S T A T E   O F   M I C H I G A N

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of **SEMCO ENERGY GAS COMPANY** for approval of an experimental pilot program for residential gas customer choice, a suspension of its gas cost recovery clause, a moratorium on distribution rate adjustments, suspension of its current income sharing mechanism, adoption of a new income sharing mechanism, and related relief.	)	Case No. U-11776

At the September 11, 1998 meeting of the Michigan Public Service Commission in Lansing, Michigan.

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

ORDER APPROVING APPLICATION

On September 4, 1998, SEMCO Energy Gas Company (SEMCO) filed an application seeking authority to: (1) implement an experimental residential gas customer choice program; (2) establish gas service performance criteria; (3) suspend its gas cost recovery (GCR) clause; (4) roll into its base rates and freeze for three years a gas charge of $3.24 per thousand cubic feet (Mcf), composed of an unbundled commodity charge of $2.99 per Mcf and a balancing recovery charge of $0.25 per Mcf; (5) freeze distribution rate adjustments for the same three-year period, with exceptions; and (6) suspend its current income sharing mechanism and adopt a new income sharing mechanism for use during the 1999, 2000, and 2001 calendar years.

As represented in its application, SEMCO is currently authorized to provide customer choice through its Aggregated Transportation Service (ATS) program to commercial and industrial customers only. Like Consumers Energy Company (Consumers) in Case No. U-11599 and Michigan Consolidated Gas Company (Mich Con) in Case No. U-11682, SEMCO seeks authority to implement an experimental three-year program ending March 31, 2002, which will allow residential customers throughout SEMCO's service territory to choose their gas supplier. SEMCO will continue to offer its ATS program.

SEMCO states that under the experimental program, up to 21,000 residential customers, or 11% of the company's residential customer base, will be allowed to participate by the beginning of the third year of the program. SEMCO states that participation will be strictly voluntary and that participating customers will be selected on a first-come, first-served basis. Under the experimental program, residential customers will be allowed to choose to participate at any time during any 12-month period.

SEMCO also seeks to suspend its GCR clause and to roll into its base rates a total fixed gas charge of $3.24 per Mcf, composed of an unbundled gas commodity charge of $2.99 per Mcf and a balancing recovery charge of $0.25 per Mcf for a three-year period, beginning with the April 1999 billing cycle and ending with the March 2002 billing cycle. SEMCO represents that by suspending its GCR clause and rolling in a total fixed gas charge of $3.24 per Mcf, it assumes the risk for recovering its gas costs and customers choosing to remain as sales customers will enjoy long-term price stability.

Under SEMCO's proposal, the GCR period of April 1, 1998 through March 31, 1999 would be subject to reconciliation in the normal fashion. However, to dispose of any 1998-1999 GCR over- or undercollections in a timely manner, SEMCO proposes implementing a GCR surcharge rate.

SEMCO also proposes to freeze distribution rate adjustments beginning with the April 1999 billing cycle and continuing through the March 2002 billing cycle. This rate moratorium, however, is subject to the following exceptions: (1) SEMCO will credit customers' bills pursuant to a modified income sharing mechanism if earnings exceed certain levels, and (2) SEMCO or other interested parties may seek a limited issue rate case to adjust rates to reflect significant changes in laws, regulations, accounting requirements, or taxes affecting SEMCO's annual revenue requirement by $1 million or more.

Further, SEMCO seeks to prospectively suspend its current income sharing mechanism, which was approved by the Commission's October 29, 1997 order in Case No. U-11220, and to adopt a new income sharing mechanism that will substantially match the mechanism approved for Consumers in Case No. U-11599 and Mich Con in Case No. U-11682. Under SEMCO's proposal, if SEMCO's return on equity for its natural gas utility business exceeds 12.75%, amounts equal to 50% of the shareable income between 12.76% and 16.75%, plus amounts equal to 75% of the shareable income over 16.75%, would be credited to customers. The methodology for determining the amount subject to credit is described in SEMCO's application.

Finally, to demonstrate its commitment to high quality service, SEMCO proposes performance criteria for use during the effective period of its experimental residential customer choice program. According to SEMCO, the safe and reliable operation of its system has been, and will continue to be, the company's highest priority. SEMCO therefore recommends using four performance measurements concerning issues of safety, customer service, and reliability. Specifically, SEMCO proposes to (1) maintain an average leak response time of 30 minutes or less; (2) achieve and maintain a ranking in the top quartile of utilities whose safety performance is compiled by the American Gas Association; (3) continue to process all striking and clearing requests required by

"Miss Dig" notices in a timely manner; and (4) maintain an annual level of 90% or greater for its actual–as opposed to estimated–meter reads. These performance measurements will be used to adjust the sharing threshold percentage under the income sharing mechanism.

Discussion

The Commission has been active in investigating and promoting ways to introduce more competition into the industries it regulates. SEMCO's proposed experimental residential customer choice program provides a valuable opportunity to gain information regarding whether and how gas transportation service should be extended to all customers.

The proposed experimental program extends customer choice to residential customers. In contrast, SEMCO's current customer choice program is limited to commercial and industrial customers. Thus, the proposed experimental program will provide substantial information and experience concerning the degree to which retail gas customers at the residential level desire the opportunity to select alternative gas suppliers.

Moreover, SEMCO's proposal to suspend its GCR clause and roll into its base rates a total fixed gas charge of $3.24 per Mcf (composed of an unbundled commodity charge of $2.99 per Mcf and a balancing recovery charge of $0.25 per Mcf), when coupled with its proposal to freeze distribution rate adjustments from the April 1999 billing cycle to the March 2002 billing cycle, would insulate customers from potential cost increases that, under traditional regulation, would be recoverable through increased rates. Furthermore, the Commission previously approved the suspension of GCR clauses in Cases Nos. U-11599 and U-11682. The Commission has also approved the suspension of power supply cost recovery (PSCR) clauses in Case Nos. U-10923, U-10994, and U-11166. The relevant provisions of Act 304 are the same for both electric and gas service.

During the three-year program, there is no mechanism for SEMCO to increase charges for system supply gas even if gas commodity prices increase. However, there are two exceptions to the freeze on distribution rate adjustments: one is the incentive income sharing mechanism, and the other is rate revisions arising in response to unanticipated legislative or accounting actions.

As stated in the application, SEMCO seeks to prospectively suspend its current incentive income sharing mechanism and to adopt an income sharing mechanism that will substantially match the mechanism approved for Consumers and Mich Con in Cases Nos. U-11599 and U-11682, respectively. As set forth in the application, the proposed income sharing mechanism provides for a portion of earnings to be credited to customers, pursuant to a specific formula, if earnings on common equity exceed certain levels. Within three months of the end of each 12-month period, SEMCO will file a report identifying the amount, if any, to be credited. Parties will have 30 days to request a hearing regarding the calculations, and the scope of any hearing will be limited to the accuracy of the calculations. It is further proposed that SEMCO be allowed to promptly implement any applicable credit. If the Commission ultimately modifies the self-implemented credit, the credit will be adjusted at the time of the Commission order.

The second exception to the distribution rate freeze relates to significant changes in laws, regulations, accounting requirements, or taxes that affect SEMCO's annual revenue requirement by $1 million or more. If such changes occur, SEMCO or other interest persons would have a right to seek a limited issue rate case to adjust rates to reflect the effect of such changes. This provision does not establish that a change will occur. Rather, it gives parties a right to seek such a change, if necessary. Any change would be subject to all applicable procedural and statutory requirements, including any applicable requirements for notice and a hearing.

After a review of the application, the Commission finds that SEMCO's proposals are reasonable and in the public interest, and should be approved. This finding reflects the Commission's belief that experimentation with alternative, more flexible regulatory mechanisms is appropriate in view of the changing nature of the natural gas utility industry. Further, the Commission is persuaded that approval of the proposed experimental program is appropriate because, among other things, it provides incentives to the utility to operate in an efficient manner and should enhance the utility's ability to respond to market demands. SEMCO's experimental program should also provide valuable information to assist the Commission in future decisions that may address whether it is in the public interest to permanently extend or approve transportation tariffs for residential customers. This information should quantify customer benefits or disadvantages associated with customers choosing to participate in the program.

Approval of SEMCO's application will not increase the rates and charges of any customer. Therefore, the Commission may approve the experimental program without providing notice or an opportunity for a hearing, pursuant to MCL 460.6a; MSA 22.13(6a).

The Commission FINDS that:

a. Jurisdiction is pursuant to 1909 PA 300, as amended, MCL 462.2 et seq.; MSA 22.21 et seq.; 1919 PA 419, as amended, MCL 460.51 et seq.; MSA 22.1 et seq.; 1939 PA 3, as amended, MCL 460.1 et seq.; MSA 22.13(1) et seq.; 1982 PA 304, as amended, MCL 460.6h et seq.; MSA 22.13(6h) et seq.; 1969 PA 306, as amended, MCL 24.201 et seq.; MSA 3.560(101) et seq.; and the Commission's Rules of Practice and Procedure, as amended, 1992 AACS, R 460.17101 et seq.

b. SEMCO's application for authority to implement an experimental pilot program for residential customer choice, suspend its GCR clause, roll into base rates and freeze an unbundled commodity charge and balancing recovery charge, implement a moratorium on distribution rate adjustments, suspend the current income sharing mechanism, establish a new income sharing mechanism, and implement gas performance criteria should be approved.

c. Adoption of the experimental program, as reflected in the tariff sheets, examples, and illustrations attached to this order as Attachments A through E, is reasonable and in the public interest, and should be approved.

d. SEMCO's proposed performance criteria are reasonable and should be adopted.

e. Suspension of the GCR clause from the April 1999 billing cycle through the March 2002 billing cycle, as well as the rolling into base rates of a total fixed gas charge of $3.24 per Mcf (composed of an unbundled commodity charge of $2.99 per Mcf and a balancing recovery charge of $0.25 per Mcf), is reasonable and in the public interest, and should be approved. SEMCO should not be required to file a GCR plan or reconciliation case for any of the three years beginning April 1999, April 2000, and April 2001. The total fixed gas charge of $3.24 per Mcf should not be subject to reconciliation with actual gas costs during the three-year experimental program.

f. SEMCO should be required to file, according to the normal schedule, an application for a GCR reconciliation proceeding for the year April 1, 1998 through March 31, 1999, including the implementation of its 1998-1999 GCR surcharge rate to account for any GCR over- or undercollections during the 1998-1999 plan year.

g. Approval of a moratorium on distribution rate adjustments, subject to potential income sharing mechanism adjustments and the exception for significant changes, as more fully described in the order, is reasonable and in the public interest.

h. Suspension of the currently authorized income sharing mechanism and adoption of the proposed income sharing mechanism for the calendar years 1999, 2000, and 2001, as proposed in the application, is reasonable and in the public interest.

i. The relief granted will not increase the rates of any customer.

THEREFORE, IT IS ORDERED that:

A. SEMCO Energy Gas Company is authorized to implement the experimental residential customer choice program described in its September 4, 1998 application.

B. The performance criteria proposed by SEMCO Energy Gas Company are adopted as proposed in the application.

C. SEMCO Energy Gas Company is authorized to suspend its gas cost recovery clause effective with the April 1999 billing cycle for a three-year period during which a fixed unbundled commodity charge of $2.99 per thousand cubic feet and a fixed balancing recovery charge of $0.25 per thousand cubic feet will be rolled into its base rates. SEMCO Energy Gas Company shall file all tariff and rule changes arising from the suspension of the gas cost recovery clause and the establishment of a fixed unbundled commodity charge and balancing recovery charge, all of which are currently contained in Attachment A, no later than March 1, 1999. A reconciliation proceeding shall be conducted for the plan year ending March 31, 1999, and SEMCO Energy Gas Company shall file the 1998-1999 gas cost recovery reconciliation according to the normal schedule, including any surcharge rate necessary to minimize any over- or undercollection of 1998-1999 gas cost recovery costs.

D. Effective with the April 1999 billing cycle, a three-year moratorium on distribution rates is approved, subject to the sharing mechanism proposed in the application and the exception for significant changes as described in the application.

E. SEMCO Energy Gas Company's currently authorized income sharing mechanism is suspended effective at the end of the 1998 calendar year, and its proposed income sharing mechanism is adopted effective for the 1999, 2000, and 2001 calendar years.

The Commission reserves jurisdiction and may issue further orders as necessary.

Any party desiring to appeal this order must do so in the appropriate court within 30 days after issuance and notice of this order, pursuant to MCL 462.26; MSA 22.45.

MICHIGAN PUBLIC SERVICE COMMISSION

/s/ John G. Strand
Chairman

(S E A L)

/s/ John C. Shea
Commissioner

/s/ David A. Svanda
Commissioner

By its action of September 11, 1998.

/s/ Dorothy Wideman
Its Executive Secretary

D. Effective with the April 1999 billing cycle, a three-year moratorium on distribution rates is approved, subject to the sharing mechanism proposed in the application and the exception for significant changes as described in the application.

E. SEMCO Energy Gas Company's currently authorized income sharing mechanism is suspended effective at the end of the 1998 calendar year, and its proposed income sharing mechanism is adopted effective for the 1999, 2000, and 2001 calendar years.

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MICHIGAN PUBLIC SERVICE COMMISSION

Chairman

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By its action of September 11, 1998.

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Suggested Minute:

"Adopt and issue order dated September 11, 1998 authorizing SEMCO Energy Gas Company to implement an experimental pilot program for residential gas customer choice and approving its request to suspend its gas cost recovery clause, place a moratorium on distribution rate adjustments, and replace its current income sharing mechanism with a new mechanism, as set forth in the order."