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April 16, 2010

Ms. Mary Jo Kunkle
Executive Secretary
Michigan Public Service Commission
6545 Mercantile Way
Lansing, Michigan 48909-7721

Re: In the matter of the application of Michigan Consolidated Gas Company
for authority to increase its rates amend its rate schedules and rules
governing the distribution and supply of natural gas, and for miscellaneous
accounting authority
MPSC Case No. U-15985

Dear Ms. Kunkle:

Attached for electronic filing in the above-referenced matter is Michigan Consolidated Gas Company's Exceptions to the PFD. Also attached is a Proof of Service.

Very truly yours,

Richard P. Middleton

RPM/kbt
Attachments
cc: Service List

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
MICHIGAN CONSOLIDATED GAS COMPANY)
for authority to increase its rates, amend its rate)
schedules and rules governing the distribution)
and supply of natural gas, and for miscellaneous)
accounting authority.)
_____)

Case No. U-15985
(Paperless e-file)

MICHIGAN CONSOLIDATED GAS COMPANY'S EXCEPTIONS

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Dated: April 16, 2010

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I. INTRODUCTION.

Michigan Consolidated Gas Company (“MichCon” or the “Company”) submits these exceptions to the Proposal for Decision (“PFD”) issued on April 2, 2010 by Administrative Law Judge Mark E. Cummins (“Judge Cummins” or the “ALJ”). While MichCon finds merit in many of the recommendations reflected in the PFD, MichCon respectfully disagrees with some of the ALJ’s recommendations.

Further support for MichCon’s positions and the reasons for those positions on many of these Exceptions may be found in MichCon’s February 5, 2010 Initial Brief and February 16, 2010 Reply Brief, and the Attachments to those briefs,¹ as well as MichCon’s testimony and exhibits, all of which are incorporated by reference in these exceptions.² For consistency and ease of reference, these Exceptions are largely presented in the order that the underlying issues were discussed in the PFD.

II. EXCEPTIONS.

Exception No. 1. The Commission Should Approve the Transfer and Integration of the Saginaw Bay Pipeline (“SBPL”) Into MichCon.

Atlas Gas & Oil Company, LLC, BreitBurn Operating LP, HighMount Exploration & Production Michigan, LLC, HighMount Midwest Energy, LLC, and O.I.L. Energy Corporation (collectively, “Atlas”) proposed the transfer of the Saginaw Bay Pipeline (“SBPL”) to MichCon, where it would become a part of MichCon’s integrated utility system (5 T 589-609). MichCon supports Atlas’ proposal, and supports a Commission order approving a transfer of SBPL to MichCon at its construction cost and corresponding accumulated depreciation as discussed by

¹ Unless otherwise indicated, references to Attachments are to the Attachments accompanying MichCon’s Exceptions to the PFD.

² MichCon, of course, maintains all of its appellate rights.

witness Rynearson (4 T 437-39; Attachment C), including recognition of the costs of the additional treatment facilities to ensure production gas entering SBPL meets gas quality standards (5 T 1383-86).

The ALJ stated that he agreed with the overall conclusion reached by the Attorney General (“AG”), Michigan Community Action Agency Association (“MCAAA”), and the Staff, “namely that the Commission should not—at least in the context of the present case—include the SBPL as part of MichCon’s net utility plant. According to the ALJ, while it may make sense to eventually incorporate the SBPL into the Company’s transmission system, the record fails to adequately support the increased revenue requirement that would result from adopting the joint Atlas/MichCon proposal at this time” (PFD, p 16).

The ALJ suggests that a comprehensive cost/benefit analysis should have been provided, and further suggests that certain concerns were raised that should have been further addressed (PFD, pp 17-18). The ALJ therefore recommended “that the Commission reject the joint Atlas/MichCon proposal and, instead, direct MichCon to provide a cost/benefit analysis concerning the proposed SBPL transfer (including a full analysis of all associated costs) as part of its next general rate case filing” (PFD, p 19). The ALJ’s recommendation is erroneous because the evidence in this case provides sufficient basis to approve the transfer. Furthermore, the only disagreement with this transfer comes in the form of baseless speculation. MichCon will address each of the ALJ’s three reasons (PFD, pgs 17-19) for concluding that there is insufficient evidentiary basis for approving the transfer of the SBPL to MichCon.

The ALJ’s first stated reason (PFD, p 17) is his belief that no comprehensive cost/benefit analysis has been provided with regard to this proposal. Apparently, the basis for this belief comes from a misunderstanding of MichCon’s presentation of the benefits described by

MichCon witness Mr. Springstead (5 T 1387), and MichCon's Exhibit A-30, which calculates the cost / revenue requirement created by transferring SBPL into MichCon. The ALJ suggests that additional costs, which have not been reflected in the revenue requirement calculated on Exhibit A-30, are necessary in order to realize some of the operational benefits, i.e., allowing better balancing of the Alpena-Gaylord system and providing additional supply security by interconnecting the SBPL with both the Gaylord Pipeline and Great Lakes Transmission pipeline system (5 T 1387). Contrary to ALJ's finding, Mr. Springstead's testimony shows that the two operational benefits that the ALJ chose to focus on are not immediate, but rather potential future benefits that could be realized once the transfer is complete (5 T 1387). Additional costs of future potential benefits are not included in the Company's proposed revenue requirement. The only operational consideration that requires immediate attention is the construction of an odorization facility at the existing Saginaw Bay to Alpena meter station (5 T 1383), and this was addressed in the revenue requirement calculation performed on Exhibit A-30. Thus, the record demonstrates that the proposed transfer will provide benefits to MichCon customers that outweigh the increase in annual cost of service, if it is done consistent with the operational and on the financial basis noted above and further discussed in MichCon's rebuttal testimony (4 T 437; 5 T 1361, 1365-66).

The ALJ's second stated reason (PFD, pgs 17-18) is that the Company (MichCon) provides little support for its belief that the SBPL should be transferred to MichCon at the construction cost as opposed to the pipeline's book value. MichCon disagrees. MichCon witness Mr. Peter Ryneanson provided all of the data necessary to support the transfer of the SBPL to MichCon at its Original Cost. Specifically, Mr. Ryneanson explained that in 1998, because Antrim gas could no longer flow untreated on the SBPL, the asset was considered

impaired and an accounting impairment of \$15.8 million was recorded reflecting a significantly lower book value, as defined under Generally Accepted Accounting Principles, as compared to the Original Cost as defined by the Commission's Uniform System of Accounts. (4 T 438-439).

The record demonstrates that upon transfer, the SBPL would become an integrated part of MichCon's utility pipeline system thus removing the impairment that exists as long as SBPL is an independent Act 9³ pipeline. No additional information is needed to support the transfer at the depreciated Original Cost of the SBPL.

Finally, the PFD suggests, without citation to law, rule, order or evidence that any transfer of SBPL to MichCon "would seem to constitute an affiliate transaction, engendering a higher degree of scrutiny than a run-of-the-mill transaction." (PFD, p. 18) While it is wholly unclear what additional scrutiny is required beyond that applied in a fully litigated contested general rate case, the PFD's reference presumably is referring to either the recent enactment of MCL 460.6q or the Commission's affiliate transaction guidelines neither of which are applicable in this instance.

MCL 460.q is not applicable because it only requires Commission review for utilities with 500,000 or more retail customers when there is a transaction that involves a transfer of an asset having an original book cost equal to or in excess of \$50 million. SBPL's construction cost of \$36.4 million (Exhibit A-40) is significantly less than \$50 million.⁴

³ MCL 483.101 et seq.

⁴ See January 25, 2010 MPSC Order in case No. U-15795 which approved interpretive standards defining when a utility asset transfer must receive MPSC approval pursuant to the provisions of MCL 460.6q. The MPSC approved standards entitled "Standards For Implementation of MCL 460.6q" are attached to the order, and p. 2 of these standards contains the threshold criteria for MPSC review of asset transfers.

The Commission's affiliate transaction guidelines are also not applicable. Guideline 6 of the affiliate transaction guidelines, as adopted by the Commission relative to MichCon in Case No. U-10150, pertaining to the value of assets transferred between affiliates states that:

“6. The utility shall notify the Commission in writing within thirty days prior to any transfer to non-utility affiliates of any utility assets or property exceeding a fair market value of \$100,000. Asset transfer from regulated to non-regulated shall be at the higher of cost or fair market value and non-regulated to regulated shall be at the lower of cost or fair market value. All services and supplies provided by non-regulated enterprises shall be at market price or 10% over fully allocated cost, whichever is less.”

There is no transfer of utility property involved in the proposed SBPL transactions. More importantly, there is also no transfer of a non-regulated asset to a regulated utility because SBPL is a pipeline fully regulated by the Commission pursuant to Act 9. Thus, the asymmetrical pricing provision of the affiliate transaction guideline number 6 does not apply to the proposed SBPL transfer. Thus, there is no basis in rule, law, or Commission order for the ALJ's recommended “higher level of scrutiny” for the transfer of the SBPL to MichCon.

The ALJ also states that producers in Michigan's northeastern lower peninsula may be adversely affected by incorporating the SBPL into MichCon (PFD, pgs 18-19). Although the ALJ notes that Mr. Springstead represented that Atlas “stated that all of the impacted producers have agreed to either re-route their gas to another transporter and/or have their gas treated at an existing facility at no cost to MichCon”, he apparently concludes that this representation is insufficient evidence upon which to recommend the transfer of SBPL to MichCon. The ALJ errs in reaching this conclusion because this conclusion ignores the fact that in this case Atlas represents the interests of numerous producers that currently move gas on the SBPL.⁵ Moreover, all producers had an opportunity to participate in this case. To the extent producers

⁵ Breitburn Operating LP, HighMount Exploration & Production Michigan, LLC, HighMount Midwest Energy, LLC, and O.I.L. Energy Corporation.

that ship gas on SBPL did not participate, this lack of producer participation cannot be used as a basis to cast doubt on the veracity of MichCon's testimony nor the propriety of approving the transfer. Atlas' representation of producers and MichCon's testimony on rebuttal are sufficient evidence that any producer's concerns that may be attendant to the transfer of SBPL to MichCon are adequately addressed in this case.

MichCon objects to the tactics employed by MCAAA and the AG, in their briefs because they appear to have misled the ALJ. Specifically, MCAAA proposed to defer this issue to MichCon's next rate case, claiming that the transaction needs more investigation and review (MCAAA Initial Brief, pp 22-24). MCAAA's accusations and insinuations were based entirely on speculation and hyperbole. MCAAA ignored the record and offered no evidence to support its unfounded accusations. MCAAA assertions on this issue should be given no weight because MCAAA did not challenge the testimony offered by MichCon or Atlas through cross examination and MCAAA offered no evidence of its own. It is improper for MCAAA to wait until the time of briefing, to suggest that other parties should have presented additional evidence to address newly-conceived criticisms because the other parties have no opportunity to rebut such criticisms once the record is closed. *See*, January 11, 2010 Opinion and Order in Case Nos. U-15768 and U-15751, pp 37-38.

The AG similarly asserts that he "believes that the Commission should reject this proposed transfer until MichCon makes a more convincing case . . ." (AG Initial Brief, p 28). The AG's belief is unfounded, and ignores the record in this case, which fully supports a decision by the Commission.

Staff supported the transfer of SBPL to MichCon on the same terms proposed by the Company, without qualification (See Exhibit ATL-6; 5 T 582). Staff also stated that it supported

the proposed transfer “in concept” and specifically recognized several benefits of the transfer (Staff Reply Brief, pp 41-42). Staff recommended, however for the first time in its brief, that MichCon should file a thorough cost benefit analysis in its next rate case, stating: “While the pipeline transfer would be beneficial, there is not sufficient information to quantify the costs to be included in the Company’s Rate Base” (Staff Reply Brief, p 42). The Staff’s suggested need for a cost/benefit analysis (and the ALJ’s corresponding recommendation) is unfounded, contradicted by Staff’s unqualified support for the transfer (Exhibit ATL-6), and because it is raised for the first time in Staff’s brief, should be given no weight.

The record demonstrates that Commission approval of this transfer would provide MichCon and its customers with various operational benefits over the short and long term including: (1) an additional source of supply for the Alpena-Gaylord system, (2) removing the dependence on local production (which is declining and is expected to continue to do so), (3) limiting reliance on the Alpena compressor station to meet peak winter demands from Alpena-Gaylord markets, and (4) potentially connecting into the Gaylord pipeline to allow better balancing of the system and provide additional alternatives to Gaylord area markets. Because SBPL crosses Great Lakes Transmission pipeline system, there is also the potential for a future interconnect for added continuity of service. (5 T 1387)

These benefits exceed the costs of the transfer. The record demonstrates that transfer of the SBPL to MichCon would require an \$11.1 million increase in rate base (4 T 437; Exhibit A-40, line 4). The increase in rate base related to SBPL consists of two elements. Transfer of SBPL will require an odorization facility investment of \$0.1 million at the existing Saginaw Bay to Alpena meter station, and the small volumes of production gas that currently enter the SBPL will have to be treated or redirected to ensure that the gas stream after transfer meets MichCon’s

gas quality specifications for heavy hydrocarbons, hydrocarbon dew point, and carbon dioxide (CO₂) content (5 T 1383-84). The second element is the transfer of the SBPL to MichCon at its Original Cost and corresponding accumulated depreciation (4 T 438). MichCon requests that the Commission explicitly authorize MichCon, based on the longstanding utility accounting and ratemaking treatment of “Original Cost” accounting for utility plant, to transfer SBPL without regard to the accounting impairment recognized in 1998 pursuant to SFAS 121 (4 T 438-39).

Furthermore, MichCon would realize a decrease in transportation fees paid to third party pipelines in the form of no further payments being made to SBPL (\$810,000 annual cost). Annual fuel and O&M savings could be generated from limiting reliance on running the Alpena compressor station to meet peak winter demands from Alpena-Gaylord markets. This would mean that MichCon would be able to use this transmission asset to provide utility service to additional areas not currently serviced by MichCon, but within MichCon’s service territory (larger customer base). Finally, MichCon would be able to provide the transportation and storage services through a better integrated system. In total, the benefits, both operational and non-operational, outweigh the small incremental cost increase associated with the transfer. (5 T 1388)

Specifically, the incremental cost of service would be \$2,380,000 (Attachment C, Lines 6–9). MichCon would lose \$2,265,000 of transportation revenue (Attachment C, Line 11), and \$516,000 of associated GIK⁶, which currently offset MichCon’s proposed revenue requirement. This would be partially offset by an \$810,000 decrease to MichCon’s revenue requirement for transportation fees that MichCon would no longer pay to Saginaw Bay (Attachment C, Line 10).

⁶ MichCon’s original calculation on Exhibit A-30, Line 12, identified a revenue requirement related to a reduction in Gas in Kind collected by MichCon due to the reduced Off-system Transport volumes of \$962,000. This was the 2008 GIK revenue from Atlas and other producers transporting on the SBPL. Attachment D to MichCon’s Reply Brief calculates the 2010 GIK revenue (\$516,000) that will be lost if the SBPL is transferred to MichCon based on MichCon’s proposed bifurcated GIK methodology.

The total impact on MichCon's revenue requirement of transferring SBPL to MichCon is \$4.351 million (Attachment C, Line 13).

Exception No. 2. The Commission Should Adopt a 6.24% Weighted Cost of Long-Term Debt.

The ALJ agreed with the Staff's recommended 6.22% cost of long-term debt, which was based on the removal of interest rate hedges (PFD, pp 33-34). MichCon disagrees, and asserts that the Commission should adopt a 6.24% weighted cost of long-term debt (5 T 1110, 1121-23, 1127, 1341; Exhibit A-11, Schedule D-2). The ALJ's rejection of the inclusion of the cost of interest rate hedges is apparently based on the Staff's claim that "If the Company hedges correctly then it makes money, if the Company hedges incorrectly then it requests that the costs of the hedge be passed off to customers"⁷ and his own observations that the Company's comparison of interest rate hedges to the inclusion of the costs of forward natural gas contracts in the GCR is inapt. Both of these bases for rejection are without merit. First, the ALJ's reliance on the Staff's claim of any asymmetrical cost recovery of interest rate hedges and the benefit of such hedges is improper since the record is devoid of any factual support for such claim. Mr. Megginson, the Staff's expert witness on this matter, proposed the exclusion of the interest rate hedges based on the claim that the Commission has not recognized interest rate hedges in previous rate cases and his belief that hedging activities "are speculative and **can** lead to unnecessary and avoidable costs". (Emphasis added, 6 T 1680) However, as explained by MichCon witness Solomon, the actual value of interest rate hedges is the ability to lock in interest rates for an upcoming debt issuance in a period of volatile interest rates. This enables the Company and its customers to avoid the exposure to sudden increases in the cost of the upcoming debt issuance. (5 T 1130-1) In this way, the interest rate hedges are very similar to

⁷ Staff Reply Brief, p.12.

the customary practice of locking-in future gas prices within the GCR. (5 T 1131) *See also, Attorney General v Public Service Comm*, 215 Mich App 356, 365; 546 NW2d 266 (1996) (affirming inclusion of costs associated with hedging program as costs of gas sold). The ALJ opined that this comparison was inapt in that “(1) gas price hedging pertains to actual, widely-traded commodity for which carefully-monitored protocols have been established, and (2) the GCR plan and reconciliation process would appear to provide a ready means for ensuring that benefits arising from hedging activities are shared with the utility ratepayers”. (PFD, pp 33-34) This conclusion implies that the market for interest rate hedges is inefficient and that the benefits of interest rate hedges will not be shared with customers.⁸ There is no record basis for either observation.

Moreover, while the actual costs in question are minor (slightly more than \$143,000, as per Exhibit A-11, Schedule D2), it is important that the Commission clarify its policy for the ratemaking treatment of interest rate hedges. While the Company entered into these hedges to provide for the long term benefit of locking in interest rates of long-term debt to be issued in a volatile financial environment, the Company would likely cease such prudent practice if the costs of such hedges were deemed to be non-recoverable in rates, regardless of the economic value of the hedges. For the foregoing reasons, the cost of the interest rates hedges should be included in the cost of Long-Term Debt and the rate recommended by the ALJ be increased from 6.22% to 6.24%.

⁸ The ALJ further concludes in a footnote that a more accurate comparison could be made between interest rate hedges and common stock floatation costs, the ALJ also excludes in his determination of the Company’s cost of capital. (PFD p. 34, n 16) Although the ALJ’s basis for this favorable comparison is not described, to the extent his recommendation to exclude such costs is adopted by the Commission, he is accurate that the exclusion of both costs that are incurred and absorbed by the Company in advance of the issuance of securities while the Company’s customers realize the long-term benefit of such costs has a similar unreasonable effect.

Exception No. 3. MichCon's Equity Ratio Should Be Increased In Light Of New Depreciation Rates.

The ALJ agreed with MichCon's proposal for a permanent capital structure consisting of 50.4% equity and 49.6% debt, and recommended that the Commission adopt MichCon's projected common equity balance of \$948,236,000 (PFD, pp 34, 36-37). The ALJ further recommended that the depreciation rates established for MichCon as a result of the Commission's March 18, 2010 Opinion and Order in Case No. U-15699 should be factored into the rates established by the Commission's final order in this case, but the PFD does not reflect the effects of the new depreciation rates (PFD, p 62, n 28 and p 132).

Mr. Solomon testified that if the Commission does not adopt MichCon's proposal in Case No. U-15699 to maintain MichCon's currently-authorized depreciation rates, then MichCon's equity ratio would have to increase to a 52% to 53% range, in order to offset the financial impact of decreased cash flow, and avoid a credit rating downgrade (5 T 1131-32). The ALJ found that "in addition to being wholly speculative, neither this assertion nor its proposed resolution have been adequately reviewed and addressed by the parties. As a result, this issue should be deferred for resolution in a future general rate case" (PFD, p 37, n 17).

MichCon takes exception to the ALJ not recognizing the need for an increase in MichCon's equity proportion in its capital structure to offset the adverse effect on MichCon's credit metrics as a result of the inclusion of the impact of new depreciation rates in the Company's revenue requirement. This matter is set forth on the record, and beyond reasonable dispute. In Consumers Energy's depreciation case, the Commission acknowledged the important tie between appropriate cash flows and the financial health of a utility and ultimately the rates utilities charge their customers:

“Finally, the Commission finds that the Attorney General’s proposed [net present value] method significantly decreases the cash flows available to utilities to meet their infrastructure and other public service obligations. This, in turn, has a negative financial effect on both the utility and its customers by requiring that such obligations be met with more expensive sources of external financing and by driving up the cost of obtaining money in the capital markets” (September 29, 2009 Opinion and Order in Case No. U-15629, p. 12).

In MichCon’s depreciation case, the Commission ordered MichCon to “implement revised depreciation rates in customer rates in conjunction with a Commission order setting new base tariff rates in Case No. U-15985” (March 18, 2010 Opinion and Order in Case No. U-15699, p 14). The Commission further stated that “issues regarding the sufficiency of the company’s cash flows should be addressed in the context of a general rate proceeding” (*Id*, p 12).

This is the general rate proceeding that needs to address this issue. MichCon specifically requested approval in this case to increase its equity ratio to 52-53% range if the Commission ordered MichCon in Case No. U-15699 to decrease its depreciation rates. On March 18, 2010 after the close of the record in this case and two weeks before the issuance of the PFD the Commission issued its order in Case No. U-15699. Thus, the PFD’s conclusion that the need for an increase in the Company’s equity ratio to mitigate the financial impact of not increasing the equity ratio is wholly speculative and is completely erroneous. Both the record in Case No. U-15699 and the record in this proceeding contain evidence sufficient to support a 52-53% equity range. Parties in this case had an opportunity to rebut Mr. Solomon’s testimony (5 T 1131-32) and did not. Asserting in the PFD that yet another contested case must examine this issue is contrary to the evidence, and would inappropriately delay approval of an appropriate equity ratio fully supported by the record in the Commission’s order in Case No. U-15699. Contrary to the ALJ’s assertions, there is nothing speculative about the need or support for a 52-53% equity ratio for MichCon. Accordingly, the Commission should increase the Company’s equity ratio to reflect that in April 2010, DTE Energy infused \$25 million in equity, which using the ALJ’s

capital structure as proposed in his PFD adjusted by that equity infusion, results in a permanent capital structure consisting of 51.7% equity and 48.3% debt (Attachment A, p 4)⁹.

MichCon has also calculated the reduction in the revenue deficiency in this case from applying the depreciation rates approved in Case No. U-15699 of \$22.2 million as shown on Attachment G to these Exceptions. MichCon also excepts to the PFD's failure to reflect the impacts of the implementation of Standard Retirements Units (SRUs) that the Commission also required in its Order in Case No. U-15699. To address the costs of implementing the new SRUs MichCon has reflected the increase in O&M expense of \$1.5 million (4 T 420) arising from the change in SRUs on Attachment A, page 2 of 4. Similarly, the related reduction of \$6.4 million in the Company's 2010, 13 month average of Accumulated Depreciation reserves for the impact of lower depreciation expense accruals to be recognized in 2010 as well as a \$0.75 million reduction in Gross Plant for the implementation of the change in SRUs must be reflected in the Commission's order in this case and these changes have been included on Attachment A, page 3 of 4.

Exception No. 4. MichCon's Return on Common Equity ("ROE") Should Be Increased, Not Decreased.

The ALJ recommended that the Commission reduce MichCon's return on common equity ("ROE") from 11.0% to 10.5%, which combined with other cost rates, would yield a 6.99% overall rate of return (PFD, p 46). The ALJ's recommendation is inappropriate, particularly because the ALJ seemingly neglected to appreciate that MichCon continues to face credit risk, significant business challenges, and challenges from Michigan's economy.¹⁰

⁹ MichCon's actual equity ratio for 2010 is projected to be 52% on a thirteen month average basis.

¹⁰ For MichCon, the challenges include the risks of funding and recovering the costs associated with its utility operations; the poor economic health of MichCon's service territory, which is dominated by the struggling domestic auto industry; and the increase in commodity prices (5 T 1117). Michigan's economy has been and is currently one

Accordingly, the Commission should increase MichCon's ROE from 11% to 11.25%. The corresponding, weighted after-tax rate of return is 7.35% (shown on Attachment A, p. 4), and weighted pre-tax overall rate of return is 10.24% (shown on Attachment A, p. 4)¹¹. MichCon supports the use of the 7.35% overall rate of return in the derivation of its revenue requirements, and the use of the 10.24% pre-tax overall rate for the return on all amortization and regulatory asset balances.

MichCon's ROE expert witness Dr. Morin recommended that a just and reasonable ROE for MichCon's common equity capital is 11.25%, assuming that the Commission approved MichCon's proposed Revenue Decoupling Mechanism ("RDM"), approved MichCon's requested 50.4 % equity ratio, and continued MichCon's currently-authorized depreciation rates as MichCon proposed in Case No. U-15699. Dr. Morin's recommended ROE increases to 11.50% if the Commission does not adopt MichCon's proposed RDM (5 T 1025, 1080-81, 1083, 1117, 1120-21, 1127).¹² The Commission has routinely adopted 11% ROEs for Detroit Edison and MichCon based on, at least in part, Dr. Morin's expert ROE recommendation.¹³

of the weakest, if not the weakest, economies in the United States. The poor economic situation is having a significant negative impact on MichCon's customer base (5 T 1119-20). Moreover, the utility industry as a whole is at greater risk than in the past due to conservation initiatives, deteriorating economic conditions, increasing operating costs, and largely uncontrollable costs such as active employee and retiree healthcare (5 T 1118).

¹¹ The 7.35% weighted after-tax rate of return and the 10.24% pre-tax overall rate for the return reflect MichCon's 51.7% equity ratio. The weighted after-tax rate of return is 7.30% and the pre-tax overall rate of return is 10.12% with a permanent capital structure consisting of 50.4% equity and 49.6% debt as supported by the PFD.

¹²As indicated in Exception No. 3, the Commission has reduced MichCon's depreciation rates, and thus MichCon's equity ratio should be increased to a 52% to 53% range (5 T 1120, 1131-32).

¹³ See Orders in Case Nos. U-13808, U-15244, U-13898 and as recently as January 11, 2010 for Detroit Edison in Case No. U-15768.

Dr. Morin based his conclusion on studies that he performed using the Capital Asset Pricing Model (“CAPM”), and an empirical approximation to the CAPM (“ECAPM”)¹⁴ using current market data; he performed an additional Risk Premium analysis using historical data from utility industry aggregate data, using the current yield on long-term utility bonds; and he performed Discounted Cash Flow (“DCF”) methodologies analysis on two surrogates for MichCon (1) a group of investment-grade, dividend-paying natural gas distribution utilities; and (2) a group of investment-grade combination electric and gas utilities with the majority of their revenues from regulated operations (5 T 1077-78). The results are summarized in the table below:

STUDY	ROE
CAPM	9.0%
Empirical CAPM	9.4%
Historical Risk Premium	11.6%
DCF Natural Gas Utilities Value Line Growth	10.1%
DCF Natural Gas Utilities Zacks Growth	12.2%
DCF Combination Electric Utilities Value Line Growth	12.4%
DCF Combination Electric Utilities Zacks Growth	12.4%

It is important to keep in mind, however, that a rational investor will not make or maintain an investment unless it provides a return corresponding to its risk. The higher the risk, the higher the required return. MichCon faces risks that are greater than the risks faced by average utilities, so Dr. Morin applied his professional judgment to conclude that a just and reasonable, but conservative, return on equity for MichCon is 11.25%, assuming that the

¹⁴ The CAPM is a fundamental paradigm of finance, based on the idea that risk-averse investors demand higher returns for assuming additional risk, and higher-risk securities are priced to yield higher expected returns than lower-risk securities. The CAPM quantifies the additional return, or risk premium, required for bearing incremental risk using, (a) a risk free rate, (b) beta, and (c) a market risk premium.

Commission implements MichCon's proposed RDM,¹⁵ and approves MichCon's recommended 50% equity ratio.¹⁶

Staff supported a ROE range of 10.5% to 11.0%, with a recommendation of 10.85%, (Staff Initial Brief, pp 16, 19; 6 T 1684, 1697, 1699). The ALJ found that the Staff's ROE range was reasonable, but he rejected the Staff's 10.85% recommendation in favor of his own 10.5% recommendation, which is at the low point of the Staff's range (PFD, pp 44-45).

The ALJ suggested four reasons in an attempt to support his recommendation to reduce MichCon's ROE from 11.0% to 10.5% (PFD, pp 45-46). All of those reasons are faulty, as discussed below. The Staff's range and recommendation are also understated because, as further discussed below, if Staff had made necessary technical corrections to its CAPM and DCF analyses, accounted for MichCon's higher-risk profile, and appropriately recognized flotation costs, then its ROE range and recommendation would be in line with Dr. Morin's 11.25% recommendation (5 T 1093-94). To avoid repetition, the ALJ's adoption of the Staff's ROE range and his recommendation at the low point of that range are discussed collectively.

1. The ALJ's Reliance on Decisions By Other State Regulatory Agencies Is Misplaced.

The ALJ's first reason for his 10.5% ROE recommendation was: "First, the Staff's review of recent decisions issued by other regulatory agencies revealed that the average approved return on equity was 10.4%. Thus, while the rate of return recommended in this PFD is admittedly at the low end of the Staff's range, it is 10 full basis points above the average granted by other state commissions" (PFD, p 45).

¹⁵ Without the RDM, MichCon's risk increases and MichCon's ROE should be 11.5% (5 T 1078-79). See also Exhibit AG-23 which explains that the 11.25% recommendation reflects data for utilities that already have decoupling mechanisms.

¹⁶ If MichCon's equity ratio is lowered, then the required rate of return must be increased. Empirical finance literature demonstrates that with a reduction in the common equity ratio, the necessary return on equity must be increased (5 T 1080).

The ALJ's reference to other regulatory agencies is based on just a one-page summary entitled "Gas Utility Rate Case ROE Decisions (2004-2009)" (Exhibit S-4, Schedule D-5, page 11). Assuming for the sake of argument (but not admitting) that the summary accurately reflects the decisions indicated, it is still plainly incomplete so its nation-wide accuracy is speculative, at best. On its face, the summary only covers 21 states, and omits, for example, the states of Maryland and Nevada, which the Staff references elsewhere (Staff Reply Brief, p 15), as well as Oregon, as further discussed in Footnote 27 below.

This bare summary of apparent decisions in 21 states from 2004 through 2009 also does not provide any indication that any utility in any of those states faced the uniquely high risks that MichCon faces as a Michigan utility in the present economic climate (as indicated above, and further discussed below). The summary is plainly weighted towards years preceding the current economic crisis. Moreover, the Staff's same exhibit reflects that, for the proxy group of utilities that Staff used in its ROE analysis, the average return on equity from 2004 through 2008 was 12.6% (5 T 1690; Exhibit S-4, Schedule D-5, page 4).

The one-page summary also lacks any explanation of critical factors such as the underlying reasons for the ROE determinations, the proportion of equity to total capital,¹⁷ the existence and effects of any offsetting factors, and whether the agency determinations withstood appellate review. The Commission has also recently noted that it does not look to other state commissions in determining just and reasonable rates for Michigan utilities (January 11, 2010 Opinion and Order in Case Nos. U-15751 and U-15768, p 48).¹⁸

¹⁷ For example, the authorized return on equity of 10.51% for NICOR on 9/30/05 must be evaluated in the context of NICOR's average common equity ratio of 65.2%. (Exhibit S-4, Schedule D-5, p. 3)

¹⁸ The ALJ's willingness to rely on other state regulatory orders with respect to ROE matters as compelling is completely at odds with his summary rejection of other state's regulatory orders on incentive compensation issues. (PFD, p.45, 65)

2. CAPM and ECAPM Estimates Should Have Little, if Any, Weight.

The ALJ's second reason for his 10.5% ROE recommendation was: "Second, the overall range of rates (9.0% to 12.4%) provided by MichCon's own witness, Dr. Morin, results in a midpoint of 10.7%. Adjusting that figure to remove his 0.3% flotation cost adder (consistent with the above-mentioned finding) also produces a cost rate of 10.4%" (PFD, p 45).

The ALJ's simplistic finding of a 10.7% midpoint neglects to recognize that Dr. Morin's 9.0% CAPM and 9.4% ECAPM results (shown in the chart above) are unrealistic outliers. Dr. Morin explained that little, if any, weight should be accorded to CAPM and ECAPM estimates under present economic conditions for three reasons. First, the estimates are suspect because they are not significantly above the cost of new debt capital. Second, the impact of the ongoing financial crisis is not fully captured in the betas, since they are estimated over five-year historical periods. Third, the CAPM results are lowered by the substantial decrease in government interest rates following the Federal Reserve's expansionary policies designed to jumpstart the economy, while at the same time, the cost of corporate debt and the cost of equity for utilities have increased significantly, as evidenced by record high corporate yield spreads, and by the DCF results for utilities, which have increased significantly by some 150-200 basis points in response to lower stock prices (higher dividend yields) following the financial crisis. There is a fundamental structural upward shift in risk aversion as capital markets are re-pricing risk. Capital has become, and will continue to be, more expensive for all market participants over the next 18-24 months at least (5 T 1027-29, 1069-60, 1100).

The ALJ erred further to the extent that he relied on the Staff's CAPM analyses, which he apparently did in adopting the Staff's ROE range (PFD, pp 44-45). Dr. Morin used 6.5% for the market risk premium ("MRP") (5 T 1051). Staff witness Mr. Megginson made two MRP

estimates: (1) a 6.47% estimate that he derived from historical returns from stocks and bonds from 1926-2008, and (2) a 5.48% estimate that he derived from the same data, with the exclusion of the 1926-1957 period. Dr. Morin explained that this CAPM estimate based on the 1958-2008 MRP is unreasonable and therefore should be given little, if any, weight, since it produces cost of equity estimates that are less than the cost of debt. (5 T 1090-93).

Staff supported its use of 1958-2008 data (Staff Initial Brief, pp 20-21) due to its exclusion of certain “turbulent periods,” including the period of non-market based administered interest rates. Staff’s discussion on this point is not relevant because the current recession is the worst since both the Great Depression and the end of non-market based administered interest rates. More importantly, however, the entire CAPM methodology is suspect because it produces cost of equity estimates that are not significantly above the cost of debt. Such a result is plainly unreasonable because equity shareholders are subordinate to bondholders in corporate dissolutions. Therefore, the CAPM in general, and Staff’s CAPM results based on the 1958-2008 MRP in particular, should be given little, if any, weight.¹⁹

3. The Staff’s DCF Estimates Are Understated.

The ALJ also apparently found that the Staff’s DCF methodologies were appropriate in adopting the Staff’s ROE range (PFD, pp 44-45). In order to apply the DCF model, two components are required: (1) the expected dividend yield; and (2) the expected long-term growth rate.²⁰ For the dividend component in his DCF model, Staff used a spot dividend yield inflated

¹⁹ The longest period available should be used, as Dr. Morin did, in arriving at his historical market risk premium estimates. It is important to use returns realized over long time periods instead of returns over more recent periods, because only over long time periods will investor return expectations and realizations converge. The period must be long enough to smooth out short-term aberrations, and encompass several business and interest rate cycles. (5 T 1052-53, 1091-92)

²⁰ Dr. Morin explained that the traditional DCF formula states that under certain assumptions, the equity investor's expected return can be viewed as the sum of an expected dividend yield, plus the expected growth rate of future dividends and stock price (5 T 1063-64). The standard DCF model requires the following main assumptions: a

by one-half of expected dividend growth (6 T 1692). Staff supported the Semi-Annual Compounding Model (Staff Initial Brief, p 20). As explained by Dr. Morin, Staff's method fails to measure the full dividend flows expected by the investor, contrary to the spirit and fundamental nature of the DCF model. The annual DCF model states very clearly that the expected rate of return on a stock is equal to the expected dividend at the end of the year divided by the current price of the stock, plus the expected growth rate. Moreover, the basic annual DCF model ignores the time value of quarterly dividend payments and assumes dividends are paid once a year at the end of the year. Multiplying the spot dividend yield by $(1 + g)$ is actually a conservative attempt to capture the reality of quarterly dividend payments and understates the expected return on equity. Use of this method is conservative in the sense that the annual DCF model ignores the more frequent compounding of quarterly dividends. Since the appropriate dividend to use in a DCF model is the prospective dividend to be received at the end of the year rather than one-half of that dividend, Staff's approach incorrectly understates the proper dividend yield. Staff's approach understates the cost of equity by approximately 15 basis points (5 T R 1089-90).

4. MichCon's Return on Equity Should be Adjusted for Flotation Costs.

All of Dr. Morin's market-based estimates included an adjustment for flotation costs because common equity capital is not free. Flotation costs are incurred. They are not expensed at the time of issue. Therefore, they must be recovered via a rate of return adjustment.²¹ Total

constant average growth trend for both dividends and earnings, a stable dividend payout policy, a discount rate in excess of the expected growth rate, and a constant price-earnings multiple, which implies that growth in price is synonymous with growth in earnings and dividends (5 T 1064).

²¹ Dr. Morin explained that most regulatory commissions, including the FERC, routinely do this for bond and preferred stock issues (5 T 1073). Dr. Morin explained that flotation costs are very similar to the closing costs on a home mortgage. In the case of issues of new equity, flotation costs represent the discounts that must be provided to place the new securities. Flotation costs have a direct and an indirect component. The direct component is the compensation to the security underwriter for its marketing/consulting services, for the risks involved in distributing

flotation costs generally amount to about 5% of gross proceeds. This in turn amounts to approximately 30 basis points for MichCon. That is, dividing the average expected dividend yield of approximately 5% for utility stocks by 0.95 yields 5.3%, which is 30 basis points higher (5 T 1074-76, 1096-97; Exhibit A-11, Schedule D5.10).

The expected dividend yield component of the DCF model must be adjusted for flotation costs by dividing it by $(1 - f)$, where f is the flotation cost factor. Staff did not perform this adjustment, so its DCF estimates contain a downward bias of approximately 25 basis points (5 T 1086-87).

The ALJ found that flotation costs should not be factored into MichCon's ROE, relying on a prior Commission observation that flotation costs are incurred by the parent company and not the regulated company (PFD, p 44). He then relied on that finding to reduce the 10.7% midpoint of Dr. Morin's ROE range to 10.4%, as part of his second reason for his 10.5% ROE recommendation (PFD, p 45, quoted above). The ALJ inappropriately relied on a proposition that ignores the fact that the parent-subsidary relationship does not eliminate the costs of a new issue, instead the relationship merely transfers those costs to the parent. To simply pass the costs on to a parent company would be unfair and discriminatory to the parent company's shareholders. Furthermore, it does not matter whether future equity issuances are contemplated (See Exhibit A-11, Schedule D5.10 pp. 5-6) (5 T 1087). The point of cost incurrence is not germane to the issue of recoverability of the cost, since the Commission routinely recognizes operating costs that were incurred at the parent company level and allocated to the utilities. This Commission has, in the past, recognized an allowance for flotation costs in setting a utility's ROE in the instance when its parent company incurred such costs. (October 28, 1993 Order in

the issue, and for any operating expenses associated with the issue (printing, legal, prospectus, etc). The indirect component represents the downward pressure on the stock price as a result of the increased supply of stock from the new issue. The latter component is frequently referred to as "market pressure." (5 T 1074).

Case No. U-10150, p. 26). Because, there is no logical basis in this proceeding for excluding the quantified flotation costs on the basis that the cost is incurred at the parent company, such exclusion is simply arbitrary.

5. The ALJ's Reliance on MichCon's Capital Structure is Misplaced.

The ALJ's third reason for his 10.5% ROE recommendation was:

“Third, as noted earlier, MichCon has been experiencing a very stable capital structure (with its equity-to-permanent capital ratio averaging 50% over the five-year period ended December 31, 2008) and has pledged to take all steps necessary to maintain such levels in the future. 5 Tr 1112-1113. This strategy, when coupled with the ALJ's recommendation to adopt the Company's proposed levels of long-term debt and common equity, should help to reduce the financial risk faced by MichCon's common equity shareholders, thus reducing the cost of equity” (PFD, p 45).

The ALJ's reliance on MichCon's existing equity to permanent capital of 50% to justify the adoption of the low end of the Staff's recommended ROE is not supported by the records. While the Company disagrees with certain aspects of Mr. Megginson's recommendation of a range of 10.5% to 11.0% authorized return on equity in this case, it is clear from the scope and depth of Mr. Megginson's analysis that MichCon's 50% equity to total permanent capital was already reflected in the determination of his proposed ROE range. Moreover, the proxy group used in Mr. Megginson's analysis had an average five year equity ratio of about 55%. (6 T 1689) More importantly, the most recent data suggest that the gas proxy group has adopted more conservative capital structures since the 2008 equity ratio has increased to 58%, as reflected in the table below, as extracted from Exhibit S-4, Schedule D-5:

Gas Proxy Group Common Equity Ratio (%)		Five Year <u>Average</u>
	<u>2008</u>	
AGL Resources	49.7%	48.7%
Atmos Energy	49.2%	47.9%
Energen Corp.	74.0%	65.2%
Equitable Resources	62.1%	57.6%
Laclede Gas	55.5%	52.1%
National Fuel Gas	61.6%	55.6%
NICOR GAS	68.4%	65.2%
Northwest Natural Gas	55.1%	53.9%
Piedmont Natural Gas	52.8%	54.2%
South Jersey Industries	60.8%	55.6%
Southwest Gas Corp	44.7%	39.6%
WGL Holdings	62.4%	60.0%
Average	58.0%	54.6%

Since Mr. Megginson’s recommendation already reflects MichCon’s more highly leveraged capital structure, there is no basis to infer from the mere stability of its historical capitalization that the low end of Mr. Megginson’s range is proper

Accordingly, the ALJ’s reliance on MichCon’s 50% capital structure to support his proposed ROE reduction is misplaced. Instead, if the Commission adopts MichCon’s existing capital structure, then MichCon’s ROE must be increased by 20 to 30 basis points, to offset the impact of new depreciation rates. Any ROE reduction (which would be entirely inappropriate) would require a compensating increase in MichCon’s equity ratio (5 T 1080).

6. MichCon’s High Business Risk Justifies a Higher Return on Equity, and Any Change in MichCon’s Risk Profile Based on a Pilot RDM and Continuation of MichCon’s UETM is Contrary to The Record in This Case, and Contrary to the Commission’s Recent Decisions Regarding Detroit Edison and Consumers Energy.

The ALJ’s fourth reason for his 10.5% ROE recommendation was: “Fourth, and most importantly, in light of the significant reduction in risk that should result from the recommended

approval of an RDM and the continued use of the existing UETM (albeit, on a slightly revised basis), a cost rate of 10.5% is more than generous” (PFD, pp 45-46).²² The ALJ’s reasoning implicitly finds that MichCon has below average risk, since the Staff’s 10.85% ROE recommendation reflected the Staff’s position that MichCon’s risk is comparable to the industry average (6 T 1698-99; Staff Reply Brief, p 14). The ALJ (and to a lesser extent the Staff) is wrong because MichCon has above-average risk.

Dr. Morin explained that MichCon’s risk environment exceeds the industry average due primarily to Michigan’s difficult economic climate, caused in large part by the continued decline in the domestic automotive market share, energy conservation, and the reduction in usage per customer as well as the number of customers. MichCon also suffers from the lack of a revenue decoupling mechanism and weak financial metrics for its credit rating (5 T 1024, 1087). Furthermore, on May 22, 2009, S&P put MichCon on negative outlook, and ***reduced*** MichCon’s business risk profile to “strong.”²³ This demonstrates that MichCon’s business risk is increasing. Another indication that MichCon’s risk is above average is that its parent company’s market-to-book ratio is among the lowest in the industry at 0.97 versus the industry average of 1.39 (5 T 1088).

MichCon further notes that the ALJ’s (and to a lesser extent the Staff’s) recommendation to reduce MichCon’s 11.0% ROE is similar to Staff’s recommendations to reduce The Detroit Edison Company’s (“Detroit Edison”) 11.0% ROE in its last two rate cases. The Commission rejected Staff’s recommendations in those cases in light of economic and financial conditions.

²² The ALJ’s RDM and UETM recommendations are discussed in Exception Nos. 9 and 10.

²³ According to S&P’s article dated June 8, 2009 titled “US Regulated Electric Utilities, Strongest to Weakest, the ‘Strong’ Business Profile Represents Only 12% of Regulated Utilities or 22 Out of 186” (5 T 1088).

MichCon faces economic and financial challenges that are similar to those faced by Detroit Edison.

In Case No. U-15244, with regard to Detroit Edison, the Commission explained: “. . . that maintaining the status quo on the company’s ROE in light of Michigan’s economic circumstances and the U.S. credit crisis is the most prudent course of action.” The Commission also expressed its “concern for the utility’s continued ability to provide financing for infrastructure investment needs, and then to continue to provide safe, reliable, and abundant power at reasonable rates” (December 23, 2008 Opinion and Order in Case No. U-15244, p. 22).

In Case No. U-15768, Staff recommended a ROE range of 10.5% to 11.0%, with a midpoint recommendation of 10.75 % for Detroit Edison (much like Staff’s present 10.5% to 11.0% ROE range and 10.85% recommendation for MichCon). In an order issued only three months ago, the Commission correctly maintained Detroit Edison’s 11.0% ROE. The Commission explained that it was appropriate to maintain the ROE at the top of the Staff’s range, not reduce it (and certainly not reduce it to the bottom of the range as the ALJ recommends here): “The Commission is persuaded that the economic conditions in Detroit Edison’s service territory remain uncertain and that, although the financial markets have stabilized somewhat, access to credit remains uncertain as well. The Commission agrees with Detroit Edison that in light of the foregoing, the company’s risk environment will continue to be challenging and that **a ROE at the top of Staff’s recommended range is appropriate.**” (January 11, 2010 Opinion and Order in Case Nos. U-15768 and U-15751, pp 20-21, emphasis added). This same rationale applies directly to MichCon in this case, particularly since the Commission adopted a UETM and pilot RDM program for Detroit Edison (*Id.*, pp 60, 65), and

properly declined to reduce Detroit Edison's ROE to reflect any allegedly-reduced risk from such tracking mechanisms (*Id.*, p 21).

The ALJ was apparently persuaded by the AG's and ABATE's suggestions that MichCon's business risk is reduced by the existing UETM and contemplated RDM. The ALJ neglected to recognize that risk is already reflected in data regarding comparable companies, and MichCon's risk is high when compared to those companies. Dr. Morin explained that the approval of adjustment clauses, riders, and cost recovery mechanisms by regulatory commissions is widespread and mainstream policy in the natural gas utility industry, so it is already embedded in financial data, such as stock prices, bond rating and business risk scores. Any risk reduction is also offset by significant factors that increase MichCon's risk, including the structural weakening of Michigan's economy, MichCon's substantial capital spending program that requires external financing, relatively weak financial metrics, and regulatory risks (5 T 1101; *See also*, 5 T 1438-39 and Exhibit AG-23)²⁴.

Mr. Feingold further explained that the RDM would only concern revenues, so MichCon would remain subject to ongoing pressures on its earnings due to the risks of rising costs from a variety of sources beyond its control, such as increased commodity prices and government mandates. MichCon's proposed RDM (which the Commission should adopt, as discussed in Exception No. 10) is symmetrical, so to the extent that MichCon's downside risk may be limited, there would be a corresponding limit to MichCon's upside opportunities (5 T 1437-40). Moreover, the financial community has indicated that utilities need RDMs just to stabilize or

²⁴ As explained in Exhibit AG-23, revenue decoupling mechanisms, weather normalization clauses, and other cost recovery tracking mechanisms are extremely common in the natural gas industry and their effect were already incorporated into Dr. Morin's proposed cost of equity because that proposal was derived from the empirical data for proxy groups that contain utilities with such mechanisms.

maintain their credit ratings, and a utility that does not have an RDM may be viewed as having increased risk of a credit downgrade (5 T 1440-41).

MichCon further emphasizes that the ALJ's fourth reason for his 10.5% ROE recommendation is plainly speculative, since it is based on conjecture about a reduction in risk that allegedly "should" result from the ALJ's recommended approval of an RDM and a modified UETM (PFD, p 45). The Commission recently rejected similar recommendations by the AG and ABATE to reduce Detroit Edison's ROE, explaining that any ROE reduction is premature, at best, because actual data is needed to assess whether there are any changes to a utility's risk profile: "At this point, the revenue decoupling program is a pilot program and **any changes to a utility's risk profile cannot be assessed without information on the actual performance of the specific RDM, coupled with other trackers**" (January 11, 2010 Opinion and Order in Case Nos. U-15768 and U-15751, p 21, emphasis added). The Commission similarly found that it would be imprudent to reduce Consumers Energy's ROE, explaining "because the revenue decoupling proposal adopted in this order is a pilot program, the Commission finds that it would be imprudent to reduce the company's ROE at this time as recommended by the Attorney General and ABATE" (November 2, 2009 Opinion and Order in Case No. U-15646, p 24. *See also*, January 25, 2010 Order in Case No. U-15645, p 11).

Despite the ALJ describing his fourth reason as most important, he does not reveal his reasoning on risk. It is hard to understand how he could find that MichCon somehow will have a "significant reduction in risk" from "continued use of the existing UETM (albeit, on a slightly revised basis)" that the Commission established, along with MichCon's existing 11.0% ROE, approximately five years ago in Case No. U-13898. Indeed, the ALJ recommends increasing MichCon's UETM risk by modifying the existing 90/10 risk-sharing mechanism to an 80/20

mechanism (which would be inappropriate, as discussed in Exception No. 10). Thus, the ALJ's 50 basis point ROE reduction would logically appear to be based entirely (at least with regard to alleged risk reduction) on his recommended RDM.²⁵

The Staff observed that one case in one state adopted such a dramatic 50 basis point ROE decrease in 2007 (before the economic crisis), but other jurisdictions adopted lesser reductions (Staff Reply Brief, p 15).²⁶ The Staff continued: "While noting that the Commission is not bound by decisions made by regulatory commissions in other states, Staff submits that further study is required before a standard or uniform basis point reduction in the ROE, **if any**, is recommended for utilities that have approved revenue decoupling mechanisms in the future. Accordingly, at this time, Staff does not recommend lowering the Company's ROE due to the implementation of a RDM" (Staff Reply Brief, p 15).

Exception No. 5. The ALJ's Recommended Long-Term Fixed-Price Contract Revenues Are Overstated.

MichCon has several fixed-price transportation customers, including Dearborn Industrial Group, LLC ("DIG"), that are under long-term agreements that include annual volume or revenue commitment true-up provisions. MichCon's forecasted revenues for these customers reflect billed fixed prices and customer charges, plus a 2010 minimum volume commitment revenue projection, for a total revenue projection of approximately \$9.9 million which is

²⁵ MichCon disagrees with the ALJ's recommended RDM, as discussed in Exception 11. Relevant to this discussion, however, the ALJ recommended an RDM that uses weather-normalized figures, which he states "should also serve the purpose of narrowing the RDM's scope significantly" (PFD, p 84). It is difficult to understand how the ALJ could believe that his recommended narrow RDM could significantly reduce MichCon's risk.

²⁶ The Staff cited, as an example of a lesser ROE reduction, *Application of Southwest Gas Corporation for authority to increase its rates and charges for natural gas service for all classes of customers in Southern and Northern Nevada*, December 16, 2009 Order of the Public Utilities Commission of Nevada in Docket No. 09-04003 (25 point ROE reduction). See also, *In the Matter of Portland General Electric Company, Request for a general rate revision*, January 22, 2009 Order No. 09-020 of the Public Utility Commission of Oregon in Case No. UE 197 (10 basis point ROE reduction) and *Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Consolidated Edison Company of New York, Inc. for Electric Service*, March 25, 2008 Order of the New York Public Service Commission in Case No. 07-E-0523 (10 basis point reduction ROE reduction for an RDM, offset by additional risks and uncertainties that were created, resulting in no adjustment to the cost of equity).

included in the total EUT revenue projection for 2010 of \$65.6 million (5 T 1232; Exhibit A-14, Schedule G2, column 2).

MichCon explained that the Staff's recommended 2010 test year distribution revenue must be reduced by \$205,000 to reverse unwarranted disallowances relating to the contracts, but the ALJ agreed with the Staff's suggested revenue shortfall (PFD, p 58). MichCon takes exception because Staff's analysis did not assign the most applicable cost based rate, which results in a significant overstatement of the revenues associated with two of the six contracts. When the most applicable cost-based rates are assigned to the contracts, it becomes clear that the contracts provide total revenues including all transportation charges and volume commitments in excess of the proposed rates. There is no revenue shortfall for this group of contracts under MichCon's proposed transportation rate design. In fact, the special contracts and fixed rate contracts contribute a 46% uplift to the transportation rate class. This uplift supports MichCon's methodology of providing a revenue offset to the EUT cost of service (5 T 1250-51). MichCon's proposal would also send a positive message that is very much needed in the state of Michigan to attract and retain business and industrial development (5 T 1251-53).

Exception No. 6. Late Payment and NSF Revenue Should Be Based on Average Revenues from 2006, 2007, and 2008.

MichCon proposed \$15.795 million of late payment/NSF revenue based on the average revenues from 2006, 2007, and 2008 (approximately \$12.756 million, \$17.045 million, and \$17.583 million respectively) (4 T 417). Staff recommended using the 2008 base year revenue of \$17,582,913 (Staff Initial Brief, pp 22-23; 6 T 1777). The ALJ agreed with the Staff (PFD, p 59). MichCon disagrees because, although Late Payment/NSF charges had been rising through 2008, late payments were only \$12.6 million through November of 2009, and they are expected to be significantly lower than they were in 2008 due to MichCon's offering of additional

payment plans to its customers (4 T 418). Therefore, when customers are on payment plans, in accordance with the Billing Practice Rules, they do not receive late payment charges (4 T 418). MichCon's 3-year average is more appropriate than Staff's proposal and should be used.

Exception No. 7. The ALJ's Recommended Midstream Revenue Is Overstated.

MichCon realizes Midstream (a/k/a "third-party" or "off-system") revenue from selling storage services, transportation services, loan services, exchange services, and certain other services to third-party customers (4 T 230; 5 T 641). MichCon has the capability to sell 40.6 Bcf of traditional storage capacity to third parties, of which 23.1 Bcf is already under contract (resulting in \$14.4 million in revenue) (5 T 644). In accordance with the Commission's December 4, 2007 Opinion and Order in Case No. U-15457, MichCon is moving its storage sales portfolio towards a greater allocation of long-term (greater than one year) agreements to reduce MichCon's storage revenue risk profile. MichCon projects \$12.9 million of revenue from the 17.5 Bcf of open capacity, based on a strategy of selling 12.0 Bcf under new long-term contracts (resulting in \$7.7 million of revenue at a projected rate of \$0.85 per Mcf) and 5.5 Bcf under short-term contracts (resulting in \$5.2 million of revenue at a projected rate of \$1.05 per Mcf). (4 T 232; 5 T 641-46; Exhibit A-10, Schedules C3.2 and C3.3).

Staff recommended a storage revenue amount of \$46.4 million, and disagreed with the Company's \$10.9 million adjustments to its storage service revenue. The ALJ agreed with the Staff (PFD, p 60). MichCon disagrees. The ALJ and Staff's reliance on Commission orders in Case Nos. U-15457, U-15682 and U-14800 is misplaced because MichCon complied with those orders, and compliance with those orders supports MichCon's position that an adjustment should be made to historical storage revenues. Specifically, the arguments offered by Staff's witness do not support the rejection of the \$10.9 million adjustment because: (1) MichCon continues to

pursue a balanced (short and long term) storage portfolio, (2) the orders in these cases **did not** provide for MichCon to sell additional storage space to third parties beyond the 40.6 Bcf, (3) the Company reflected **the entire** 40.6 Bcf of storage for sale to third parties, (4) the storage space created in Case No. U-14800 was allocated to GCR customers, and (5) MichCon has projected the uncommitted short term space to be sold at a rate of \$1.05/Mcf. (5 T 672-3) In order to meet Staff's \$46.4 million revenue target, MichCon would have to sell the available 17.5 Bcf of open capacity at an unachievable average price of \$1.81 per Mcf²⁷, rather than the expected average market price of \$0.975 per Mcf (\$0.85 per Mcf long term; \$1.05 per Mcf short term) (5 T 672-75). MichCon is seeking in this case to remove the cap on MichCon's tariff storage rate, which was established in Case No. U-13898, because the market dictates the value of third-party storage services. If the Commission seeks to retain a cap, then MichCon recommends a rate of \$3.28 per Mcf, which is the three-year market high (5 T 645-46; Exhibit A-10, Schedule C3.4). However, raising the cap would not change the expected value of the third party storage forecast for 2010. Rather, it would simply recognize the future possibility that market spreads could again achieve previous highs.

MichCon forecasts \$37.6 million of third-party transportation revenue in 2010, and an additional \$9.4 million in other Midstream revenue categories, primarily exchange and loan services (5 T 646-50; Exhibit A-10, Schedule C3.5). If the transfer of SBPL into MichCon is approved, off-system transportation revenues will be reduced by \$2.265 million (5 T 1349; Exhibit A-30) to \$35.3 million.

Staff recommended a \$4.3 million upward revenue adjustment, resulting in off-system transportation revenue of \$51.4 million (Staff Initial Brief, p 23; 6 T 1768; Exhibit S-5, Schedule

²⁷ This is higher than MichCon's current maximum Commission approved tariff storage rate of \$1.47 per MMBtu.

F-2-5). The ALJ agreed with the Staff (PFD, p 60). MichCon disagrees because the ALJ and Staff neglected to recognize that, as a result of Case Nos. U-14800 and U-15628, MichCon (1) no longer has the physical capacity to offer exchange services to the level provided during the historical test year; (2) no longer has the physical capacity to offer loan services as provided during the historical test year; and (3) does not have incremental storage capacity nor incremental off-system transportation capability to increase its third party revenue streams. Moreover, although MichCon proposed an increase to its maximum cost of service rate for its TOS-F and TOS-I services,²⁸ there is no guarantee that a customer would execute a contract for transportation services at this higher rate (5 T 675-77).

Exception No. 8. The Commission Should Allow MichCon’s Recovery of Incentive Compensation.

MichCon has employee incentive compensation plans (“EICP”) for both employees and executives, and seeks to recover the total compensation costs for both executives and employees. MichCon does not seek recovery of variable compensation costs (approximately \$1.8 million) allocated to MichCon for DTE's five most senior officers (5 T 949, 1162-63).

The ALJ recommended 100% disallowance of expenses associated with MichCon’s EICPs, based on prior Commission disallowances, and reduced O&M by \$9,970,000 as proposed by the Staff (PFD, pp 64-66; Exhibit S-3, Schedule C5).

MichCon recognizes that the Commission has disallowed the recovery of EICP costs, but maintains that incentive compensation costs are properly recoverable. For example, Staff cited Case No. U-15244, where the Commission disallowed Detroit Edison’s proposed recovery, but also stated that it “strongly encourages Detroit Edison to continue refining its incentive compensation program for submission in a future rate proceeding” demonstrating the

²⁸ Staff incorrectly states that MichCon has not proposed to increase these rates (6 T 1768).

Commission's belief in the value of such compensation programs and suggesting that improvements merit cost recovery (December 23, 2008 Opinion and Order in Case No. U-15244, p. 38). More importantly, the legal precedents cited by Staff and in previous Commission orders are at odds with either the facts or the findings articulated in the foundational order related to this matter issued by the Commission October 28, 1993 in consolidated Case Nos. U-10149 and U-10150.

In the case, *In Re Michigan Consolidated Gas Company*, Opinion and Order, consolidated Case Nos. U-10149 and U-10150 (October 28, 1993) the Commission only disallowed fifty percent (50%) of the costs for bonuses paid to MichCon's top executives resulting in a \$523,000 decrease in base O&M expense. See, *supra*, p. 56. The Commission's reasoning for the partial disallowance of top executive pay was that it could not fully evaluate the "reasonableness" of MichCon's top executive bonuses since no evidence was offered to indicate whether MichCon's total top executive compensation package was in line with packages offered by other utilities and corporations. See, *supra*, p. 56. Nevertheless, the Commission recognized that "executive bonuses have often been viewed as an appropriate cost of operating a utility." See, *supra*, p. 56. Accordingly, the Commission approved fifty percent (50%) of the bonuses paid to MichCon's top executives and placed MichCon on notice that "future approval of an incentive bonus plan [for top executives] like this requires a showing that it will not result in excessive costs and that the benefit to the utility's ratepayers will be commensurate with those costs." See, *supra*, p. 56.

Twelve years later, the Commission expanded the application of its Order in Case Nos. U-10149 and U-10150 without explanation to constitute a legal precedent applicable to MichCon's non-executive incentive compensation plan as well as top executive bonuses. See *In*

Re Michigan Consolidated Gas Company, Opinion and Order, Case Nos. U-13898 and U-13899 (April 28, 2005). The Commission in that case disallowed one hundred percent (100%) of the non-executive incentive compensation plan despite recognizing that at least thirty percent (30%) of such a program did in fact reward “behaviors or actions that could fairly be said are directly related to ratepayer or societal interests.” See, *supra*, p. 21.

Shortly thereafter, the Commission disallowed Consumers Energy’s non-executive incentive compensation premised on the misinterpretation of the Commission’s prior ruling in Case Nos. U-10149 and U-10150 stating that such ruling concerned both executive and non-executive incentive compensation plans. See *In Re Consumers Energy Company*, Opinion and Order, Case No. U-14347 (December 22, 2005), p. 34. To the contrary, the Commission’s prior ruling in Case Nos. U-10149 and U-10150 only concerned top executive bonuses and it makes no reference whatsoever to non-executive incentive compensation. Further, not only was the recovery of non-executive incentive compensation not an issue in that proceeding, the Commission approved full recovery. Subsequently, the Commission again misinterpreted the legal precedents for disallowance of incentive compensation when it stated that “the Commission has consistently required utilities to provide some quantification of the benefits of incentive programs to ratepayers and demonstrate that the benefits of the program outweigh the costs.” See *In Re The Detroit Edison Company*, Opinion and Order, Case No. U-15244 (December 23, 2008), p. 38. A review of the foregoing cases indicates that the Commission never previously requested quantification of the benefits of incentive programs to ratepayers. Assuming *arguendo* that the Commission had previously requested such quantification, the Commission nevertheless disallowed one hundred percent (100%) of Edison’s non-executive compensation plan despite

recognizing that fifty to sixty percent (50%-60%) of Edison's non-executive compensation plan was based on performance measures that affect ratepayers. See, *supra*, p. 37.

In short, the Commission's original ruling concerning top executive bonuses in Case Nos. U-10149 and U-10150 has been misinterpreted and misapplied to subsequent inapposite cases that concern non-executive compensation plans.

MichCon recognizes that the Commission previously suggested that benefits should be quantified through a cost/benefit analysis (January 11, 2010 Opinion and Order in Case Nos. U-15768 and U-15751, pp 48-49; December 23, 2008 Opinion and Order in Case No. U-15244, p. 38). The ALJ stated that "no true quantifiable data has been produced to show that the value of benefits received by ratepayers meets or exceeds the cost of the EICP" (PFD, p 65).²⁹ To the contrary, MichCon provided a detailed description of the customer benefits associated with each component of incentive compensation. The record reflects that MichCon has clearly provided a tangible and quantifiable benefit to its customers for the net income related component of incentive compensation. Specifically, without the \$61 million in cost savings measures and the incremental \$58 million in Midstream revenue growth, MichCon customers would have otherwise had a \$100 million incremental increase in their cost of service. The cash flow related component of incentive compensation has resulted in employee focus on proper cash flow management through expense control, timely accounts receivable collection and tightly managed capital expenditures, all of which directly benefit ratepayers by mitigating the costs of utility services. Improved cash flows benefit customers through lower borrowing costs because any potential credit downgrade due to inadequate cash flow results in a 25 basis point increase in the

²⁹ The Commission has never provided an explanation of how a variable-compensation cost benefit analysis should be performed, or what the Commission considers to be customer benefits. If the Commission continues to deny recovery without ever articulating what constitutes "customer benefits," how a dollar value could be specified for any of them, and in light of the Commission's repeated and consistent rejection of utilities' attempts to recover incentive compensation, the Commission has, in effect, set an insurmountable obstacle to recovery (5 T 950).

cost of debt. Although it is more difficult to specifically quantify the impact of improvements in the customer satisfaction measure within the EICP, this goal results in MichCon using direct customer feedback to identify opportunities to address customer concerns resulting in improved levels of service and reliability. Reducing the number of customer complaints to the MPSC, another incentive compensation measure, is another tangible way to measure the improvement in customer service. Additionally, reducing customer complaints also reduces the costs of investigation and resolution, benefiting customers through lower rates. MichCon's incentive compensation measure tied to safety also benefits customers through lower costs associated with workplace injuries, estimated to be \$50,000 per workplace injury for medical costs, reduced work time on the job, and reduced overall productivity. MichCon's incentive compensation measure tied to diversity hiring is difficult to quantify, however, a workforce that is a demographic representation of its service territory provides benefits to its customers in terms of allowing MichCon to better understand its customers and better respond to their needs. (5 T 977-82. *See also*, Exhibit S-3, Schedule C5.2). MichCon demonstrated that, with the exception of the 10% component that is related to DTE EPS, recovery of all incentive compensation is fully justified because even the portion of the variable compensation tied to so-called financial metrics provides significant customer benefits.³⁰ This is the only record evidence on these matters, and it demonstrates that on a cost/benefit basis, MichCon's variable compensation plan provides benefits to customers that far outweigh its costs (5 T 982).³¹ More importantly, in the

³⁰ Customers benefit from incentive compensation measures that relate to increasing revenues and decreasing costs for MichCon. MichCon's financial performance also directly affects its ability to raise capital, as well as the cost of capital, that it needs to invest in its system. Financially-healthy utilities also require less frequent and lower rate relief than financially-distressed utilities. Customers benefit through lower rates. Accordingly, the costs of encouraging managers and employees to provide excellent customer service with an eye on the financial bottom line is fully justified (5 T 977-79).

³¹ The AG proposed to exclude incentive compensation in part because "MichCon cites its CTA/PEP program as part of these benefits but conveniently forgets that MichCon is seeking to charge its customers twice for this

absence of contrary evidence there is no lawful basis upon which the Commission can determine that recovery of incentive compensation is unjust or unreasonable.

The ALJ suggested that MichCon's customers may not receive additional benefits from the EICP because many of the EICP's goals parallel the requirements imposed by the Commission's Service Quality and Reliability Standards (PFD, pp 65-66). This parallel, however, confirms the appropriateness of the EICP's goals. It is also unrealistic to suppose that simply imposing a requirement on MichCon will induce MichCon's employees to embrace the requirement as a goal. Employees have to be fairly compensated for their work. Thus, a goal placed upon the Company that is also a means upon which employees are paid results in a proven marriage between corporate and personal goals.

There is no evidence from Staff or any other party in this case that MichCon's total annual compensation, which includes an incentive component, is unreasonable or imprudent. The focus on the variable portion of total compensation is also inappropriate because MichCon's incentive programs are **not** additional compensation over and above what other companies pay for similar jobs. Instead, MichCon's incentive compensation programs are one of two components that make up MichCon's total annual compensation package which is comparable to other companies competing for these same employees. Without the prospect of total annual compensation equal to the fixed plus the variable compensation components, MichCon will not be able to attract and retain a highly-skilled workforce, or provide incentives for its employees to engage in activities that benefit customers (5 T 949-50, 977, 1155, 1166). Customers benefit every day from employees who have the requisite skills and experience to ensure the delivery of

program such that the costs clearly exceed the benefits." (AG Initial Brief, pp 29). The AG inaccurately presumed that MichCon realized superior earnings due to PEP savings. Instead, MichCon's average return from 2006 through 2008 was only 10.3%, which was less than its 11% authorized return on equity (5 T 998).

quality customer service. Properly compensated employees having an at-risk element of compensation are motivated to focus on safe, reliable, and efficient utility service that benefits every customer (5 T 949, 1156). The only evidence in this case is that MichCon's total annual compensation is just and reasonable, and the Commission should allow full recovery.

It is also important to keep in mind that MichCon's incentive compensation programs allow MichCon to provide a lower level of base pay. If MichCon were to eliminate the variable element of compensation, as the Commission's prior action and Staff's testimony suggest, then MichCon would need to provide a commensurate increase in base pay in order to attract and retain a highly-skilled workforce. This would increase the cost of benefits, like 401(k) match and life insurance, which are tied solely to base salaries. Therefore, the Commission should recognize that variable compensation is a cost-effective component of total compensation, and allow MichCon's full recovery (5 T 1155, 1168-69; Exhibit S-3, Schedule C5.2).

The Company has also demonstrated in this case that the Commission's past policy of disallowing all incentive compensation is out-of-step with regulation in other states. Every other public service commission in the Great Lakes region, for example, allows some level of incentive compensation recovery (5 T 983; Exhibit A-41; Exhibit S-3, Schedule C5.2).³² MichCon recognizes that the Commission recently stated that: "This is not the standard that the Commission looks to in making the determination whether the cost of an EICP is just and reasonable" (January 11, 2010 Opinion and Order in Case Nos. U-15768 and U-15751, p 48).

³² MichCon researched other state public service commissions, predominantly in the Great Lakes region, and found that this Commission stands alone. No other state commission disallowed 100% of incentive compensation. The commissions in Ohio, Pennsylvania, Indiana, Illinois, Minnesota and Wisconsin provide for at least some recovery of incentive compensation costs for both executive and non-executive employees. Other state commissions generally permit full recovery of incentive compensation costs that are linked to non-financial goals or operational-effectiveness goals because those goals directly benefit customers. Some states allow recovery of all incentive compensation (5 T 983; Exhibit A-41; Exhibit S-3, Schedule C5.2).

However, the Commission's lone position among its peers on this issue should be sufficient cause for the Commission to reconsider its complete-disallowance policy.³³

In addition, MichCon's research (performed by three consulting companies) further supports recovery of this portion of compensation because it shows that MichCon's level of variable compensation is reasonable. Specifically, MichCon's research found that 81% of all types of companies, and 86% of utility companies, have annual incentive programs as part of their total annual compensation (5 T 1167; Exhibit A-35; Exhibit S-3, Schedule C5.2).

MichCon's annual incentive compensation is very much in line with, and in fact somewhat lower than, the external market (5 T 1158, 1162, 1167; Exhibit A-36).³⁴ A sample of 10 positions further reflects that MichCon is, on a weighted-average basis, approximately 1.0% under the market level for total annual cash compensation (5 T 1168; Exhibit A-37).

There is no legal basis to disallow all incentive compensation based on the Commission's undefined "customer benefits" policy when it is beyond any dispute or reasonable interpretation that 50% of MichCon's variable compensation is expressly based on customer-focused metrics. More importantly, MichCon has demonstrated that, with the exception of the 10% component that is related to DTE EPS, recovery of all incentive compensation is fully justified because even the portion of the variable compensation tied to so-called financial metrics provides significant customer benefits.

³³ The ALJ's willingness to rely on other state regulatory orders with respect to ROE matters as compelling is completely at odds with his summary rejection of other state's regulatory orders on incentive compensation issues. (PFD, p.45, 65)

³⁴ The most recent analysis for non-executives indicates that their base salaries are, on average, approximately 3% below the midpoints in the comparative market (5 T 1158). The most recent analysis for DTE executives indicates that their total compensation (base, and variable annual and long-term pay) was approximately 6.0% under the median of the comparable market (5 T 1162).

Accordingly, the ALJ inappropriately removed \$9.97 million of incentive compensation expense, and this amount should be added back to his recommended revenue requirement.

Exception No. 9. The Commission Should Not Order MichCon, as part of its next general rate case application, to file a detailed cost/benefit analysis of the CTA/PEP.

The ALJ recommended that, "...in addition to allowing recovery of these [CTA] cost in the context of this rate case proceeding, the Commission require Mich Con (sic) to file (as part of its next general rate case application) a detailed cost/benefit analysis of the CTA/PEP on a going forward basis." This recommendation is based on Staff's reply brief statement that the "increasing costs of the program are starting to mitigate its benefits". MichCon disagrees. MichCon's annual PEP savings in this case are \$47.3 million for 2010 and each year forward (Exhibit A-10, Schedule C-13). In other words the \$47.3 million is a permanent reduction in MichCon's costs. Comparing the \$47.3 million permanent reduction in costs to the CTA amortization of \$2.8 million and the return on the CTA deferral of \$3.0 million (Exhibit A-10, Schedule C-13), both of which will phase out over the next ten years, clearly shows that the PEP savings far exceed the PEP CTA and that the costs of the PEP program are not starting to mitigate its benefits.

Exception No. 10. The Commission Should Continue MichCon's Uncollectible Expense True-Up Mechanism ("UETM") With Its Existing 90/10 Risk-Sharing Structure.

The ALJ appropriately recommends that the Commission should continue MichCon's Uncollectible True-up Mechanism ("UETM") with: (1) a 2010 UETM base level of \$69.9 million (based on a three year average of net write offs) implemented prospectively from the date of Commission final order in this case, and (2) the use of symmetrical carrying charges (using the Company's short-term borrowing rate for both under- and over-recoveries) applied to any UETM balances, and the use of prior year's actual sales and transportation volumes by rate

schedule to calculate the surcharge for each rate (PFD, pp 71, 73). MichCon disagrees, however, with the ALJ's further recommendation of an 80% true up, based on the UETMs that the Commission approved for Consumers Energy in Case No. U-15645 and for Detroit Edison in Case No. U-15768 (PFD, pp 72-73).

The ALJ appears to base his recommendation for an 80/20 sharing mechanism on his belief that MichCon has not increased its efforts to reduce its bad debt expense in the face of increasing uncollectible expenses. This belief is unsupported. The ALJ, citing MCAAA's initial brief, states that MichCon did not significantly increase its spending on revenue protection or revenue collection (PFD, p 73). MichCon did not have to significantly increase its spending because it had already increased its efforts to reduce uncollectibles and improved the efficiency with which it performed this work. MichCon's witness Amy Walt explained in her testimony that staffing in our field collections, responsible for locking customers for non-pay, has increased the number of occurrences in which MichCon actually goes out and locks its customers for non-payment. Furthermore, Ms Walt explained that MichCon has been able to offset some of the increased field collections costs through more efficient collection strategies in its upfront collections, through its phone collections, and through other continuous improvement efforts that have been implemented (5 T 804). Ms Walt described the significant initiatives that MichCon has implemented to improve its collection effectiveness, including: (1) increasing the number of resources available to complete necessary field disconnections caused by customer non-payment, while at the same time, enhancing the efficiency in the field by performing continuous improvement exercises such as automation of routing and combining residential and commercial routes; (2) optimizing collection strategies and resources by utilizing a blend of internal and external support to contact customers at the time the account becomes delinquent and to continue

to work with the customer until the account has been paid or for the duration of the delinquency until account write-off; (3) enhancing customer service by implementing a payment plan program utilizing risk scores that provides non-low income customers with additional options for fulfilling their payment obligations to the company; (4) implemented technological enhancements to its billing systems to optimize its ability to validate the identity of potential new customers in its service territory regardless of the form of positive identification provided; (5) implemented technological enhancements to its billing systems to more effectively collect customer payments at the point of voluntary service cancellation; (6) increasing its assistance to low income customers by becoming more visible and approachable in the communities it serves by deploying low income case management professionals into business offices, promoting partnerships with community agencies and by supporting faith-based initiatives all designed to provide customers with more information about low income assistance and weatherization (specifically as an example, the Detroit Economic Recovery Project); and, (7) work at the State and Federal levels for the adoption and passage of increased low income funding amounts and to promote improved efficiency of the distribution of low income funds (5 T 795 – 798).

In addition, the record demonstrates that there are fundamental business structure differences between electric utilities, such as Consumers Energy’s electric division, and gas utilities like MichCon.³⁵ Regardless of whether or not it is appropriate for Consumers Energy (electric) to absorb 20% of its uncollectible expense, a 20% sharing applied to MichCon would have a much greater financial impact than a 20% sharing for Consumers Energy (electric), and therefore should not be adopted for MichCon. Electric utilities, for example, require a much

³⁵ The record focuses on Consumers Energy’s business structure rather than Detroit Edison’s business structure due to the timing of the Commission’s decisions in Case No. U-15645, which concerned Consumers energy’s electric rates in relation to this case’s schedule, but plainly Detroit Edison is also an electric utility and MichCon is a gas utility.

larger capital investment as integrated energy providers, with a commensurately larger earnings base, than gas utilities that merely distribute energy produced by others. The effective risk borne by MichCon of a 20% absorption of uncollectible expense is much larger than that borne by Consumers Energy's electric business. Specifically, a 20% sharing percentage would produce an impact on MichCon's actual return on equity that is two and a half times greater than the impact on Consumers Energy based on the same change in actual uncollectible expense. Similarly, given the difference in the scope and scale of MichCon relative to Consumers Energy's electric division, an 8% sharing proportion would result in a comparable impact on MichCon's return on equity as a 20% sharing proportion would have on Consumers Energy's electric division. Since there has been no justification offered by the parties for the imposition of a sharing percentage with disproportionate negative financial impact on MichCon, there is no evidentiary basis in this record for the mechanistic imposition of the 20% sharing level simply because the Commission adopted a 20% sharing level for the electric division of Consumers Energy and Detroit Edison. Therefore, it is appropriate to maintain the current 10% sharing percentage as an incentive for MichCon to minimize its uncollectible expense (5 T 984-88, 992; Exhibits A-42 and A-43).

Moreover, due to the level of uncollectibles at MichCon and the continuing economic struggles in the communities it serves, MichCon's continuation of a 10% at risk portion is sufficiently large enough to maintain an incentive to minimize its actual expenses. Contrary to MCAAA's assertions (which the ALJ apparently found persuasive, PFD, pp 72-73), MichCon has demonstrated that even with the current UETM, which includes a 10% at risk amount, the Company has and will continue to increase its efforts in Revenue Management and Protection (5 T 795-798). This is demonstrated by the projected reduction in uncollectible expense from \$125.6 million, for the 12 months ended December 31, 2008, the historical test year (5 T 789,

801), to \$94 million in 2010 (5 T 801), a reduction of \$31.6 million. Further, MichCon's proposed base uncollectible expense level for the UETM was derived by an historical average of write-offs, which have not yet reflected the surge in uncollectible expense that MichCon has experienced over the last year. Last, since MichCon's projected uncollectible expense for 2010 is \$94 million (5 T 801), an incremental 10% increase to the at risk portion results in an unwarranted \$2.4 million penalty³⁶ in light of MichCon's engagement in effectively addressing this issue under the current mechanism³⁷.

Exception No. 11. The Commission Should Approve MichCon's Proposed Revenue Decoupling Mechanism ("RDM").

MichCon proposes a full Revenue Decoupling Mechanism ("RDM") in accordance with section 89(6) of 2008 PA 295, MCL 460.1089(6).³⁸ MichCon's RDM proposal is consistent with its comprehensive Energy Optimization ("EO") program, which MichCon developed in accordance with 2008 PA 295, and is implementing in accordance with the Commission's June 2, 2009 Opinion and Order in Case No. U-15890 (4 T 236, 239). RDMs also align utility

³⁶ The difference between the projected 2010 uncollectible expense of \$94 million (5 T 801) and the base level of \$69.9 million multiplied by 10%.

³⁷ Alternatively, if the Commission is committed to the adoption of a uniform UETM absorption percentage among electric and gas companies, the Commission should adopt the Company's 2010 projected uncollectibles expense of \$94 million in both the revenue requirement and as the UETM base implemented prospectively from the date of the Commission's final order to mitigate the added penalty inherent in the doubling of the percentage of the increase in uncollectible expense absorbed by MichCon.

³⁸ MCL 460.1089(6) states:

"The commission shall authorize a natural gas provider that spends a minimum of 0.5% of total natural gas retail sales revenues, including natural gas commodity costs, in a year on commission-approved energy optimization programs to implement a symmetrical revenue decoupling true-up mechanism that adjusts for sales volumes that are above or below the projected levels that were used to determine the revenue requirement authorized in the natural gas provider's most recent rate case. In determining the symmetrical revenue decoupling true-up mechanism utilized for each provider, the commission shall give deference to the proposed mechanism submitted by the provider. The commission may approve an alternative mechanism if the commission determines that the alternative mechanism is reasonable and prudent. The commission shall authorize the natural gas provider to decouple rates regardless of whether the natural gas provider's energy optimization programs are administered by the provider or an independent energy optimization program administrator under section 91."

objectives with key public policy goals, such as energy conservation, by removing the link between sales and earnings, and thereby eliminating the economic disincentive to encourage energy efficiency (which reduces sales and would otherwise reduce revenues) (5T 1403-04, 1413-14; Exhibit A-19, Schedule L3). Because of these factors, there is a growing recognition throughout the utility industry with endorsement by legislators, conservation advocates and the financial community, of ratemaking approaches that decouple a utility's sales from its revenues (5 T 1418-27; Exhibit A-19, Schedule L4). An RDM is particularly appropriate for MichCon because approximately 73% of its current non-gas revenue is at risk for recovery through its volumetric distribution charges, which is very high compared to other gas distribution utilities (5 T 1407). Mr. Feingold, a revenue decoupling expert, testified that MichCon's proposed RDM is fair, symmetrical, and beneficial to MichCon and its customers (5 T 1428-29). He further explained that MichCon's proposal is conceptually consistent with the RDMs that are currently in effect for other gas distribution utilities, and that it incorporates many of the key design elements that he would expect to see in this type of ratemaking mechanism (5 T 1427-28).³⁹

The ALJ recommends that the Commission adopt the Staff's proposal for a RDM, which includes an implicit customer tracker and uses a straight revenue algorithm with weather normalization (PFD, pp 80-85). Staff's straight revenue algorithm methodology reconciles actual jurisdictional revenue with jurisdictional revenue requirements as established in the Commission's order in this case. Staff's proposal also includes a recommendation that MichCon

³⁹ To implement its RDM proposal, by March 31 each year, MichCon would file an application reconciling actual non-gas sales revenue for the previous calendar year to the corresponding non-gas revenue reflected in MichCon's last general rate case. The Commission would issue an order, after notice and an opportunity for hearing, and MichCon would then implement rate-schedule-specific credits or surcharges that reflect any revenue surplus or shortfall. Any year-end over or under recovery, plus interest at MichCon's applicable short-term borrowing rate, would be the beginning balance for the next year of the program. Exhibit A-17, Schedule J1 is an illustrative example of the required rate adjustment computations under MichCon's proposed RDM (4 T 242-45).

file an RDM reconciliation within 120 days of the end of each 12 month period in which the Commission-approved rates have been in effect, which should include a proposal for allocating any resultant surcharges or credits across customer classes and provide for the continuing implementation of those surcharges or credits until the Commission authorizes new surcharges or credits. (Staff Initial Brief, pp 50-52).

MichCon agrees with the recommendation to include an implicit customer tracker in the RDM mechanism if the customer tracker is limited to addressing customer losses (4 T 241-242). If the implicit customer tracker recommendation includes all changes in customer count, MichCon does not agree with the recommendation. With MichCon's tariff provision C8, new customers are expected to bring sufficient load to the system to cover the cost of construction for the attachment to MichCon's system. If the new load is not sufficient, the new customer is assessed a contribution in aid of construction surcharge. If the new customer revenues were contemplated in the RDM, then MichCon would not have those resources for recovery of capital expenditures associated with the customer attachment nor would MichCon have the resources to address the incremental costs associated with providing services to a new customer (i.e., billing, meter reading, etc.) As a result, MichCon recommends that new customer additions are excluded from the RDM. (4 T 264)

MichCon disagrees with the recommendation to use weather normalized revenues in the RDM, which is contrary to the Commission's recent adoption of a pilot RDM for Consumers Energy using Consumers' "actual (non-weather adjusted) sales" (November 2, 2009 Opinion and Order in Case No. U-15645, p 53) and a pilot RDM for Detroit Edison using "Detroit Edison's actual (non-weather adjusted) sales" (January 11, 2010, Opinion and Order in Case No. U-15768, p. 67). The ALJ acknowledged these rulings, but suggested that sales levels for natural

gas utilities are much more closely linked to weather variability than are electric utility sales levels (PFD, p 84). The ALJ neglected to recognize, however, that in order to achieve the RDM goal of removing the link between energy sales and utility revenues, the RDM must address both the loss of customers and the variability of weather (4 T 256-58). The ALJ also suggested that there might be some benefit in testing several different RDMs during the RDM pilot phase (PFD, p 85). To the extent the Commission is concerned about providing a sound testing ground for the pilot mechanisms, however, it should recognize that application of a full revenue decoupling concept (i.e., to include the impact of conservation and the Energy Optimization program, weather and customer losses) for MichCon will provide ample opportunity for review of the actual performance of this ratemaking mechanism for a natural gas utility as compared with the mechanisms approved for Detroit Edison and Consumers Energy, and an appropriate assessment under varying utility operational and financial conditions.

In the very long run, while MichCon agrees with Staff that with appropriate weather normalization, there should be no statistically-significant revenue impact, this does not mean that actual sales revenues should be weather normalized each year as part of the RDM's computational process. Specifically, Mr. Stiers and Mr. Feingold explained that the purpose of an RDM is to address near-term conditions that affect a utility's ability to fully recover its revenue requirement between rate cases rather than acknowledging a long-term phenomenon. Weather has significant short and medium term impacts, and therefore it should be included in an RDM. In contrast, adopting an RDM with weather normalization of sales revenues would simply perpetuate the volatility of MichCon's revenues and continue to impair MichCon's ability to recover its costs, mitigating the primary purpose of an RDM. Weather normalization could also result in MichCon's customers overpaying in colder than normal weather, instead of those

customers receiving refunds which would occur under MichCon's proposal. The ALJ's weather-normalized RDM recommendation is also contrary to ratemaking in the natural gas distribution utility industry, where 32 states have approved ratemaking mechanisms that accommodate weather variability in setting delivery service rates (4 T 257-59; 5 T 1435-37; Exhibits A-31 and A-32). Furthermore, Exhibit A-32 presents a listing of revenue decoupling mechanisms that have been approved for gas utilities in the U.S. This Exhibit indicates that the vast majority of gas utilities have received approval to implement full revenue decoupling mechanisms. Accordingly, the Commission should reject the ALJ's weather-normalized RDM recommendation, and instead adopt an RDM for MichCon that includes the impact of weather, as the Commission did for Consumers Energy and Detroit Edison.

MichCon agrees with the proposal to file its RDM reconciliation within 120 days of the end of each 12 month period in which the Commission-approved rates have been in effect. MichCon agrees that the reconciliation should use a straight revenue algorithm that reconciles actual jurisdictional revenue with jurisdictional revenue requirements as established in the Commission's order in this case, if this method involves comparing the authorized non-gas sales and EUT revenue as adopted by the Commission in designing the rates approved in this case with MichCon's actual non gas sales and EUT revenue for the 12 month reconciliation period, less revenue from new customer additions associated with MichCon's tariff provision C8 added during that same 12 month reconciliation period to determine any short-fall to be recovered through an RDM surcharge or surplus to be refunded through an RDM credit. (4 T 243; Exhibit A-17, Schedule J1). MichCon does not agree with any other calculation to determine any revenue short-fall or surplus. As Staff's RDM does not include a specific proposal for allocating any resultant surcharges or credits across customer classes, MichCon proposes that the short-fall

or surplus resulting from the straight revenue algorithm would be allocated to each of the rate schedules by the percentage of each rate schedules' authorized non-gas revenue compared to the total authorized non-gas revenue. The resulting allocated revenue shortfall or excess would then be divided by the actual annual sales and EUT volumes for the 12 month period being reconciled to calculate the proposed surcharge/credit per Mcf. (4 T 243; Exhibit A-17, Schedule J1) MichCon agrees with Staff's proposal that the surcharges or credit would continue until such time that the Commission authorizes the implementation of new surcharges or credits for the next RDM reconciliation period. MichCon does not agree, however, if this reconciliation method does not allow for the determination of any over- or under- collection of the RDM amount at the end of the recovery or credit period, and does not allow for that over- or under-collection to be prospectively rolled into the surcharge or credit determination for the next period RDM adjustment (4 T 243; Exhibit A-17, Schedule J1).

Exception No. 12. The Commission Should Adopt MichCon's Proposals For Company Use ("CU") and Lost And Unaccounted For ("LAUF") Gas Volumes, and Gas-In-Kind ("GIK") Percentages.

MichCon's proposed 2010 Company Use ("CU")⁴⁰ gas is 2,538 MMcf, including 462 MMcf of known and measurable changes (Exhibit A-12, Schedule E13). Staff supported just 1,987 MMcf, suggesting that MichCon has no actual need for more CU gas (6 T 1762). The ALJ agreed with the Staff (PFD, p 88). MichCon disagrees. The ALJ's adoption of a CU level that is approximately halfway between the high and low CU volumes over the past 10 years does not appear to consider the wide range of CU volumes (from 1,629 MMcf to 2,405 MMcf, which is a 48% swing), and apparently disregards the effects of weather and storage levels during the injection and withdrawal cycles (5 T 1378). The ALJ's understated CU volume should also be

⁴⁰ CU volumes are predominantly related to fuel used to operate and maintain MichCon's transmission and storage facilities (5 T 622, 1355).

rejected because it ignores a known and measurable change in the gas that MichCon needs as fuel for operation of its new equipment, and is thus entitled to recover. The undisputed record in this case demonstrates that MichCon needs compressor fuel (the primary CU component) to operate the new compression equipment that was added to the Belle River storage facility in 2008 and at Willow Gate Station in 2009, as well as fuel to operate the Belle River storage facility's refrigeration unit and the Sumpter Pipeline, which went into service in 2009 (5 T 1377-82).⁴¹

Using MichCon's proposed five-year average of booked Lost And Unaccounted For ("LAUF")⁴² gas, the LAUF volume is 6,447 MMcf. Staff suggested 6,836 MMcf (6 T 1764). The ALJ agreed with the Staff (PFD, p 88). MichCon disagrees because Staff Exhibit S-5 contains five errors, which when corrected result in a recalculated five-year average of 6,447 MMcf. When these corrections are made to Staff's LAUF amount, MichCon and Staff support the same lost gas methodology, and 2010 volume level (5 T 653-54, 660-61, 664-65).

Staff supported ABATE witness Mr. Selecky's corrected GIK percentages of 1.66% for sales and transportation customers, and 1.63% for off system transportation customers. The ALJ agreed (PFD, p 89). MichCon disagrees. Staff overstated sendout by using a 12-month-ended August 2008 sendout in deriving its 2010 GIK factor. Exhibit A-47, page 1, recalculates the Staff's proposed GIK percentages from Exhibit S-5, Schedule F-2-3, incorporating appropriate mechanical numerical corrections as well as three specific modifications to the Staff's method. These changes result in a recalculated GIK of 1.76%, even with the use of Staff's understated

⁴¹ See also, December 23, 2008 Opinion and Order in Case No. U-15244, p. 47, where the Commission agreed with Detroit Edison to include O&M costs for new equipment, and explained "that the Staff's position, in supporting additional capital expenditures for pollution control equipment while failing to recognize increased O&M, is inconsistent."

⁴² LAUF represents the difference between booked sources of gas and booked disposition of gas (5 T 620).

1,987 MMcf of CU volume and overstated throughput. While the Company continues to oppose the Staff's overall methodology in determining the GIK, it is nevertheless worthwhile that the Commission adopt the modifications reflected on Exhibit A-47 that are necessary regardless of whether the Commission adopts the use of either projected volumes or the bifurcated GIK percentages. Specifically, the GIK percentages recommended by the ALJ should be adjusted to reflect 1) the elimination of Company use and lost and unaccounted for gas from the sendout calculation, 2) the inclusion of storage injections in the calculation, and 3) the exclusion of exchange transaction volumes included in Off-System Transportation from the calculation. First, the elimination of the CU and LAUF volumes from the denominator used to calculate the GIK percentage is based on the simple fact that MichCon's CU and LAUF are volumes not subject to the GIK. Rather these volumes are a cost to be recovered through the GIK. Computing the GIK based on volumes that will never be billed, results in MichCon not having an opportunity to recover the cost of CU and LAUF. Second, volumes pertaining to storage injection should be included since such volumes represent physical gas flows and therefore are subject to the GIK. Third, exchange transactions with 3rd parties should be excluded from the derivation of the GIK since such volumes are the result of contemporaneous non-physical exchanges of volumes that are not subject to the GIK because no incremental gas flows result from such transactions. All of these adjustments have the effect of creating symmetry between the method by which the GIK is developed and collected. In contrast the ALJ's GIK percentages result in an inherent conflict between the development and the collection of GIK related costs and thus the PFD recommendations if adopted by the Commission will create an inappropriate systematic undercollection of such costs. Exhibit A-48 reflects corresponding dollar adjustments. (5 T 655-59, 662-66, 670-71). More accurately, however, when these corrections

are combined with the decreased throughput and increased CU projected to occur in the 2010 projected test year rather than historical and overstated actual volumes from 2008 and are appropriately factored into the GIK percentage, MichCon's overall GIK factor increases to 1.95% (Exhibit A-47, p. 3 of 3). Furthermore, if the transfer of SBPL into MichCon's system is approved by the Commission, off-system transportation volumes will be reduced 12.9 Bcf (5 T 589). This reduction in off-system transportation volume increases MichCon's overall GIK factor to 2.01% (Attachment D; See footnote 53).

MichCon proposes to bifurcate the GIK percentage and create two GIK charges based on the use of cost-causation principles to allocate LAUF to the customer classes creating the expenses.⁴³ LAUF occurs on both MichCon's transmission and distribution systems. All of MichCon's retail and off-system customers use and benefit from MichCon's transmission and storage systems, and should share in the cost recovery for the associated LAUF. Distribution LAUF represents activity by retail sales and transportation customers utilizing MichCon's distribution facilities, so those customers should bear the related costs. Under MichCon's two step bifurcated GIK, the GIK recovery for transmission-only users would be 1.41% (Exhibit A-47, page 3 of 3). The GIK recovery for full system users would be 2.44%. EUT customers would reimburse MichCon in the form of GIK at 2.44%. Distribution sales customers would have the cost recovered in their non-gas distribution charge at a rate of \$0.185 per Mcf, which is the proposed 2.44% GIK percentage multiplied by the \$7.59 projected cost of gas for 2010 (5 T 661-62; Exhibit A-47). The 12.9 Bcf reduction in off-system transportation volumes resulting from the transfer of SBPL into MichCon (5 T 589) increases MichCon's two step bifurcated GIK for transmission-only users to 1.45% (Attachment D). The GIK recovery for full system users

⁴³ MichCon is agreeable to implementing the bifurcated GIK % factor methodology in two steps, as alternatively reflected on Exhibits A-47 and A-48 (5 T 661-64, 671).

would be 2.49%. EUT customers would reimburse MichCon in the form of GIK at 2.49%. Distribution sales customers would have the cost recovered in their non-gas distribution charge at a rate of \$0.189 per Mcf, which is the proposed 2.44% GIK percentage multiplied by the \$7.59 projected cost of gas for 2010 (Attachment D).

Exception No. 13. The Commission Should Adopt MichCon’s Proposal for a Lost Gas True-Up Mechanism (“LGTM”).

MichCon proposes a Lost Gas True-Up Mechanism (“LGTM”) as an appropriate tracking mechanism for costs that are subject to wide variation and essentially beyond MichCon’s control. The Commission has repeatedly, and appropriately, adopted responsive mechanisms in analogous circumstances.⁴⁴ The LGTM would protect MichCon from significant cost increases, and protect MichCon’s customers from significant cost decreases (4 T 235-36; 5 T 625, 634, 962-65).⁴⁵

The ALJ recommended that the Commission reject MichCon’s proposed LGTM, inaccurately reasoning that an insufficient basis has been provided for allowing MichCon to implement its proposed LGTM, based primarily on two factors (PFD, pp 91-92). First, the ALJ agreed with the Staff’s proposition that 2008 PA 286 greatly reduces MichCon’s risk of under-recovery due to regulatory lag (PFD, p 91; 6 T 1769-70). MichCon disagrees. MichCon’s proposals to maintain the UETM, and implement an RDM and LGTM, are designed to provide

⁴⁴ See, April 28, 2005 Opinion and Order Granting Rate Relief in Case Nos. U-13898 and U-13899, pp 70-74, adopting MichCon’s current UETM; November 23, 2004 Opinion and Order in Case No. U-13808, p 50, adopting a Pension Equalization Mechanism (“PEM”) for Edison; Case No. U-14838 settlement agreement, adopting a Choice Incentive Mechanism (“CIM”) for Edison; December 23, 2008 Opinion and Order in Case No. U-15244, pp 54-55, adopting a restoration expense true-up mechanism for Edison; and June 10, 2008 Opinion and Order in Case No. U-15245, adopting a CIM for Consumers Energy.

⁴⁵ Under the proposed LGTM, by November 30 of each calendar year, MichCon would submit an application, as a continuation of this case, comparing its actual LAUF and CU gas for the year ended August 31 to the base level set in this case. There would be an opportunity for a hearing, and presumably narrow and prompt proceedings resulting in the difference between the base and actual amounts being collected from, or refunded to, MichCon’s customers through a temporary surcharge or credit. Any year-end over or under recovery, plus interest at MichCon’s short-term borrowing rate, would be the beginning balance for the next year of the program (5 T 634-36, 965).

the Company with timely recognition of the most volatile components of its revenue requirement, and mitigate future rate increases that may otherwise be needed (5 T 994-96). The LGTM will also provide a timely mechanism to flow savings to customers. Moreover, due to the extreme volatility of gas costs and the inherent lag in the recognition of increased lost gas volumes (since they are based on a five-year historical average), annual rate cases would be unable to set rates reflective of MichCon's actual LAUF and CU gas costs (5 T 994-95).

Second, the ALJ agreed with the MCAAA's assertion that MichCon should be incentivized to reduce gas theft or, alternatively, MichCon should be required to institute more aggressive programs to reduce gas theft (PFD, pp 91-92; 6 T 1538-39). This position, without any sound basis, essentially proposes to penalize MichCon when MichCon has already embarked on aggressive efforts to reduce gas theft (5 T 996), and has incorporated incremental funds in this application to increase those efforts.

The ALJ generally indicated that he agreed with all of the arguments presented in opposition to MichCon's proposed LGTM (PFD, p 91), but he only discussed the two above. Therefore, for completeness, MichCon will proceed to address the additional arguments.

Staff took issue with MichCon's examples of the causes for the shortfall in MichCon's recovery of LAUF and CU cost, such as increases in gas commodity prices, increases in theft losses, and declining markets (5 T 627). With regard to increases in commodity prices, Staff stated that the projected cost of natural gas in this case is \$7.59 per Mcf, while the cost of gas in the Company's last rate case, Case No. U- 13898 was \$7.529 per Mcf, a difference of \$0.061 per Mcf (6 TR 1769-1771). Staff was incorrect. MichCon's cost of gas in its last rate case, Case No. U-13898 was \$6.83 per Mcf (4 T 225, 227, 235), not \$7.529 per Mcf. In addition, it is not just the increase in the gas commodity prices, but the volatility of gas costs (4 T 298-299) that

supports the need for the LGTM. With regard to theft losses and declining markets, Staff stated that the utility has not had dramatically increased volumes in lost gas and neither has the Company had declining markets; actually total sendout has fluctuated over the past five years, while lost volumes and company use volumes have been staying approximately the same. (Staff Initial Brief, p. 56; 6 T 1770). MichCon disagrees. MichCon's lost gas volumes have increased from the 12 months ended August 2004 level of 5.0 Bcf to the 12 months ended August 2008 level of 7.5 Bcf, a 50% increase. This is a significant increase over this time period. MichCon's lost gas volumes over the last five years are more volatile than consistent, and appear to be trending upward (5 T 664). In addition, MichCon's CU volumes have not been consistent; volumes over the past 10 years have varied by as much as 48% (5 T 1382). With regard to sendout, Staff's analysis of MichCon's sendout is also flawed. First, the periods from September 1998 through August 2003 omit the inclusion of off-system transportation volumes. Second, not all off-system transportation is a physical transaction necessitating a GIK recovery. Today, these transactions happen regularly as part of MichCon's Mid-stream services. Third, sendout for GIK calculation purposes should include third Party injections to storage which have not been included on Exhibit S-5. Fourth, using the Staff's unadjusted sendout numbers for the 12 month period ended August 2008 of 532,246 MMcf (Exhibit S-5, Schedule F-2-3, Page 4) produces a lower sendout than the 12 month period ended August 1999 which is 598,049 MMcf when using the same components in both calculations. Staff's position also omitted the off-system and Exelon transportation volumes from its August 1999 calculation. (5 T 665-66)

The AG opposed MichCon's proposed LGTM "because he believes that the Commission lacks the statutory authority to adopt such a tracking mechanism" (AG Initial Brief, p 13). This is the same flawed argument that the AG asserted against the UETM, and which the ALJ

appropriately rejected for lack of merit (PFD, p 70). The Michigan Court of Appeals rejected the AG's challenge to MichCon's UETM in Case No. U-13898. *Attorney General v Public Service Comm*, 281 Mich App 545; 761 NW2d 482 (2008), and the Michigan Supreme Court denied his application for leave to appeal. 483 Mich 1017 (2009). The Court of Appeals' decision is binding precedent, and the AG has dismissed his additional UETM appeals (Court of Appeals Docket Nos. 282890 and 291324). The Court of Appeals has also repeatedly rejected the Attorney General's "lack of authority" arguments in analogous cases involving the establishment and implementation of continuing rate adjustment mechanisms.⁴⁶

The AG also opposed the proposed LGTM on policy grounds (AG Initial Brief, pp 13-15; 6 T 1613-16). ABATE agreed (ABATE Initial Brief, pp10-11). Ms. Minor explained that the AG's reasoning supporting his opposition to the LGTM lacks merit because it is inaccurate and unsupported (5 T 666-70, 672). The AG claimed that the Company's cost of lost and unaccounted for gas and Company use has not been historically volatile. The AG's claim is incorrect. The actual cost of lost and unaccounted for gas and Company Use has increased at a compound annual growth rate of 21% between 1999 and 2008 (\$15.5 million v. \$87.5 million per Exhibit A-12, Schedule E16) and the increase between 2007 and 2008 alone was 31% (\$66.8 million v. \$87.5 million per Exhibit A-12, Schedule E16). There can be little doubt that the cost of lost and unaccounted for gas and Company Use is subject to sudden and unpredictable change.

⁴⁶ See, for example, *Attorney General v Public Service Comm #1*, 133 Mich App 719; 349 NW2d 539 (1984) (affirming Commission orders implementing the Other Operations and Maintenance Expense Indexing System, under which the Commission held a full and complete hearing in an initial rate case and established the system for Edison, and provided for additional, single-factor hearings to apply the established formula); *Attorney General v Public Service Comm*, 122 Mich App 777, 786; 333 NW2d 131 (1983) (affirming Commission orders establishing purchased power adjustment clause, and approving monthly increase in Consumers Power Company's rates pursuant to the clause); *Attorney General v Public Service Comm #2*, 133 Mich App 790, 797; 350 NW2d 320 (1984) (affirming orders allowing Edison rate increases pursuant to the System Availability Incentive Provision that the Commission established in Case No. U-5108); *Attorney General v Public Service Comm*, 136 Mich App 515, 518-20; 358 NW2d 351 (1984) (following cited cases and rejecting AG's duplicative arguments); *Attorney General v Public Service Comm*, 157 Mich App 198; 403 NW2d 467 (1986).

(5 T 666-7). The AG asserts that higher gas prices have not created the volatility in the cost of LAUF and CU volumes. Again, this assertion is inaccurate. The Company's cost of gas has increased at a compound annual growth rate of 14% between 1999 and 2008. While the Company's program of locking in a portion of its supply has moderated the degree of price volatility, the spike in prevailing gas prices in early 2008 and the collapse of prices in late 2008 demonstrate that gas prices are susceptible to unpredictable and sudden changes. (5 T 667) The AG claimed that the under recovery of the cost of LAUF and CU volumes were the result of the Company's decision not to file rate cases to recover such costs. Contrary to this claim, Exhibit A-12, Schedule E16 shows that MichCon's actual under recovery of the cost of lost and unaccounted for gas and Company use volumes amounted to \$159 million between 1999 and 2008, which demonstrates both the year-to-year variability of these costs and the inherent inefficiency of the traditional regulatory treatment of these costs. The extent to which the Company could have increased its rates to recognize updated volumes and prices in no way undermines the basic fact that historical volumes are a poor proxy for the recognition of the impact of actual volumes. Indeed, even if MichCon had implemented new rates in 2008 based on a five year average of actual historical lost and unaccounted for gas for the prior five years, actual 2008 Company Use and the actual 2008 cost of gas, the Company would still have realized a \$20 million under recovery of its cost of lost and unaccounted for gas and Company use volumes. The under-recovery of MichCon's lost and unaccounted for gas and Company Use costs on a comparable basis would have been over \$35 million. (5 T 667-8)

The AG maintains that the Company's increased efforts for the prevention and early detection of gas theft reduces the need of the LGTM. While the Company's efforts to reduce the theft of gas service will no doubt lead to reducing the volumes of gas lost, it is impossible to

predict the extent and timing of the benefits of these efforts. Moreover, there exists a substantial possibility that these additional actions will only reduce the rate of growth in lost gas volumes in the early years of implementation. Further, even with reductions in lost gas volumes due to theft prevention, the Company will still be exposed to the unpredictable variability of gas prices (5 T 668). The AG's arguments imply that adoption of the LGTM would reduce the Company's resolve to minimize gas theft. The AG provides no basis for this assertion. Moreover, the AG's claim is inconsistent with management practices at MichCon, DTE and its utility subsidiaries, including MichCon, who are all committed to providing affordable utility service to its customers. This is reflected in DTE's Performance Excellence Process and Continuous Improvement initiatives that were both designed to allow for the reductions in costs while improving customer service (5 T 669).

The AG opined that adoption of the LGTM would decrease the Company's incentive to reduce costs. Apparently the AG believes that it is improper to allow for efficient cost recognition processes that are not available to so-called "real" competitive businesses. There is no basis to assume that timely reflection of the Company's actual costs in its rates will reduce the Company's incentive to effectively manage those costs. Unlike so-called "real" competitive businesses, MichCon may not unilaterally raise prices, unilaterally eliminate non-profitable services, or earn returns unencumbered by regulatory approvals. Because MichCon's potential for supra-competitive returns is eliminated under this Commission's rate of return regulation, it is only reasonable to provide MichCon a meaningful opportunity to recover its actual costs through mechanisms such as the LGTM. Last, while recent experience has reflected significant cost under recoveries by MichCon of its cost of lost and unaccounted for gas and Company use, operation of the LGTM would also allow customers to receive a timely pass through of any

unanticipated savings in these costs, either due to reductions in volumes or declines in gas prices. (5 T 669-70).

Finally, ABATE suggests that if the Commission implements an RDM, then the need for other tracking mechanisms such as the UETM and the proposed LGTM is greatly diminished (ABATE Initial Brief, pp 9-10; 6 T 1568). MCAAA similarly expressed general opposition to tracking mechanisms, other than an RDM (MCAAA Initial Brief, pp 13-17). Contrary to this hyperbole and speculation, MichCon's proposed RDM will ameliorate MichCon's revenue variability due to changes in sales levels, but it will not address changes in MichCon's costs (5 T 995). There is similarly no merit in MCAAA's assertion that there is a risk of double counting the effects of gas theft with an RDM and LGTM (MCAAA Initial Brief, p 20; 6 T 1538). Instead, both an RDM and LGTM are needed to fully compensate MichCon for the total effects of gas theft (5 T 997).

Exception No. 14. The Commission Should Not Order MichCon to File a Report Regarding a UWUA Power for America Taft-Hartley Training Trust.

Utility Workers Local 223 ("UWL 223" or "Local 223") generally supported MichCon's rate increase request, and requested that the Commission provide a rate increase that is also sufficient to set aside funds for a training expense trust ("UWUA Power for America Taft-Hartley Training Trust") to address MichCon's aging workforce and the anticipated shortage of necessary workers. UWL 223 further requested that the Commission order MichCon to file a report on training needs similar to the reports that the Commission ordered Consumers Energy Company ("Consumers Energy") and Detroit Edison to file in Case Nos. U-15645 (November 2, 2009 Opinion and Order, p 61) and U-15768 (January 11, 2010 Opinion and Order, p 63), and require MichCon to explain its plans for recruiting and hiring.

The ALJ recommended that “consistent with its recent orders concerning Consumers and Detroit Edison, the Commission direct MichCon to file in this docket, within 90 days of the date of its final order, a report evaluating its present and expected future safety and training needs, the amount of its budget presently devoted to that issue, its estimated future costs, and the potential costs and benefits to the utility and the public of a ratepayer-funded training trust” (PFD, p. 100). MichCon disagrees with this recommendation, but agrees with the ALJ’s further recommendation that the Commission reject Local 223’s other forms of requested relief (PFD, p101).

MichCon recognizes the need for worker training and is committed to providing appropriate funding to maintain a highly-skilled workforce that provides safe and reliable service to its customers. MichCon disagrees, however, that the UWL 223’s proposed training trust is either necessary or appropriate. The ALJ’s recommended report is similarly unnecessary and inappropriate, and would ultimately be moot.⁴⁷

It is undisputed on this record that MichCon has budgeted and is seeking an appropriate amount of money for safety and training. UWL 223 presented no evidence to disagree with MichCon’s requested level of funding, and characterized that level of funding as “reasonable” (UWL 223 Initial Brief, p 9).⁴⁸ UWL 223 suggested that it has some concern about MichCon’s exercise of discretion with respect to training funds, but never cited any instance where MichCon has allegedly misspent any funds, or any other tangible reason to now establish a trust.

⁴⁷ An issue is moot when it is impossible for the decision maker, if it should decide in favor of the complainant, to grant any relief. *Swinehart v Secretary of State*, 27 Mich App 318, 320; 183 NW2d 397 (1970); *Plumbers and Pipefitters Local Union No 190 v Wolff*, 141 Mich App 815, 818; 369 NW2d 237 (1985) (declining to address moot issues).

⁴⁸ UWL 223 states, “Based on this projection [safety and training expenditures of \$28,725,843], this amount is a reasonable set aside for placement into the UWUA Power for America Taft-Hartley Training trust for the training of MichCon’s gas workers.” (UWL 223 Initial Brief, p. 9). This amount is for both safety and training and therefore it would not be appropriate to set aside for placement in the trust for training only.

Therefore, there is no factual basis in this record upon which the Commission should take any action on this matter.

There is also no sound legal basis for the ALJ's recommended report. UWL 223 suggested various sources of implied authority, but never cited any specific grant of such authority to the Commission.⁴⁹ UWL 223's suggested authority regarding worker safety and system reliability are also misplaced in light of the lack of any dispute about the level of funding or how MichCon has spent the funds (as discussed above). There is no credible issue regarding safety or reliability involved in UWL 223's attempt to mandate MichCon's participation in a training expense trust. UWL 223 essentially wants the Commission to dictate a management decision for MichCon, which the Commission lacks authority to do. See, *Union Carbide v Public Service Comm*, 431 Mich 135, 148; 428 NW2d 322 (1988); *Detroit Edison Co v Public Service Comm*, 221 Mich App 370, 386-88; 562 NW2d 224 (1997).

UWL 223's position also essentially constitutes an attempt to engage in, or complain about, matters of a collective bargaining nature, which is improper before this Commission. The Commission has no authority to become involved in, let alone dictate results for, collective bargaining between MichCon and UWL 223. To the extent that UWL 223 has any cognizable complaint about an existing labor contract (which it does not), jurisdiction would be in a United States District Court under section 301(a) of the Labor Management Relations Act, 29 USC 185(a).

⁴⁹ For example, UWL 223's reliance on MCL 460.6 (UWL 223 Initial Brief, p 10, n 8; p 11) is misplaced because that statute is merely an outline of the Commission's jurisdiction, and not a grant of specific authority to the Commission. See, e.g., *Union Carbide v Public Service Comm*, 431 Mich 135, 147; 428 NW2d 322 (1988). It is also well established that the Commission has no common law powers, and the legal maxim *expressio unius est exclusio alterius* is the appropriate guide in construing its enabling statutes. *Taylor v Michigan Public Utilities Comm*, 217 Mich 400, 402-03; 186 NW 485 (1922). The Commission has only the limited authority that the Legislature has granted to it through clear and unmistakable statutory language. *Mason Co Civil Research Council v Mason Co*, 343 Mich 313, 326-27; 72 NW2d 292 (1955); *Consumers Power Co v Public Service Comm*, 460 Mich 148; 596 NW2d 126 (1999). A doubtful power does not exist. *Mason Co Civic Research Council v Mason Co*, 343 Mich 313, 326-27; 72 NW2d 292 (1955).

UWL 223 vaguely acknowledged the Labor Management Relations Act, and suggests that 29 USC 186's requirement for a written agreement can be overcome because "the Union's agreement is obviously a foregone conclusion" (UWL 223 Initial Brief, p 7, n 6). But MichCon's agreement is also needed, and MichCon does not agree. MichCon further notes that Consumers Energy's February 1, 2010 Report on Utility Worker Training in Case No. U-15645, p 3, states:

"A plain reading of the statute clearly makes the creation of such a training trust to be a matter for collective bargaining between the employer and the labor representative; i.e., such a trust could only be considered lawful if established pursuant to a 'written agreement.' Neither the employer nor the labor representative may force the other party into accepting the terms of such a trust arrangement. Further, any attempt by a third party to force the parties into such an agreement would place the employer and labor representative in precarious legal positions, potentially subjecting both parties to fines and imprisonment."

In the event that the Commission orders a report (which MichCon denies would be appropriate), that report should be limited to the same type of report that the Commission ordered for Consumers Energy in Case No. U-15645, and for Detroit Edison in Case No. U-15768. Those reports are limited to training. There is no reason to place any additional burden on MichCon. The ALJ recognized that the Commission rejected UWL 223's proposal to expand the report into recruitment and hiring in Detroit Edison's case; however, he recommended a MichCon report that includes safety matters (PFD, p 100), which are irrelevant in this context, and beyond the scope of the issues to be reported in Case Nos. U-15645 and U-15768.

In summary, there are important, unanswered questions regarding the Commission's authority with respect to UWL 223's proposal that the Commission order MichCon to participate in a training expense fund; UWL 223's suggested bases of Commission authority are inconsistent with the substance of UWL 223's proposal; and there is no sound basis in the record for that proposal. Accordingly, the ALJ appropriately recommends that the Commission reject

that proposal. The ALJ's recommended report is similarly unfounded, unnecessary and inappropriate, and it would ultimately be moot on relevance and jurisdictional grounds. Therefore, the Commission should not order MichCon to file any such report.

Exception No. 15. The ALJ's Recommended Revenue Deficiency Should be Modified.

The ALJ found MichCon's 2010 revenue deficiency to be approximately \$142.9 million (PFD, p 102). MichCon requests approximately \$175.4 million in rate relief. Attachment A summarizes MichCon's computation of its revenue deficiency, starting with the ALJ's PFD position⁵⁰ as discussed throughout these Exceptions. Attachment B to these Exceptions shows those adjustments to the ALJ's revenue deficiency that are necessary to properly reflect the costs that the Company will incur in 2010 and provide revenues sufficient to allow MichCon an opportunity to earn a reasonable return on its investment. MichCon requests that the Commission approve \$175.4 million in rate relief as shown in Attachment B.⁵¹ Based on the issues discussed in these exceptions to the PFD, the following summarizes the additions that must be made to ALJ's proposal to capture all known and measurable changes:

- (1) Increase MichCon's allowed return on equity to 11.25% (\$12.0 million);
- (2) Include the Cost of Interest Rate Hedges in Long Term Debt (\$0.2 million)

⁵⁰ Attachment A starts with the ALJ's PFD position and corrects for two errors, i.e., normalizing income taxes on the reduction in AFUDC and the exclusion of the implicit interest savings on State & Local Taxes, net of FIT. When taken together these two corrections only increase the ALJ's revenue deficiency by approximately \$30,000.

⁵¹ Attachments A, B and C start with the ALJ's positions in his PFD, as corrected, with respect to Net Operating Income and Revenue Deficiency and reconcile the specific areas of disagreement between the ALJ and MichCon. Attachment A is the computation of the revenue deficiency, including net operating income, rate base and rate of return; Attachment B is the specific components of the Company's revenue requirement adjustments to the PFD; Attachment C calculates the impact on MichCon's revenue requirement of rolling Saginaw Bay pipeline into MichCon; and Attachment D calculates the impact on Other Operating Revenue and the GIK percentage of the reduced transportation volumes that result from rolling into MichCon the Saginaw Bay Pipeline. Attachment E calculates the difference between MichCon's revised revenue deficiency as supported in its reply brief, of \$192.6 million (Attachment E to the Reply Brief) and MichCon's revenue deficiency of \$175.4 million supported in these Exceptions. Attachment F calculates the correction for the two errors, i.e., normalizing income taxes on the reduction in AFUDC and the exclusion of the implicit interest savings on State & Local Taxes, net of FIT that the ALJ made in calculating his recommended revenue deficiency. Attachment G calculates the reduction in the revenue deficiency from applying the depreciation rates approved in Case No. U-15699 to this case.

- (3) Adjust Capital Structure for Equity Infusion to create an equity ratio of 51.7% (\$2.6 million);
 - (4) Increase Rate Base for the reduction to accumulated depreciation resulting from the lower depreciation rates approved in U-15699 and decrease Rate Base for the change in Standard Retirement Units (\$0.5 million);
 - (5) Reduce revenues from late payment fees (\$1.8 million) and gas sales of (\$0.2 million);
 - (6) Reduce revenues from MichCon's Mid-stream services (\$15.3 million) and Gas-in-Kind (\$5.0 million)
 - (7) Include in O&M the costs of incentive compensation (\$10.0 million);
 - (8) Increase O&M for the change in Standard Retirement Units resulting from the Order in U-15699 (\$1.5 million)
 - (9) Reflect higher company use and lost and unaccounted for gas costs (\$1.2 million);
 - (10) Reflect the effect of the lower Depreciation Rates Ordered in U-15699 (\$22.2 million);
- and,
- (11) Include the net plant, revenue and expenses of the roll-in of the Saginaw Bay Pipeline into MichCon (\$4.4 million)⁵².

Exception No. 16. The ALJ's Recommended Allocation of the Residential Income Assistance ("RIA") Credit Should Be Modified.

The ALJ agreed with the Staff's proposal to allocate the \$13 million revenue from its proposed RIA credit to all rate classes based on test year throughput (PFD, p 106; Staff Initial Brief, p 37; 6 T 1851). MichCon disagrees because the proposal is unjustified. The RIA credit

⁵² This assumes that the prerequisite approval of the Commission to make this asset transfer has occurred.

should instead be allocated within the residential rate class by increasing the distribution charge by \$13 million (5 T 1312-15; Exhibits A-23, A-24, A-25). The RIA credit should be allocated only to Residential customers because the costs being allocated are classified as residential in the COSS. This would be consistent with the treatment of the Rate AS discounts which the RIA credit is replacing (5 T 1314-15).

If the Commission finds that the RIA credit should be allocated to all customer classes, however, then MichCon agrees with the ALJ (PFD, p 107) that it should be allocated based on Allocation Factor No. 20 (Cost of Service plus Cost of Gas, which is used to allocate uncollectibles) instead of throughput (5 T 1314-15; Exhibit A-26).

Exception No. 17. The Commission Should Adopt MichCon’s Proposed Rate Treatment For The Exelon Contract.

Pursuant to the Commission’s directive, there is a separate rate class comprised of Exelon Energy Company (“Exelon”).⁵³ Exelon pays MichCon \$4.45 million per year for 6 Bcf of pipeline capacity (to which Exelon has a contractual right and which Exelon is expected to use), with a cost of service of approximately \$4.9 million per year (5 T 967-69). This slight under-collection is allocated to all rate groups in proportion to standard rate delivery volumes. This allocation is appropriate, and it would be inappropriate to require MichCon to absorb this revenue shortfall, since the Exelon agreement provides benefits to all of MichCon’s customers, as well as the State of Michigan. (5 T 969-70, 1308).

The ALJ agreed with the Staff’s suggestion that the Exelon agreement should be treated as a special contract, and that MichCon has not demonstrated that it satisfies the requirements for recovery under the Commission’s February 14, 2001 Order in Case No. U-12825 (PFD, pp 110-

⁵³ MichCon and Exelon entered into an easement agreement that grants Exelon a right to pipeline capacity on MichCon’s distribution system, and thereby gives Exelon the ability to compete in the overlapping service territories of Edison and MichCon (5 T 848, 966). The Commission approved the easement agreement, and required MichCon to account for the easement agreement as a separate rate class in future cost of service studies (February 14, 2001 Order Approving Special Contract in Case No. U-12825, pp 4-5).

12). MichCon disagrees because the Exelon agreement is a unique easement agreement that provides Exelon with up to 20 Bcf of pipeline capacity within MichCon's distribution system where it overlaps with the Detroit Edison service territory wherein Exelon operates its own complete natural gas utility business independent of MichCon tariffs. (5 T 974). Even if the Exelon agreement is evaluated as a special contract, MichCon has demonstrated that the agreement provides significant benefits to MichCon's customers as well as benefits to the State of Michigan, in general. Specifically, the agreement provides customers of MichCon in the overlap territory the opportunity to negotiate agreements with competitive rates, terms, and conditions for natural gas delivery service. (5 T 969-970). Customers appear to be taking advantage of this opportunity as Exelon exercised its right to purchase 1 additional Bcf of supplemental capacity in 2005. (5 T 967). Additionally, the Exelon agreement is designed to promote the development of electric generation facilities, which benefits the entire State of Michigan as it reduces the need to rely on power generated outside of Michigan. Finally, the Exelon agreement was a requirement for the Federal Trade Commission to approve the merger between DTE and MCN. This merger resulted in cost reduction synergies related to the elimination or reduction of common support functions, the combination of corporate headquarters and certain economics of scale. Customers have permanently realized a financial benefit as a result of MichCon utility rates that are lower only due to the merger (5 T 970).

Exception No. 18. The Commission Should Adopt MichCon's Proposed Monthly Customer Charges and Rate Schedule Economic Break Even Points.

MichCon proposed an \$11.00 monthly customer charge for residential Rate A and Rate AS. To maintain historical consistency, the same charge should apply to the Rate 2A-Meter Class 1. MichCon established the monthly customer charges for the general rate schedules and the EUT schedules based on the approximate economic break even points established for the rate

schedules currently used in MichCon's Rate Book. The COSS analysis (Exhibit A-13, Schedule F3 (Revised)) showed that the general service rate schedules required an increase of approximately 47.4%, so the Rate GS-1 monthly service charge was established at \$30, with an identical charge for Rate 2A-Meter Class II. The Rate GS-2 monthly service charge is \$700. The Rate S monthly service charge is \$200. The monthly customer charges for EUT Rates ST, LT, LT, and XXLT are \$2,000, \$4,000, \$18,800, and \$115,000, respectively (5 T 1235-38; Exhibit A-13, Schedule F2 (Revised), pp. 4-5).

Staff's proposed rate design for rate schedules A, AS, 2A, GS-1, GS-2, ST, LT and XLT maintain MichCon's proposed economic break points; however, Staff proposed lower increases in the monthly customer charges and higher volumetric charges than MichCon. The ALJ agreed with the Staff (PFD, pp 114-16). MichCon continues to support its proposed monthly customer charges and that the final rate design approved in this case should maintain MichCon's proposed economic break points and specifically, the rate design for the EUT rate schedules. Maintaining the economic break points is extremely important because it minimizes rate switching between the various sales rate schedules particularly between the sales and EUT rate schedules (5 T 1237). Rate switching, which will occur if the current economic break points are not maintained, will result, all else being equal, in MichCon not collecting its authorized cost of service since customers will switch to the lower cost alternative.

MichCon's proposed rate design for the EUT rate schedules provides MichCon a cost base rate structure needed to retain and grow its very largest industrial accounts and mitigate further losses to interstate bypass. The Staff's proposed rate design will not provide a rate structure that will attract the very largest customers to transport gas on MichCon's system.

Exception No. 19. The Commission Should Adopt MichCon’s Proposed Charge for Refusal on the Part of the Customer to Provide Reasonable Access Under Tariff Section C5.1.

MichCon proposed to revise Section C5.1, Access to Meters and Appliances, to charge \$20 and to recover all billed and unbilled service revenue and associated costs for refusal on the part of the customer to provide reasonable access to install, inspect, read, repair, turn off, relocate or remove its meter (5 T 1219; Exhibit A-13, Schedule F5.1 (Revised)). Staff opposed this charge stating that it is “unnecessarily punitive and unlike any other Michigan gas utility Access to Customer Premises tariff provisions.” (6 T 1778) Staff then proposed the MichCon be directed to modify Section C5.1 to read as follows:

The Company’s authorized agents shall have access to the customer’s premises at all reasonable times to install, inspect, test, read, turn off, relocate, repair, or remove meters and other property of the Company situated on said premises, and to inspect and determine the load characteristics of appliances installed on said premises.

This is basically the same language that MichCon currently has in its Tariff book under Section C5.1 (Exhibit A-13, Schedule F5.1 (Revised)). The ALJ agreed with Staff on this tariff revision (PFD, p 124).

Staff’s assertion that MichCon’s proposal is “unlike any other Michigan gas utility” is absolutely correct, because, **MichCon is unlike any other Michigan gas utility** in that it has over 400,000 inside meters (6 T 1835). Staff has indicated that they believe that MichCon has a significant number of inside meters with a gas vent problem and has recommended that MichCon be directed to develop a program to systematically move inside meters to outside locations (6 T 1835). In response MichCon indicated that an important barrier to prompt remediation of those meter conditions is gaining access to the customers premise to perform the remediation (5 T 1484). MichCon’s proposed tariff revision directly addresses this barrier by implementing a financial penalty to be assessed to customers that are unwilling to provide MichCon access to the

inside meter or other equipment. It is MichCon's position that this is a less significant penalty than MichCon's current option, which involves a cut and cap of the customer's gas service to gain access. Therefore, the Commission should adopt MichCon's proposed revisions to Schedule C5.1.

Exception No. 20. It is Unnecessary and Inappropriate to Formalize Pipeline Safety Matters in New Commission Dockets.

Staff expressed a number of safety and reliability concerns, and recommended that the Commission require MichCon to take certain actions, including the filing of a new docket for MichCon's cast iron replacement program, and a new docket for MichCon's meter move out program (Staff Initial Brief, pp 56-72; 6 T 1832, 1836). Staff stated on pages 56-57 of its Brief that the Commission, in its final order in this case, should require MichCon to: (1) commit to a specific capital expenditure to "improve [its] natural gas system and file a report in each rate case analyzing the effectiveness of the expenditures at preventing leaks"; (2) file a semi-annual leak backlog remediation plan to reduce the backlog of all leaks and allow the Company to repair newly found leaks; (3) file in each subsequent rate case a report of capital expenditures focused on leak repair and progress made towards reducing the backlog of leaks; (4) file a plan to eliminate the backlog of pending corrosion work, and complete new corrosion remediation work; (5) file in each subsequent rate case a report on the effectiveness of the corrosion plan; (6) dedicate sufficient resources to a main renewal program and develop a long-term plan to significantly reduce the amount of cast iron main, and file a separate docket in which MichCon would detail the proposed main renewal program; (7) develop a program to systematically move inside meters outside which would be filed in a new docket.

The ALJ agreed with the Staff's recommendations (PFD, p 129). MichCon agrees that maintaining a safe reliable natural gas system requires diligent attention to these matters.

MichCon disagrees, however, that it is either necessary or appropriate to formalize the process through new Commission dockets. MichCon also disagrees with some of the Staff's underlying assertions, which are based on apples to oranges comparisons.

There is no need to establish new dockets for MichCon's cast iron main replacement and meter move out programs because MichCon is making inroads in both areas and continues to measure the impact of its efforts and to assess the best methods to move forward in addressing each area. MichCon has and will continue to work closely with Staff on an informal basis to review and further develop appropriate responses in these areas, without formalizing these discussions in new dockets. If, however, the Commission were to require new dockets for these programs, the dockets must also incorporate the three important and relevant elements MichCon suggested, as the ALJ appropriately recommends (PFD, p 129).⁵⁴

MichCon also disagrees with the PFD's apparent support for other staff comparisons and conclusions. Staff made comparisons between Consumers Energy ("Consumers") and MichCon, asserting that MichCon should be more like Consumers. This comparison is not appropriate because it ignores that MichCon's system is substantially older than Consumers' system. Specifically, 17.1% of MichCon's mains and 8.8% of MichCon's services were installed prior to 1950 versus 5.6% and 1.7% respectively for Consumers (5 T 536). Moreover, the percentage

⁵⁴ First, the dockets must incorporate an analysis of customer affordability associated with each initiative, because the potential cost associated with moving out all inside meters and the full replacement of cast iron could reach \$3.5 billion, based on current dollars, if every mile of pipe and every inside meter were ultimately addressed. For this reason, any new dockets should include an evaluation of the financial impact on the customer of discrete programs and the appropriate sizing of these programs. (4 T 265-6).

The second element that needs to be incorporated into the dockets is a review of the most appropriate method of financing and segregating these programs from other capital spending of the Company. The third element that must be included in the dockets is consideration of the most appropriate means of recovering the associated costs from MichCon's customers for the incremental capital expense associated with these programs (4 T 266). While a separate docket, if ordered, is one means to address and develop these plans, a future general rate case is the proper proceeding to consider and determine recovery of the costs of implementing such plans.

differences cannot be attributed to more aggressive replacements or renewal by Consumers. (5 T 536).

Staff's assertion that MichCon is not safely operating its Southeastern Michigan gas distribution system (Staff Initial Brief, pp. 61-64) is also incorrect. MichCon is safely operating its gas distribution system because: (1) MichCon's internal Standards and Procedures meet or exceed the MGSS rules, which ensures that all leaks, system wide, receive corrective action or are monitored as required; (2) MichCon conducts system wide leak surveys on a schedule that meets the requirements of the MGSS; (3) MichCon annually performs a system wide winter leak survey of its cast iron system; (4) MichCon monitors the number of cast iron main breaks and the frost depth each winter to determine if the Frost Procedure needs to be implemented, including additional inside and outside leak detection whenever MichCon is at a customer premise (for any reason); and (5) Grade 3 leaks are considered non-hazardous and only require annual monitoring. (5 T 1481)

Other conclusions reached by Staff are incorrect. Specifically, MichCon demonstrated that:

- Staff's conclusion that a high number of pending leaks indicates an increase in the probability of pipeline failure (Staff Initial Brief, p. 65) is incorrect because Grade 3 leaks are non-hazardous at the time of detection, and because this type of leak is expected to remain non-hazardous. These leaks are rechecked annually to assure that they continue to be non-hazardous. MichCon also performs a winter cast iron survey annually. Furthermore, since distribution mains, by definition operate at low stress levels, no catastrophic pipeline failure could occur. (5 T 1481)

- Staff’s conclusion that MichCon supplies inside meters from systems operating from 10 to 60 psig (Staff Initial Brief, p. 71) is incorrect because MichCon supplies inside meters off systems operating at less than or equal to 10 psig, i.e., at maximum pressures of ¼ psig, 2 psig, 5 psig and 10 psig. (5 T 1483).
- Staff’s conclusions that MichCon is unable to “timely inspect and remediate identified problems with its meter conditions” is inconsistent with remediation efforts undertaken by the Company which include:
 1. The remediation of 3,027 meter conditions identified as having an inside vent issue in 2009 (5 T 1483).
 2. On-going processes for identifying and remediating these conditions such as:
 - a. During our annual leak survey as part of the Meter Assembly Checks (“MACs”), any meter conditions are addressed immediately by sending a “Notifies Dispatch” in an attempt to arrange immediate access to the home in order to remediate the vent condition;
 - b. Identifying and remediating these issues when MichCon is conducting routine maintenance such as meter removals and exchanges, a service restoration event, or a meter turn on event; and
 - c. Actively scheduling the remediation of vent conditions by matching the pending vent conditions to other customer requests to ensure that the condition is remediated. (5 T 1484).

It must be remembered that an important barrier to prompt remediation of these conditions is gaining access to the customer premise. When MichCon is unable to gain access to

perform the remediation, MichCon's only alternative is to terminate gas service to these customers through service abandonments (5 T 1484).

MichCon also disagrees with Staff's characterization that MichCon has experienced an increase in the number of leaks (6 T 1821). While total leaks including category 3 leaks have increased from 5,161 on December 31, 2008 to 7,945 as of November 22, 2009, there is no safety issue because in accordance with the requirements of Rule 460.20327 of the MGSS MichCon has no outstanding grade 1 or grade 2 leaks that are overdue for repair (5 T 1479). In fact, MichCon has no leaks that are pending a repair outside of the MGSS requirements. While there are 6,801 Grade 3 (non-hazardous) leaks being monitored, none of these are overdue (5 T 1479).

Moreover, the category 3 leak increase is the result of MichCon's reallocation of internal field resources from repairing non-hazardous leaks to efforts to address increasing theft and collection issues. MichCon believes gas theft and meter tampering poses a higher safety risk than the risk of monitored Grade 3 leaks. In fact, the Company reviewed this issue with the MPSC Staff on several occasions. As a point of reference MichCon terminated approximately 24,000 gas thefts in its territory in 2009 compared to 15,649 gas thefts in 2008 (5 T 1480).

In summary, when all appropriate facts in this record are considered, there is no evidence that warrants a conclusion that MichCon's gas distribution system is being operated in an unsafe manner or that more formal plans need to be filed in new Commission dockets. If, however, the Commission believes the Company should formalize its commitments to these issues in new dockets, then the Commission must also ensure that proper timely and separate recovery of the costs is provided and that customer affordability issues are fully considered.

Exception No. 21. Refunding of Any Overcollection From Self-Implementation in This Case Should not be on an Equal Percentage Basis.

The ALJ finds that Staff's recommendation that, should the Commission order MichCon to issue a refund of any difference between what MichCon self-implemented and the rate increase approved by the Commission's final order in this case, the refund should be issued to each customer class on an equal percentage basis, should be adopted. MichCon disagrees.

Under the statutory equal percentage allocation method, the self implementation surcharge increased the rates of transportation customers by a significantly greater percentage than is determined based on the cost-of-service rate design supported by the ALJ in his PFD in this case or requested by MichCon in this case.⁵⁵ Allocating any refund on an equal percentage basis to each customer class would result in MichCon's transportation customers paying significantly more than their cost of service while other classes of customer will pay significantly less than their cost of service, as determined in the final order in this case, during the self implementation period. MichCon believes that the allocation of any refund that results from this case should be addressed in a refund filing similar to the ones ordered by the Commission in U-15678 for Detroit Edison and U-15645 for Consumers Energy.

III. REQUEST FOR RELIEF

MichCon respectfully requests that the Commission issue its final order:

A. Granting MichCon's request for final rate relief, as further supported and explained in its Application, testimony, exhibits, Initial Brief, Reply Brief, and Exceptions (including Attachments A through G), approving rates that will recover MichCon's revenue deficiency of approximately \$175.4 million, based on a 2010 test year;

⁵⁵ MichCon requested that the Commission approve the Company's alternative self-implemented rate design to avoid this anomaly, but in the absence of a Commission order was obligated to implement rates on an equal percentage basis.

B. Approving the implementation of MichCon’s requested final relief as described in the rate design parameters set forth in MichCon’s Application, testimony, exhibits, Initial Brief (including Attachments), and Reply Brief (including Attachments) and Exceptions (including Attachments);

C. Approving MichCon’s proposal to continue its previously-approved Uncollectible Expense True-up Mechanism (“UETM”), including the modifications proposed by the Company and implementation of MichCon’s proposed new base UETM amount prospectively from the date of the Commission’s order;

D. Approving MichCon’s proposed new Lost Gas and Company Use Expense True-up Mechanism (“LGTM”);

E. Approving MichCon’s proposed new Revenue Decoupling Mechanism (“RDM”);

F. Acknowledging that MichCon has satisfied the requirements of the Commission’s Order in Case No. U-15479, requiring MichCon to submit a special cost of service study showing Dearborn Industrial Generation, LLC (“DIG”) as a “separate rate class;”

G. Acknowledging that MichCon has satisfied the requirements of the Commission’s Order in Case No. U-13898, requiring MichCon to propose a low-income energy efficiency funding (“LIEEF”) program, the costs of which would be recovered as part of its rate base structure;

H. Approve the transfer of Saginaw Bay Pipeline to MichCon at its depreciated Original Cost and the inclusion of the associated net plant, revenues, and expenses within the Company’s revenue requirements;

I. Approving MichCon’s proposal to amend certain customer rate schedules and proposed tariff changes;

J. Approving the remainder of MichCon's miscellaneous proposals as set forth in MichCon's Application, testimony, exhibits, Initial Brief and Reply Brief, and Exceptions (including Attachments A through G);

K. Granting accounting approval to charge the income tax effect of the equity component of AFUDC to a Financial Accounting Standards 109 ("FAS 109") related regulatory asset, rather than deferred federal income tax expense, on a prospective basis, consistent with FAS 109 and Case Nos. U-5281 and U-10083.

L. Granting explicit authorization from the Commission to continue capitalizing all costs related to the Pipeline Integrity Program including a waiver from (1) the FERC accounting rules regarding expense treatment of assessment and inspection costs, and (2) a change in the standard retirement units as ordered by the Commission in Case No. U-15699. This waiver would be in effect through the time the baseline assessments will be complete, which is currently estimated to be December 31, 2012;

M. Confirming that the income tax policy authorized in Case No. U-10083 for ratemaking and accounting purposes also applies to the new MBT, including the following specific authorizations:

- 1) Grant general authorization to use Accounts 190, 281, 282 and 283 offset by Deferred Income Tax Expense Account 410.1 or Credit Account 411.1 for book/tax temporary differences related to the MBT calculation originating on and after the date rates are adjusted in an Order reflecting such authorization.
- 2) Grant general authorization to use Accounts 190, 281, 282 and 283 offset by a Miscellaneous Deferred Debit Account 186 for book/tax temporary

differences related to the MBT calculations originating prior to the date rates are adjusted in an Order reflecting such authorization. The temporary differences will reverse in future years.

- 3) Authorize assurance of recovery of Miscellaneous Deferred Debit amounts in Account 186 related to the MBT calculation that will reverse in future years through current ratemaking practices. (5 T 1460-61, 1468-69).

N. Approving the use of temporary utility Account 407.3 "Regulatory Debit" for CTA amortization; and

O. Granting such other lawful relief that the Commission deems reasonable and appropriate.

Respectfully submitted,

MICHIGAN CONSOLIDATED GAS COMPANY

Dated: April 16, 2010

By: _____

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Michigan Consolidated Gas Company
 Computation of Revenue Deficiency (\$000)
 for the Year Ended December 31, 2010

Line No.	(a) Description	(b) ALJ PFD	(c) Corrected PFD	(d) MichCon's Adjustments	(e) Saginaw Bay As-Filed	(f) MichCon's PFD Exceptions	(g) Source
1	Net Utility Plant	\$ 1,669,358	\$ 1,669,358	\$ 5,646	\$ 11,120	\$ 1,686,124	Attachment A, Page 3 of 4
2	Working Capital	691,787	691,787	-	-	691,787	Attachment A, Page 3 of 4
3	Total Rate Base	\$ 2,361,145	\$ 2,361,145	\$ 5,646	\$ 11,120	\$ 2,377,911	Line 1 + Line 2
4	Rate of Return	6.99%	6.99%	0.36%	7.30%	7.35%	Exh S-1, A-1, Attach A, Pg 4
5	Income Required	\$ 165,044	\$ 165,044	\$ 8,915	\$ 812	\$ 174,771	Line 3 * Line 4
6	Adjusted Operating Income	77,880	77,861	(8,266)	(1,842)	67,753	Attachment A, Page 2 of 4
7	Income Deficiency / (Sufficiency)	\$ 87,164	\$ 87,183	\$ 17,182	\$ 2,654	\$ 107,018	Line 5 - Line 6
8	Revenue Multiplier	1.6393	1.6393		1.6393	1.6393	Exh S-3, Sch C2
9	Revenue Deficiency	<u>\$ 142,888</u>	<u>\$ 142,919</u>	<u>\$ 28,165</u>	<u>\$ 4,351</u>	<u>\$ 175,435</u>	Line 7 * Line 8

Michigan Consolidated Gas Company
 Net Operating Income (\$000)
 for the Year Ended December 31, 2010

Line No.	(a) Description	(b) ALJ PFD	(c) PFD Corrections	(d) Corrected PFD	(e) MichCon's Adjustments	(f) Saginaw Bay	(g) MichCon's PFD Exceptions	(h) Source
1	Revenues	\$683,186		\$ 683,186				Exh S-3, Sch C-1
2	Adjustments:							
3	- Midstream Revenue				(15,264)	(2,265)		Attach B, p1, Attach C
4	- Gas-in-Kind				(5,029)	(516)		Attach B, p1, Attach C
5	- Late Payment Fees				(1,788)			Attachment B, page 1
6	- Gas Sales				(205)			Attachment B, page 1
7	Total Revenues (Line 1 thru Line 6)	683,186		683,186	(22,286)	(2,781)	658,119	
8								
9	O&M Expenses	304,422		304,422				Exh S-3, Sch C-1
10	Adjustments:							
11	- Executive & Employee Incentive Compensation				9,970	0	9,970	Attachment B
12	- Standard Retirement Units - Distribution				1,500		1,500	Attachment B
13	- Saginaw Bay					(506)	(506)	Footnote 2
14	Total O&M Expense (Line 9 thru Line 12)	304,422		304,422	11,470	(506)	315,386	
15								
16	Company Use & Lost Gas	66,962		66,962	1,234		68,196	Exh S-3, Sch C-1
17								
18	Gas Uncollectibles	69,900		69,900			69,900	Exh S-3, Sch C-1
19								
20	Depreciation and Amortization	111,319		111,319	(22,173)	821	89,967	Attachment G
21								
22	Property & Other Taxes	57,196		57,196		130	57,326	Exh S-3, Sch C-1, Attach C
23								
24	Pretax Operating Income (Line 7 - Line 13 through Line 21)	73,387		73,387	(12,817)	(3,226)	57,344	
25								
26	Federal and Other Income Taxes	(4,291)		(4,291)			(4,291)	Exh S-3, Sch C-1
27	Adjustments:							
28	MBT Tax Adjustment	1,847	(646)	1,201			1,201	
29	Tax Impact of Synchronization of Implied Interest	(2,078)	2,162	84	448	(121)	411	Attachment F Pgs 1 & 2
30	Aggregate Tax Effect of Other NOI Adjustments				(4,998)	(1,263)	(6,261)	Footnote 1
31	Total Federal and Other Income Taxes (Line 25 through Line 28)	(4,522)		(3,006)	(4,550)	(1,384)	(8,940)	
32								
33	AFUDC	-	1,497	1,497			1,497	
34	PFD AFUDC Adjustment	(29)	-	(29)		-	(29)	Exh S-3, Sch C-1
35								
36	Adjusted Net Operating Income (L23 - L29 + L31)	\$ 77,880		\$ 77,861	\$ (8,266)	\$ (1,842)	\$ 67,753	

Footnote 1 - (Line 21+Line 29 - Line 25) x (1 - (1 ÷ 1.6393))

Footnote 2 - Attachment C, net of O&M of \$304M and reduced transportation fees of (\$810)M

Michigan Consolidated Gas Company
 Rate Base - Average Net Plant (\$000)
 for the Year Ended December 31, 2010

Line No.	(a) Description	(b) ALJ PFD	(c) MichCon's U-15699 Adjustment	(d) Saginaw Bay	(e) MichCon's PFD Exceptions	(f) Source
1	Utility Plant in Service: Plant in Service	\$ 3,608,352	(\$750)		\$3,607,602	Exh S-2, Sch B1
2	<u>Plant In-Service Adjustments:</u> Saginaw Bay			11,120	11,120	Attachment C
3						
4	Adjusted Plant in Service	\$ 3,608,352	\$ (750)	\$ 11,120	\$ 3,618,722	
5	Property Held for Future Use	1,256			1,256	Exh S-2, Sch B1
6	Construction Work in Progress	62,061			62,061	Exh S-2, Sch B1
7	Gross Utility Plant	\$ 3,671,669	\$ (750)	\$ 11,120	\$ 3,682,039	
8	<u>Deduct:</u> Accum. Depreciation and Depletion for Plant in Service	2,002,311				Exh S-2, Sch B1
9	<u>Accumulated Depreciation Reserve Adjustments:</u> Lower depreciation rates		(6,396)		(6,396)	Note 1
10	Adjusted - Accum. Depreciation and Depletion for Plant in Service	\$ 2,002,311	\$ (6,396)	\$ -	\$ 1,995,915	
11	Net Capital Lease Property	0			0	Exh S-2, Sch B1
12	Net Utility Plant	\$ 1,669,358	\$ 5,646	\$ 11,120	\$ 1,686,124	
13	Less: Capital Lease Obligations	0			0	Exh S-2, Sch B1
14	Net Plant	\$ 1,669,358	\$ 5,646	\$ 11,120	\$ 1,686,124	
15	Working Capital	691,787			691,787	Exh S-2, Sch B1, Exh A-39
16	Total Rate Base	\$ 2,361,145	\$ 5,646	\$ 11,120	\$ 2,377,911	

Note 1: Reduction in Depreciation expense effective with Rate order (Lower depr for 9 months) - Amount represents 13 month average

Michigan Consolidated Gas Company
 Overall Rate of Return Summary (\$000)
 for the Year Ended December 31, 2010

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	
Line No.	Description	ALJ PFD	MichCon's U-15699 Equity Adj.	MichCon's PFD Exceptions	Permanent Capital	Total Capital	ALJ PFD Cost Rate (1)	MichCon's Cost Rate (2)	Weighted Cost of Permanent Capital	Weighted Cost of Total Capital	Revenue Multiplier	Pretax Overall ROR
1	Long-Term Debt	\$ 933,529	\$ (25,000)	\$ 908,529	48.28%	37.16%	6.22%	6.24%	3.01%	2.32%	1.0081	2.34%
2												
3	Common Equity	948,236	25,000	\$ 973,236	51.72%	39.80%	10.50%	11.25%	5.82%	4.48%	1.6393	7.34%
4												
5	Sub-Total	\$ 1,881,765	\$ -	\$ 1,881,765	100.00%				8.83%			
6												
7	Short-Term Debt	\$ 123,424		\$ 123,424		5.05%	6.24%	6.24%		0.32%	1.0081	0.32%
8												
9	Customer Deposits	15,756	-	15,756		0.64%	7.00%	7.00%		0.05%	1.0081	0.05%
10	Other Interest Bearing Debits	-	-	-		0.00%						
11	Other Interest Bearing Credits	61,510	-	61,510		2.52%	6.24%	6.24%		0.16%	1.0081	0.16%
12												
13	Net Deferred Federal Income Tax	353,768		353,768		14.47%	0.00%	0.00%		0.00%	1.0081	
14												
15	JDITC											
16	JDITC - Long-Term Debt	4,383	-	4,383		0.18%	6.22%	6.24%		0.01%	1.0081	0.01%
17	JDITC - Common Equity	4,452	-	4,452		0.18%	10.50%	11.25%		0.02%	1.6393	0.03%
18	Total JDITC	\$ 8,835	\$ -	\$ 8,835								
19												
20	Total	\$ 2,445,058	\$ -	\$ 2,445,058		100.00%				7.35%		10.24%

Source:
 (1) Exh S-4, Sch D1, Page 1
 (2) Exh A-11, Revised Sch D1

Michigan Consolidated Gas Company
 Revenue Requirement Adjustments to Staff's Filing
 for the Year Ended December 31, 2010
 (\$000)

Line No.	(a) Description	(b) Source	(c) Total Revenue Requirements
1			(Pre Tax Amts)
2	ALJ PFD Proposed 2010 Rate Relief for M	Attachment F	\$ 142,888
3			
4	Various Minor Tax & Other Corrections	Attachment A Page 2 of 4	31
5			
6	Corrected ALJ PFD Proposed 2010 Rate F	Attachment A Page 1 of 4	\$ 142,919
7			
8	<u>Adjustments to Staff's Recommended Revenue Deficiency:</u>		
9			
10	Cost of Capital		
11	- Include Cost of Interest Rate Hedges in LTD		201
12	- ROE Adjustment (to MichCon's Filed Posi	Exh A-11, Sch D1(Revised)	11,994
13	- Equity Infusion to 52% Equity Due to Lower Deprn Rates From U-15699		2,635
14			
15	Rate Base		
16			Rate Base Changes
17	- Plant & Accum Deprn Reserve: U-15699 E	Attachment A Page 3 of 4	5,646
18			518
19	Revenues		
20			
21	- Midstream Revenues	Exh S-3, C-3	15,264
22	- Gas-in-kind Revenues	Exh A-48, Exh S-3, C-3	5,029
23	- Late Payment fees	Exh S-3, C-3	1,788
24	- Gas Sales	Exh S-3, C-3	205
25			
26	Operations and Maintenance Expenses		
27			
28	- Executive & Employee Incentive Compens	Exh S-3, Sch C5	9,970
29	- Standard Retirement Units - Distribution	4T 420	1,500
30			
31	Company Use & Lost Gas	Exh S-5, F2-5	1,234
32			
33	Depreciation	Attachment G	(22,173)
34			
35	Total Adjustments to Staff's Proposed R	Line 8 through Line 28	\$ 28,164
36			
37	MichCon's Requested Rate Relief	Line 2 + Line 30	\$ 171,084
38			
39	Saginaw Bay Revenue Requirement	Attachment C	4,351
40			
41	MichCon's PFD Exceptions Requested Ra	Line 32 + Line 34	\$ 175,435

Michigan Consolidated Gas Company

**Impact on MichCon's Revenue Requirement of Rolling in Saginaw Bay
 Amounts in (\$000)**

Line No.	(a) Description	(b) Jan 1, 2010	(c) Dec 31, 2010	(d) Source
1	Gross Plant	36,258	36,378	Exhibit A-30
2	Accumulated Depreciation	(24,787)	(25,608)	Exhibit A-30
3	Net Plant	11,471	10,770	
4	Average Rate Base		11,120	Exhibit A-30
5	Pre-tax Rate of Return		10.12%	Attachment A4
	<u>Cost of Service:</u>			
6	Return on Investment		\$ 1,125	Exhibit A-30
7	O&M		304	Exhibit A-30
8	Property Tax		130	Exhibit A-30
9	Depreciation		821	Exhibit A-30
10	MichCon Transportation Fees		(810)	Exhibit A-30
11	Lost Alpena/Petoskey Transportation Revenue		2,265	Exhibit A-30
12	Lost Gas In Kind		516	Attachment D
13	Impact on MichCon's Revenue Requirement assuming Saginaw Bay is rolled into Utility Assets		\$ 4,351	

Michigan Consolidated Gas Company

Cost of Service and Other Operating Revenue Impact of Transfer of Saginaw Bay
(MMcf and \$000)

Line No.	Description (Col. 1)	Amount (Col. 2)
MichCon's Exhibit No. A-48, Lines 32-43, Adjusted to reflect Saginaw Bay Transfer		
1	GIK - Offset to Other Operating Revenues	
2	Exhibit A-48 (Bifurcated GIK Methodolgy, Two-Step)	
3	GIK Volume - 3rd Party @ 1.41% (Exh. A-48, Line 38)	3,100
4	GIK Volume - End Users @ 2.44% (Exh. A-48, Line 39)	<u>2,164</u>
5	Total GIK Volume	<u>5,264</u>
6	Exhibit A-48 (Bifurcated GIK Methodolgy, Two-Step) Adj. for Saginaw Bay	
7	GIK Volume - 3rd Party @ 1.45% (Attach. D, Pg. 2, Col. 5, Line 19)	2,992
8	GIK Volume - End Users @ 2.49% (Attach. D, Pg. 2, Col. 4, Line 18)	<u>2,204</u>
9	Total GIK Volume	<u>5,196</u>
10	Change	(68)
11	Cost of Gas Rate (5 T 629; 5 T 849)	\$ 7.59
12	Other Operating Revenue Impact	<u>\$ (516)</u>

Michigan Consolidated Gas Company

Lost and Unaccounted for Gas and Gas Used by Company - Cost Recovery Calculation (GIK)
 Recalculation of Company's Exhibit No. A-47, Page 3, with Bifurcated, Two Stage GIK, to reflect Saginaw Bay Transfer
 (MMcf)

Line No.	Description (Col. 1)	Total (Col. 2)	Sales, Choice Aggregates (Col. 3)	End-Users (Col. 4)	3rd Parties (Col. 5)
	Projected Lost and Unaccounted for Gas and Company Use (1)				
1	Net Lost and Unaccounted for Gas	6,447	3,653	2,125	669
2	Company Use	2,538	864	503	1,171
3	Total Net Lost and Unaccounted for and Company Use Gas	<u>8,984</u>	<u>4,517</u>	<u>2,628</u>	<u>1,839</u>
	Projected Sendout for Sales, Gas Choice and End-User Transportation				
4	Sales	120,668	120,668		
5	Gas Choice	29,920	29,920		
6	Aggregates	1,739	1,739		
7	End-User Transportation	88,606		88,606	
8	Exelon Transportation	5,775			5,775
9	Off-System Transportation (2)	225,638			225,638
10	Less: Non-Physical Transactional Activity	(57,060)			(57,060)
11	Storage	32,039			32,039
12	Total Sales, Gas Choice and End-User Transportation	<u>447,325</u>	<u>152,327</u>	<u>88,606</u>	<u>206,392</u>
	Net Lost and Unaccounted for and Company Use Gas %				
13	Total Net Lost and Unaccounted for and Company Use Gas	8,984	4,517	2,628	1,839
14	Total Sales, Gas Choice and End-User Transportation	447,325	152,327	88,606	206,392
15	Gas-in-Kind (Lost and Unaccounted for and Company Use Gas) %	<u>2.01%</u>	<u>2.97%</u>	<u>2.97%</u>	<u>0.89%</u>
16	Half the difference between 2.93% and 1.95%		<u>-0.48%</u>	<u>-0.48%</u>	
17	Revised Gas-in-Kind % for Retail Market		<u>2.49%</u>	<u>2.49%</u>	
18	Re-allocated Lost and Unaccounted for and Company Use Gas (L18 x L12)		<u>3,788</u>	<u>2,204</u>	
19	Remaining Lost and Unaccounted for and Company Use Gas to be recovered from 3rd Parties				2,992
20	3rd Party Sendout charged GIK				<u>206,392</u>
21	Revised Gas-in-Kind % for 3rd Party Market				<u>1.45%</u>

(1) From Attachment D, Page 3

(2) Original Off-System Transportation of 238,538 less Transportation volumes lost (12,900 (5 T 589)) when Saginaw Bay is Rolled-in.

All of the information on this schedule is sourced from Exhibit A-47, reflects math internal to this attachment, or is data that is implicitly necessary in order to compute the full cost of service and other operating revenue impact of the transfer of Saginaw Bay Pipeline into MichCon.

Michigan Consolidated Gas Company
 Transmission and Distribution System Lost and Unaccounted For Gas
 and Gas Used by Company Allocation

Line No.	Description (Col. 1)	Lost Gas Amount (Col. 2)	GCR, GCC, Aggregates (Col. 3)	End-User Transport. (Col. 4)	3rd Party Activity (Col. 5)
1	Transmission Losses - actual - see below	1,339	424	247	669
2	Distribution Losses - remainder of total	5,108	3,229	1,878	
3	Total Lost and Unaccounted For Gas	<u>6,447</u>	<u>3,653</u>	<u>2,125</u>	<u>669</u>
4	Transmission Lost Gas %	0.30%	0.28%	0.28%	0.32%
5	Distribution Lost Gas %	1.14%	2.12%	2.12%	0.00%
6	Total Lost Gas %	1.44%	2.40%	2.40%	0.32%
7	Total Throughput for 2010	447,325	152,327	88,606	206,392 (1)
8	Total Distribution Throughput for 2010	240,933	152,327	88,606	
9	Transmission Losses Allocation		34.1%	19.8%	46.1%
10	Distribution Losses Allocation		63.2%	36.8%	
11	Total Transmission Losses for 12 month ended 3/31/09				1,339
12	Total Transmission Throughput for 12 months ended 3/31/09 (excluding such activity as GR, PEPL, etc. that feed directly into the distribution system)				413,342
13	% of Physical Transmission Throughput (Exhibit A-12, Schedule E14)				0.3239%
14	Total Gas Used by Company	<u>2,538</u>	<u>864</u>	<u>503</u>	<u>1,171</u>
15	Total Throughput for 2010	447,325	152,327	88,606	206,392 (1)
16	Total Throughput Allocation		34.1%	19.8%	46.1%
17	Total Volumes - Allocated (L3 + L14)	<u>8,984</u>	<u>4,517</u>	<u>2,628</u>	<u>1,839</u>
18	GIK %			<u>2.97%</u>	<u>0.89%</u>
19	Non-Gas Distribution Cost of Gas Rate (5 T 849)		\$ 7.59		
20	Net Cost of Service for non-GIK Customers		<u>\$ 34,286</u>		
21	Implicit Non-Gas Distribution GIK %		<u>2.97%</u>		

(1) Total Throughput for 2010 from A-12, Sch. E15, reduced by 12.9 Bcf for loss of transportation volumes from transfer of Saginaw Bay Pipeline into MichCon (5 T 589).

All of the information on this schedule is sourced from record evidence, reflects math internal to this attachment, or is data that is implicitly necessary in order to compute the full cost of service and other operating revenue impact of the transfer of Saginaw Bay Pipeline into MichCon.

Michigan Consolidated Gas Company
 Reconciliation of MichCon's Reply Brief Position to PFD Exception Position
 for the Year Ended December 31, 2010
 (\$000)

Line No.	(a) Description	(b) Amount	(c) Source
1	MichCon's Reply Brief Position	\$ 192,572	Exh. A-8, A-1 (Revised)
2			
3	Rate Base		
4	Net Plant (\$4MM Increase) - Depr Change	518	Attachment A3
5			
6	Return		
7	Capital Structure - Equity Infusion to 52% Equity	2,635	Attachment A3
8			
9	Net Operating Income		
10	O&M - Standard Retirement Units	1,500	Attachment A3
11	Depreciation	(22,173)	Attachment A3
12	Taxes & Other	383	
13			
14	MichCon Exceptions to PFD Position	<u>\$ 175,435</u>	Line 1 through Line 12

Michigan Consolidated Gas Company
Income Tax Expense Interest Expense Synchronization
for the Year Ended December 31, 2010

Line	Description	(a)	(b)	(c)	(d)		(e)
					Rate Base & Cost of Capital	Saginaw Bay	
				PFD			
1	Rate Base			\$ 2,361,145	\$ 2,366,791	\$ 2,377,911	
2	Staff Weighted Cost of Debt & Other Components			2.89%	2.84%	2.84%	
3	Adjusted Interest Expense			\$ 68,282	\$ 67,115	\$ 67,430	
4	Less: Interest Reflected in Base			68,498	68,282	67,115	
5	Increase / (Decrease) in Interest Deduction			\$ (216)	\$ (1,167)	\$ 315	
6	Composite Municipal and State Income Tax Rate			5.35%	5.35%	5.35%	
7	Municipal Tax and State Income Tax Impact			\$ 12	\$ 62	\$ (17)	
8	Federal Taxable Income			\$ (204)	\$ (1,105)	\$ 298	
9	Federal Income Tax Rate			35.00%	35.00%	35.00%	
10	Federal Income Tax Impact			\$ 71	\$ 387	\$ (104)	
11	Total Tax Effect on Net Operating Income			\$ (83)	\$ (449)	\$ 121	

Michigan Consolidated Gas Company
Income Tax Expense JDITC Synchronization
for the Year Ended December 31, 2010

Line	(a) Description	(b)	(c) PFD	(d) MichCon Adjustments		(e)
				Rate Base & Cost of Capital	Saginaw Bay	
1	Rate Base		\$ 2,361,145	\$2,366,791	\$2,377,911	
2	JDITC Portion of Capital Structure		0.18%	0.18%	0.18%	
3	Portion of Rate Base Funded by JDITC		\$ 4,233	\$ 4,243	\$ 4,263	
4	Weighted Debt Cost Included in Return Michcon LT Debt Cost		6.22%	6.24%	6.24%	
5	PFD JDITC Interest		\$ 263	\$ 265	\$ 266	
6	MPSC Staff JDITC Interest		\$ 266	\$ 263	\$ 266	
7	Difference		\$ (3)	\$ 2	\$ -	
8	Composite Municipal and State Income Tax Rate		5.35%	5.35%	5.35%	
9	Effect on State Income and Municipal Tax		-	-	-	
10	Effect on Federal Taxable Income		\$ (3)	\$ 2	\$ -	
11	Federal Income Tax Rate		35.00%	35.00%	35.00%	
12	Effect on Federal Income Taxes		\$ 1	\$ (1)	\$ -	
13	Synchronization Tax Adjustment to NOI		\$ (1)	\$ 1	\$ -	

Michigan Consolidated Gas Company
 Computation of Depreciation Adjustment per MPSC Order in U-15699 (\$000)
 for the Year Ended December 31, 2010

(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	
Line No.	Descriptions	Gross Plant	Depreciable Plant		Gross Plant Deprn Rates	U-13898/99 Depreciable Plant		U-15699 Order			Difference
			End Bal	Average Balance		Current Rates	Annual Depreciation	Gross Plant Deprn Rates	New Rates	Annual Depreciation	
1	U-15699 Depreciation case										
2											
3	2007	U-15699	U-15699		U-15699 Current Rates	U-15699 Current Rat	U-15699	U-15699 New Rates	U-15699		
4		Exhibit S-1	Exhibit S-1		Ties to Exhibit S-1	Ties to Exhibit S-1	-	Ties to Exhibit S-1	Exhibit S-1		
5	Distribution Plant	2,118,443.1	2,118,443.1		2.89%	2.89%	61,230	2.47%	52,393		(8,837)
6	Transmission Plant	340,329.4	340,329.4		2.69%	2.69%	9,163	1.36%	4,631		(4,532)
7	Storage Plant	218,798.9	218,798.9		2.76%	2.76%	6,031	1.85%	4,048		(1,983)
8	General Plant	158,132.8	139,459.0		4.91%	5.57%	7,771	4.05%	6,408		(1,363)
9	Total Presc. Rates	2,835,704.2	2,817,030.4		2.97%	2.99%	84,195	2.38%	67,480		(16,714)
10											
11											
12	U-15985 Rate Case										
13											
14											
15	2010										
16	Distribution Plant					2.91%	69,237	2,375,980	2.47%	58,687	(10,550)
17	Transmission Plant					2.84%	14,590	513,586	1.36%	6,985	(7,605)
18	Storage Plant					2.89%	10,318	356,595	1.85%	6,597	(3,721)
19	General Plant					4.81%	6,587	136,900	4.59%	6,290	(297)
20	Depreciation Tied to Depreciation Case		3,383,811.0				100,732	3,383,061.0		78,559	(22,173)
21	Production Plant						145			145	
22	Total Depreciation Expense						100,877			78,704	(22,173)
23											
24	Amortizations										
25	Intangible Plant						5,951			5,951	-
26	Cost to Achieve Amortization						2,829			2,829	-
27	Loss on Reacquired Debt Amortization						1,662			1,662	-
28											
29	Total Depreciation & Amortization						111,319			89,146	(22,173)

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of)
MICHIGAN CONSOLIDATED GAS)
COMPANY for authority to increase its rates,)
amend its rate schedules and rules governing the)
the distribution and supply of natural gas, and for)
miscellaneous accounting authority)

Case No. U-15985
(Paperless e-file)

PROOF OF SERVICE

STATE OF MICHIGAN)
) ss.
COUNTY OF WAYNE)

Estella R. Branson, being duly sworn, deposes and says that on the 16th day of April, 2010, she served a copy of the Michigan Consolidated Gas Company's Exceptions to the PFD along with a Proof of Service upon the attached service list via electronic mail.

Estella R. Branson

Subscribed and sworn to before
me this 16th day of April, 2010.

Notary Public

MPSC CASE NO. U-15985

Service List

December 3, 2009

ADMINISTRATIVE LAW JUDGE

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ABATE

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HIGHMOUNT MIDWEST ENERGY,
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SUPPLY, INC.; CONSTELLATION
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MPSC CASE NO. U-15985
Service List
December 3, 2009

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