which should not be linked by tariff with another customer's market situation. Therefore, we reject Kent County's proposed tariff language. We also agree with Mich Con that Kent County's remaining contentions are a complaint that should have been brought, and supported by witnesses' testimony, in a separate complaint proceeding.

Proposed Findings of Fact

Kent County and PetroStar submitted proposed findings of fact and conclusions of law. The APA does not require the Commission to respond to proposed conclusions of law. The Commission will respond to the proposed findings of fact in series.

Kent County's first proposed finding of fact requests the Commission to find that sufficient record evidence was presented to prove that Mich Con discriminated against the county by offering lower transportation rates to cus-

tomers of the county's steam plant. The Commission disagrees. Kent County did not present witnesses and Mich Con witness Rai Bhargava's testimony shows only that steam was treated as an alternate fuel for purposes of an alternate fuel transportation rate.

Kent County's second proposed finding of fact requests the Commission to find that a complaint proceeding would be ineffective to remedy discriminatory action by Mich Con. The Commission has found that Kent County has not shown such discriminatory action and that a complaint proceeding is an appropriate forum for review of Kent County's claims. Accordingly, the Commission cannot agree with Kent County's second proposed finding of fact.

PetroStar presented six proposed findings of fact. Proposed finding of fact number one requests the Commission to find that it should protect all Mich Con customers from abuse of any monopoly power held by Mich Con. We agree and perform that function.

PetroStar's proposed findings of fact numbers two and four request the Commission to find that gas transportation rates should be fully unbundled, should be based upon the fully-allocated cost of service, and should not exceed the fully-allocated cost of service for transportation of Michigan-produced gas. While we agree that transportation rates should be unbundled and that the cost of service should be a starting point for rate setting, we do not agree that rates need to be more fully unbundled than provided for in this order or that a fully-allocated cost of service should be arbitrarily imposed as a transportation rate standard. Substantial policy reasons may exist for establishing a rate above or below that level.

PetroStar's proposed findings of fact numbers five and six request the Commission to find that any rate offered to an end-user by Mich Con must be simi-

larly applicable to inter- and intrastate gas and that any transportation rates set should apply to Mich Con's entire system. We cannot find that transportation rates need be identical for all gas transported by an end-user. If that end-user chooses the T-1 cost-of-service-based rate, then the rates will be the same. However, if the end-user chooses the T-2 market-based rate, then that end-user's rates may vary depending upon its market position at that time. Moreover, given our establishment of a charge to be assessed transportation customers to recover production and gathering expenses, a standardized rate for all appropriate use of Mich Con's system has been authorized.

PetroStar's third proposed finding of fact requests the Commission to find that the public interest requires the encouragement of local gas exploration as well as the absence of unfair discrimination against locally-produced gas. While the Commission agrees that unfair discrimination should be discouraged, PetroStar did not present evidence regarding increased local gas exploration, its needs, its environmental impact, or its effect on existing production. Consequently, the Commission is unable to find as requested by PetroStar.

The Motion to Strike

In its exceptions, ABATE included 53 pages of supporting statements for portions of the PFD with which it agreed. Mich Con moved to strike the statements, arguing that they are contrary to the ALJ's ruling that replies to exceptions would not be allowed and that the APA permits exceptions to be filed only to issues, findings, conclusions and recommendations in the PFD that are adverse to a party. In Mich Con's view, ABATE's statements in support are beyond the allowable scope of exceptions and must be stricken.

ABATE responds that, due to the complexity and breadth of the issues pre-

sented in this proceeding, the statements in support are appropriate. Moreover, it states, the APA provides that, in addition to exceptions, written arguments may be made to the Commission. In ABATE's view, its statements in support summarize its brief and reply brief and do not contain arguments that were not presented to the ALJ; therefore, the statements should not be stricken.

The Commission will not grant the motion. While the statements in support are unnecessary and, therefore, are given little if any weight (the Commission reviews all parties' briefs and reply briefs), we do not find them objectionable.

The Commission FINDS that:

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

b. Grace's request for oral argument should be denied.

c. The Staff's mathematical balance sheet working capital method is appropriate and should be used.

d. A working capital requirement of a negative $10,267,000, net utility plant of $813,904,000, and a rate base of $803,637,000 are reasonable and appropriate.

e. An overall rate of return of 8.44% is reasonable and appropriate.

f. A sales level of 201,659 MMcf, a transportation volume of 90,728 MMcf, and combined volumes of 292,387 MMcf are reasonable and appropriate.

g. Mich Con should utilize accounting procedures and controls to separate its activities, and those of its subsidiaries and its related companies, into

easily identifiable and auditable accounts. Mich Con should make all its books and records, and those of its subsidiaries and its related companies, available for reasonable review by the Staff upon request or Commission order. Mich Con should keep its books and records, and those of its subsidiaries and its related companies, in accordance with generally accepted accounting principles, the Commission's Uniform System of Accounts and Commission orders.

h. Although SFAS 87 is a recently-issued standard, it should be implemented for financial accounting purposes, subject to review in future cases.

i. Mich Con's adjusted net operating income is $59,348,000, resulting in an income deficiency of $8,479,000 and a revenue deficiency of $13,159,000.

j. Production and gathering expenses should be separated, assessed to sales customers, and a separate charge should be assessed on any gas transported on behalf of any transportation customer through Mich Con's production and gathering system. This separate charge should be credited to sales customers to compensate them for the transportation customers' use of the production and gathering system.

k. Take-or-pay and excess pipeline costs should be assessed to Mich Con's sales and transportation customers. However, those costs are speculative at present and should be established in a later proceeding as provided for in this order.

l. Transportation customers should reimburse Mich Con for lost and company-use gas through a 1.78% gas-in-kind factor.

m. Separate market-based and cost-of-service-based transportation rates should be approved as provided for in this order. A 10% of annual contract quantity storage figure should be included in the base transportation rate. For storage above that level, ABATE's proposed rate of 2.85¢ per Mcf per month, plus

.9% for fuel for injection, should be authorized.

n. Existing gas transportation contracts should be grandfathered, and the proffered long-term gas contracts should be authorized as reasonable, appropriate and in the public interest. However, the issue of whether the long-term contract customers should bear a portion of excess pipeline and take-or-pay costs should be deferred to a future proceeding.

o. The 90/10 refund levels should remain at 90/10. Transportation revenues should be included within the 90/10 program. Tariff T-1 transportation customers and sales customers should participate in the 90/10 program.

p The Staff should review an interconnect between Consumers and Mich Con on the state's western side. Mich Con, Consumers and ABATE should assist the Staff in its review. A report should be provided to the Commission within six months of the date of this order.

q. Mich Con's motion to strike portions of ABATE's exceptions, filed on July 27, 1988, should be denied.

THEREFORE, IT IS ORDERED that:

A. The oral argument request of Grace Petroleum, Inc., PPG Oil & Gas Company, Inc., Peninsular Oil and Gas Company-Michigan Basin Venture No. 2 and Wolverine Gas & Oil Company, Inc. is denied.

B. Statement of Financial Accounting Standard 87 shall be adopted for financial accounting purposes.

C. The motion to strike filed by Michigan Consolidated Gas Company on July 27, 1988 is denied.

D. Michigan Consolidated Gas Company is authorized to increase its rates and charges for gas service by $13,159,000 for service rendered on and after

December 23, 1988, as provided for by this order.

E. Take-or-pay costs and excess pipeline costs shall be apportioned between sales and transportation customers. However, because those costs are speculative at present, the costs shall be determined and apportioned in conjunction with a future gas cost recovery proceeding. The notice for that proceeding shall also bear the Case No. U-8812 number and shall state that the proceeding will review the calculation of the take-or-pay and excess pipeline costs and other information as provided in this order.

F. Existing gas transportation contracts shall remain in effect in accordance with their terms.

G. The proffered long-term contracts presented in Case No. U-8854 are approved. However, the issue of whether those contracts shall bear take-or-pay costs and excess pipeline costs is reserved for the future proceeding in which those costs will be quantified and assessed.

H. Michigan Consolidated Gas Company shall strictly conform its record-keeping to the Uniform System of Accounts and Commission orders. The company shall separate its accounts, and those of its subsidiaries and related companies, into accurate and easily audited records and accounts, and these records and accounts shall be made available for inspection by the Commission Staff upon reasonable request or Commission order.

I. The offset study shall be eliminated from Michigan Consolidated Gas Company's rate case filing requirements, and the company shall conform its tariffs to the Consumer Standards and Billing Practices, Electrical and Gas Residential Service, R 460.2101 et seq.

J. Revised Rule B 3, the Commission Staff's proposed Rule B 4, Michigan Consolidated Gas Company's proposed Rule D 2.5 and ABATE's proposed Rule D 2.6

are adopted.

K. The Commission Staff's reporting requirements for all transportation volumes are adopted.

L. The Commission Staff shall investigate the possible interconnection between Consumers Power Company's and Michigan Consolidated Gas Company's facilities on the western side of the state. Consumers Power Company, Michigan Consolidated Gas Company and the Association of Businesses Advocating Tariff Equity shall provide all information and assistance requested by the Commission Staff. A report shall be provided to the Commission within six months of the date of this order.

M. Michigan Consolidated Gas Company shall file, within 30 days of the date of this order, all tariff sheets necessary and appropriate to comply with this 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 appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26.

MICHIGAN PUBLIC SERVICE COMMISSION

(S E A L)

/s/ William E. Long
Chairperson

/s/ Steven M. Fetter
Commissioner

I abstain.

/s/ Ronald E. Russell
Commissioner

By the Commission and pursuant to its action of December 22, 1988.

/s/ Dorothy Wideman
Its Executive Secretary

TRANSPORTATION RATE SCHEDULE NO. T-1

CHARACTER OF SERVICE:

WHO MAY TAKE SERVICE:

A customer that could otherwise purchase gas under rate schedules Nos. 1 through 10 is eligible for service under this rate schedule, except that a customer that has taken service under Rate Schedule T-2 is not eligible for a period of five years from the date the customer chose Rate Schedule T-2.

Under this rate schedule, the Company will transport gas for the customer to the interconnections between the Company's facilities and those of the customer (points of delivery) from either: 1) the interconnections between the Company's facilities and those of a third party that delivers gas to the Company for redelivery to the customer, or 2) from the outlet of the gas processing facilities located at Kalkaska, Michigan (points of receipt).

DEFINITIONS:

As used in this rate schedule, "annual contract quantity" means an annual quantity of gas specified in the contract between the customer and the Company, which is based on the customer's historical 12-month usage (determined from the latest 36 months of data), plus adjustments for known or expected changes. "Maximum daily quantity" means a daily quantity of gas specified in the contract between the customer and the Company, which is based on the customer's peak daily volume in the last three years, plus adjustments for known or expected changes. "Designated sales rate" shall be the rate that would be applied under the most economical rate schedule that the customer would pay if purchasing system-sales service.

TRANSPORTATION SERVICE:

Not less than two days prior to the first day of each month, the customer shall advise the Company of the volume of gas that the customer will cause to be delivered to the Company for transportation during that month and the points of receipt where the gas will be delivered to the Company. The points of receipt shall be those that are agreed to from time to time by the customer and the Company.

If in any month the volume of gas received by the Company at the points of receipt, less the allowance for company-use and lost-and-unaccounted-for gas, is more than the volume of gas taken by the customer at the points of delivery, then the difference shall be retained by the Company and delivered to the customer in those succeeding months when the volume of gas received by the Company is less than the customer's requirements. Should the aggregate volume of gas retained by the Company at any month-end exceed 10% of the annual contract quantity, then the Company shall have the rights: (1) to refuse to receive any additional volume of gas for that customer until the Company has satisfied itself that the volume of gas retained for the customer is less than 10% of the annual contract quantity, and (2) to charge the customer for the storage of any month-end balance that exceeds 10% of the annual contract quantity. The customer shall withdraw any gas retained by the Company within 60 days of the termination of the contract.

USE AND LOSS:

The Company shall retain 1.78% of all gas received at the points of receipt to compensate it for the company-use and lost-and-unaccounted-for gas on the Company's system. This volume shall not be included in the quantity available for delivery to the customer.

HOURS OF SERVICE:

Twenty-four hours per day.

CUSTOMER CONTRACT:

Applications for transportation service shall be in writing upon application forms to be supplied by the Company. In addition to that application, the customer is required to sign a transportation contract, limited as to time, which must be approved by an officer of the Company before it shall be binding upon the Company.

RATE:

MONTHLY CUSTOMER CHARGE: $1,000

MONTHLY ADMINISTRATIVE FEE: $300

TRANSPORTATION CHARGE:

For all volumes of gas delivered at the points of delivery in a given month, up to the volume of gas received at the points of receipt, less the allowance for company-use and lost-and-unaccounted-for gas, plus any volumes of gas retained by the Company and redelivered during that month, the transportation charge shall be $0.0452 per 100 cubic feet.

SYSTEM-SUPPLY ENTITLEMENT CHARGE:

Customers have the option of paying a system-supply entitlement charge of

$0.20 per 100 cubic feet. The Company shall discount the charge for all customers to reflect the currently effective unavoidable pipeline charges, but the charge shall not be less than $0.03 per 100 cubic feet. Once the charge (including any discounts) is in effect, that charge shall remain in effect until all appropriate customers are notified of a revised charge. Notice must occur at least 15 days prior to the beginning of the billing month in which that revised charge is to be in effect. Customers may choose to pay this charge at their option. This choice shall be made within 90 days of selecting transportation service, and a customer may choose to pay this charge on a fixed percentage of its total transportation requirements.

AUTHORIZED GAS USAGE:

(a) A customer currently paying the system-supply entitlement charge has automatic access to the Company's system supply for all gas taken by the customer in excess of the cumulative volumes delivered to the Company on behalf of that customer, up to the percentage of system-supply entitlement the customer has selected. The customer shall pay for this authorized gas usage at the customer's designated sales rate.

(b) A customer not currently paying the system-supply entitlement charge may obtain access to the Company's system supply for gas requirements in excess of the cumulative volumes delivered to the Company on behalf of that customer. To obtain access, the customer shall make prior application to the Company specifying the volumes required and the time period requested (not to exceed 90 days). The Company shall grant the request if it has sufficient volumes to do so without jeopardizing service to other customers. If the Company is unable to grant the request, in whole or in part, it shall notify the customer of the

volume available (if any), and shall maintain the application on file. If multiple customers request access, service shall be made available on a first-come, first-served basis. Existing unserved applications shall have priority over any new application.

The customer shall pay for this authorized gas usage at the designated sales rate, plus 10¢ per 100 cubic feet. The customer shall also pay 1¢ per 100 cubic feet for any unused volume that the customer received authorization to take.

UNAUTHORIZED GAS USAGE:

If a customer is not currently paying the system-supply entitlement charge or if that customer has not obtained authorized access to the Company's system supply, then the customer shall pay for unauthorized gas usage at that customer's designated sales rate plus $1.00 per 100 cubic feet for all gas taken by the customer in excess of the cumulative volume delivered to the Company on behalf of the customer.

STORAGE CHARGE:

A customer shall be charged $0.00285 per 100 cubic feet, or therm, per month, plus 0.9% for fuel for injection, for the storage of any month-end balance of gas that exceeds 10% of the annual contract quantity.

STANDBY SERVICE:

(a) Definition: "Standby service" means that gas transportation service provided by the Company that is capable of being used in place of the primary energy source and that is normally used only for emergencies.

(b) Charges: A customer taking standby service for a facility or equipment shall pay a monthly charge equal to $0.065 per cubic foot, or $65 per MMBtu, for each cubic foot, or MMBtu, of nameplate rating of the facility or equipment taking standby service.

PRODUCTION AND GATHERING CHARGE:

A customer shall pay a charge of $0.02269 per 100 cubic feet for any gas volumes that are delivered to the Company through its production and gathering facilities for transportation by the Company.

TAKE-OR-PAY AND EXCESS PIPELINE COSTS:

Take-or-pay costs or excess pipeline costs may be assessed to the customer.

TRANSPORTATION RATE SCHEDULE NO. T-2

CHARACTER OF SERVICE:

WHO MAY TAKE SERVICE:

A customer that could otherwise purchase gas under rate schedules Nos. 1 through 10 is eligible for service under this rate schedule. A customer that takes service under this rate is not eligible for Rate Schedule T-1 for a period of five years from the date the customer chose this rate.

Under this rate schedule, the Company will transport gas for the customer to the interconnections between the Company's facilities and those of the customer (points of delivery) from either: 1) the interconnections between the Company's facilities and those of a third party that delivers gas to the Company for redelivery to the customer, or 2) from the outlet of the gas processing facilities located at Kalkaska, Michigan (points of receipt).

DEFINITIONS:

As used in this rate schedule, "annual contract quantity" means an annual quantity of gas specified in the contract between the customer and the Company, which is based on the customer's historical 12-month usage (determined from the latest 36 months of data), plus adjustments for known or expected changes. "Maximum daily quantity" means a daily quantity of gas specified in the contract between the customer and the Company, which is based on the customer's peak daily volume in the last three years, plus adjustments for known or expected changes. "Designated sales rate" shall be the rate that would be applied under the most economical rate schedule that the customer would pay if purchasing system-sales service.

TRANSPORTATION SERVICE:

Not less than two days prior to the first day of each month, the customer shall advise the Company of the volume of gas that the customer will cause to be delivered to the Company for transportation during that month and the points of receipt where the gas will be delivered to the Company. The points of receipt shall be those that are agreed to from time to time by the customer and the Company.

If in any month the volume of gas received by the Company at the points of receipt, less the allowance for company-use and lost-and-unaccounted-for gas, is more than the volume of gas taken by the customer at the points of delivery, then the difference shall be retained by the Company and delivered to the customer in those succeeding months when the volume of gas received by the Company is less than the customer's requirements. Should the aggregate volume of gas retained by the Company at any month-end exceed 10% of the annual contract quantity, then the Company shall have the rights: (1) to refuse to receive any additional volume of gas for that customer until the Company has satisfied itself that the volume of gas retained for the customer is less than 10% of the annual contract quantity, and (2) to charge the customer for the storage of any month-end balance that exceeds 10% of the annual contract quantity. The customer shall withdraw any gas retained by the Company within 60 days of the termination of the contract.

USE AND LOSS:

The Company shall retain 1.78% of all gas received at the points of receipt to compensate it for the company-use and lost-and-unaccounted-for gas on the Company's system. This volume shall not be included in the quantity available for delivery to the customer.

HOURS OF SERVICE:

Twenty-four hours per day.

CUSTOMER CONTRACT:

Applications for transportation service shall be in writing upon application forms to be supplied by the Company. In addition to that application, the customer is required to sign a transportation contract, limited as to time, which must be approved by an officer of the Company before it shall be binding upon the Company.

RATE:

MONTHLY CUSTOMER CHARGE: $1,000

MONTHLY ADMINISTRATIVE FEE: $300

TRANSPORTATION CHARGE:

For all volumes of gas delivered at the points of delivery in a given month, up to the volume of gas received at the points of receipt, less the allowance for company-use and lost-and-unaccounted-for gas, plus any volumes of gas retained by the Company and redelivered during that month, the transportation charge shall be $0.067 per 100 cubic feet. The Company may discount the transportation charge to not less than $0.023 per 100 cubic feet.

SYSTEM-SUPPLY ENTITLEMENT CHARGE:

Customers have the option of paying a system-supply entitlement charge of $0.20 per 100 cubic feet. The Company shall discount the charge for all customers to reflect the currently effective unavoidable pipeline charges, but the charge shall not be less than $0.03 per 100 cubic feet. Once the charge (including any discounts) is in effect, that charge shall remain in effect until all appropriate customers are notified of a revised charge. Notice must occur at least 15 days prior to the beginning of the billing month in which that revised charge is to be in effect. Customers may choose to pay this charge at their option. This choice shall be made within 90 days of selecting transportation service, and a customer may choose to pay this charge on a fixed percentage of its total transportation requirements.

AUTHORIZED GAS USAGE:

(a) A customer currently paying the system-supply entitlement charge has automatic access to the Company's system supply for all gas taken by the customer in excess of the cumulative volumes delivered to the Company on behalf of that customer, up to the percentage of system-supply entitlement the customer has selected. The customer shall pay for this authorized gas usage at the customer's designated sales rate.

(b) A customer not currently paying the system-supply entitlement charge may obtain access to the Company's system supply for gas requirements in excess of the cumulative volumes delivered to the Company on behalf of that customer. To obtain access, the customer shall make prior application to the Company specifying the volumes required and the time period requested (not to exceed 90 days). The Company shall grant the request if it has sufficient volumes to do

so without jeopardizing service to other customers. If the Company is unable to grant the request, in whole or in part, it shall notify the customer of the volume available (if any), and shall maintain the application on file. If multiple customers request access, service shall be made available on a first-come, first-served basis. Existing unserved applications shall have priority over any new application.

The customer shall pay for this authorized gas usage at the designated sales rate, plus 10¢ per 100 cubic feet. The customer shall also pay 1¢ per 100 cubic feet for any unused volume that the customer received authorization to take.

UNAUTHORIZED GAS USAGE:

If a customer is not currently paying the system-supply entitlement charge or if that customer has not obtained authorized access to the Company's system supply, then the customer shall pay for unauthorized gas usage at that customer's designated sales rate plus $1.00 per 100 cubic feet for all gas taken by the customer in excess of the cumulative volume delivered to the Company on behalf of the customer.

STORAGE CHARGE:

A customer shall be charged $0.00285 per 100 cubic feet, or therm, per month, plus 0.9% for fuel for injection, for the storage of any month-end balance of gas that exceeds 10% of the annual contract quantity.

STANDBY SERVICE:

(a) Definition: "Standby service" means that gas transportation service

provided by the Company that is capable of being used in place of the primary energy source and that is normally used only for emergencies.

(b) Charges: A customer taking standby service for a facility or equipment shall pay a monthly charge equal to $0.065 per cubic foot, or $65 per MMBtu, for each cubic foot, or MMBtu, of nameplate rating of the facility or equipment taking standby service.

PRODUCTION AND GATHERING CHARGE:

A customer shall pay a charge of $0.02269 per 100 cubic feet for any gas volumes that are delivered to the Company through its production and gathering facilities for transportation by the Company.

TAKE-OR-PAY AND EXCESS PIPELINE COSTS:

Take-or-pay costs or excess pipeline costs may be assessed to the customer.

B3. CONTROLLED SERVICE

A. Scope

This Controlled Service Rule provides the Company with the authorization to control the attachment of additional firm and interruptible system supply load and non-system supply load, consistent with changes in gas supply as they occur.

B. Application

1. All customers requesting firm gas service, except those seeking gas for residential use or for single family space heating use, must make written application for such service on a form provided by the utility.

2. Existing firm sales customers requesting to attach additional gas burning equipment or existing transportation customers not subject to subrules B3 B.3 and B3 B.4 shall not be given preferential treatment over new customers but shall be considered the same as new customers in accordance with this controlled service rule.

3. A transportation customer who does not pay the system-supply entitlement charge may not apply for firm sales service for a period of five years after the customer initiates transportation service. If the customer pays the system-supply entitlement charge on a portion of its load, it may apply for firm sales service at any time on that portion; but it must await the completion of the five-year period on that portion for which the system-supply entitlement charge is not paid.

4. A transportation customer on Rate Schedule T-2 is not eligible for Rate Schedule T-1 or rate schedules Nos. 1 through 10 for a period of five years from the date the customer chose Rate Schedule T-2. After that period, the customer may select Rate Schedule T-1, remain on Rate Schedule T-2 or apply for firm sales service.

5. The Company reserves the right to attach new interruptible load.

C. Approval

1. As the Company is able to contract for new gas supplies at reasonable and prudent prices, terms, and conditions, applications for firm sales service will be approved.

a) Approval will be on a first-come first-served basis within each Controlled Service Priority.

b) The Company will open the highest priority first. If all the applicants within that priority are granted firm gas service, and sufficient supply is available, the next highest priority will be opened.

c) If the available supply is committed before granting all applicants firm gas service, then those applicants who do not receive firm gas service shall have their standing reserved within their priority, but will not receive preference over a later applicant who qualifies for a higher priority, when gas again becomes available and priorities are again opened.

2. An applicant whose Controlled Service Priority is open at the time of application may be granted immediate approval provided such applicant demonstrates to the satisfaction of the company that the construction and installation of the necessary equipment will proceed in a timely manner.

3. An applicant whose Controlled Service Priority is closed at the time of

application, such that gas service is not initially granted, shall have his application for firm gas service kept on file by Controlled Service Priority and date application is received.

4. Notification of approval shall specify the date within which service must be commenced.

D. Forfeiture

1. An applicant who is not initially granted firm gas service, shall notify the Company in writing, within 30 days of date of notification of approval, of his intention to accept firm gas service, otherwise approved application is void.

2. A customer shall install the necessary equipment and commence gas service by the date specified in the company's notification of approval, otherwise the customer forfeits his reservation of firm supply.

3. If any time after commencing firm gas service, a customer switches to transportation service, that customer shall pay a System-Supply Reservation Charge applied to transported volumes, otherwise such customer forfeits firm sales customer status.

4. If at any time after commencing firm gas service, a customer desires to burn an alternate fuel in place of system supply purchases, that customer will nominate stand-by Monthly Contract Quantities to which a System-Supply Reservation Charge is applied, otherwise such customer forfeits firm sales customer status. This provision is waived for customers who are being curtailed pursuant to Rule B4. or Rule D2.5.

4. A customer without entitlement to system supply, who commences firm sales service pursuant to this rule, and retains such service for a period of less than 60 months, waives his right to re-apply for firm sales service for the balance of such 60 month period.

5. The Company reserves the right to discontinue service to any customer who violates any of the provisions of this Rule.

E. Impact on Existing Customers

1. The Company may grant firm sales service to new customers, or permit the attachment of additional gas burning equipment by existing customers, when:

a) current system supplies are sufficient to provide reliable long term service to both the Company's existing firm sales customers and the new firm

sales load being attached.

b) the acquisition of additional long term supplies allows the attachment of new firm sales load. The Company will be held responsible to justify the reasonableness and prudence of such additional gas acquisitions at its GCR Plan and Reconciliation proceedings.

2. The Company may not grant firm sales service to new customers or permit the attachment of additional gas burning equipment by existing customers, if:

a) the Company is curtailing any customers under Rule D2.5.

b) the Company is curtailing any customers under Rule B4; except that the Company may attach new residential customers provided no customers in curtailment Priority Two are being curtailed.

F. Restricted Sales

1. As a result of warmer-than-normal weather, or other factors, the Company may have system-supply volumes in excess of its immediate firm and interruptible sales load. The Company may sell such excess gas to other than system supply customers. However, the availability of system supply gas to non-system supply customers is conditioned on and subject to:

a) the requirements of present and future firm and interruptible system supply customers of the utility;

b) the provision of a net economic benefit to the utility's system supply customers as a result of the sale of excess system supply gas;

c) demonstration by the company at its GCR Reconciliation proceeding that the sale of excess system supply caused no detriment to its system supply.

d) the designation of all sales of excess system supply as super-interruptible load subject to curtailment Category Eight of Rule B4.

e) Commission approval of such sales on a special contract basis, limited as to time and volume.

2. From time to time the Company may have gas supplies available to it on a short term or best efforts basis, that are not required for, and are incremental to system supply. Such supply may be sold on a special contract basis, limited as to time and volume, and subject to Commission approval. At its GCR Reconciliation proceeding, the Company must demonstrate that such incremental supplies sold on a special contract basis caused no detriment to its system supply.

G. Priorities

1. For purposes of controlling which new customers seeking firm sales

status, the following categories are hereby established, of which Priority Six constitutes the lowest priority and Priority One the highest priority:

PRIORITY ONE

The use of natural gas by any residential or commercial customer for any purpose except space heating or air conditioning.

PRIORITY TWO

The use of natural gas by any residential customer for space heating or air conditioning and the use of natural gas for services essential for public health and safety.

PRIORITY THREE

The use of natural gas by any industrial customer for industrial processing or in gas fired after burners to limit or abate obnoxious odors or air pollution.

PRIORITY FOUR

The use of natural gas by any non-residential customer for space heating or air conditioning.

PRIORITY FIVE

The use of natural gas for all other purposes not listed in Priority One through Four or Priority Six.

PRIORITY SIX

The use of natural gas for the generation of steam or electricity by utilities, or the firing of kilns which can be fired by other fuels.

2. A customer who has a pollution problem which presents a threat to the public health and welfare, where the use of natural gas offers the only feasible solution to the problem, may petition the Commission to assign a priority of use higher than that to which the customer would otherwise be entitled. The matter will be considered by the Commission pursuant to its Rules of Practice relating to petitions or complaints.

3. The use of natural gas in boilers which have alternate fuel capability shall not qualify as requirements for services essential for public health and safety without the express authorization of the Michigan Public Service Commission. The matter will be considered by the Commission pursuant to its Rules of Practice relating to petitions or complaints.

MICHIGAN CONSOLIDATED GAS COMPANY
SUMMARY OF PRESENT AND PROPOSED RATES
CASE NO. U-8812

RATE CLASS	PRESENT RATES	PROPOSED RATES
RATE 1		
CUSTOMER CHARGE	$15.00	$15.00
COMMODITY CHARGE	$1.2260	$1.4027
RATE 2		
CUSTOMER CHARGE	$7.50	$7.50
COMMODITY CHARGE	$1.0276	$1.1555
RATE 2A		
CUSTOMER CHARGE		
CLASS I	$7.50	$7.50
CLASS II	$15.00	$15.00
COMMODITY CHARGE	$1.0276	$1.1555
RATE 3		
CUSTOMER CHARGE	$7.50	$7.50
COMMODITY CHARGE	$0.9230	$1.0509
RATE 3A		
CUSTOMER CHARGE	$7.50	$7.50
WINTER CREDIT	($12.00)	($12.00)
COMMODITY CHARGE	$1.0276	$1.1555
RATE 6		
CUSTOMER CHARGE	$600.00	$600.00
COMMODITY CHARGE	$1.0081	$1.0081
RATE 7		
CUSTOMER CHARGE	$750.00	$750.00
COMMODITY CHARGE	$0.8156	$0.8156
RATE 8		
CUSTOMER CHARGE	$100.00	$100.00
COMMODITY CHARGE	$0.6538	$0.6538

MICHIGAN CONSOLIDATED GAS COMPANY
SUMMARY OF PRESENT AND PROPOSED RATES
CASE NO. U-8812

RATE CLASS	PRESENT RATES	PROPOSED RATES
RATE 9		
CUSTOMER CHARGE		
OPTION A	$10,000.00	$10,000.00
OPTION B	$20,000.00	$20,000.00
OPTION C	$50,000.00	$50,000.00
COMMODITY CHARGE		
OPTION A	$0.8294	$0.8294
OPTION B	$0.8054	$0.8054
OPTION C	$0.7754	$0.7754
RATE 10		
CUSTOMER CHARGE	$200.00	$200.00
COMMODITY CHARGE	$1.0087	$1.1295
RATE T		
CUSTOMER CHARGE		
RATE 1	$315.00	$1,300.00
RATE 2A	$315.00	$1,300.00
RATE 6	$900.00	$1,300.00
RATE 7	$1,050.00	$1,300.00
RATE 8	$400.00	$1,300.00
RATE 9A	$10,300.00	$1,300.00
RATE 9B	$20,300.00	$1,300.00
RATE 9C	$50,300.00	$1,300.00
RATE 10	$500.00	$1,300.00
COAL	$315.00	$1,300.00
COMMODITY CHARGE	$0.6158	$0.4520