April 21, 2010

Ms. Mary Jo Kunkle  
Executive Secretary  
Michigan Public Service Commission  
6545 Mercantile Way  
Lansing, MI 48911

Dear Ms. Kunkle:

Re: MPSC Case No. U-16146

Enclosed for filing in the above-captioned case please find the Direct Testimony and Exhibits of Ralph E. Miller on Behalf of Attorney General Michael A. Cox, and related Proof of Service. This filing is being submitted electronically pursuant to instruction on the Commission's website.

Sincerely,

Michael E. Moody  
Assistant Attorney General  
Environmental, Natural Resources, and Agriculture Division

MEM/wjc  
Enclosures  
c All Parties
PROOF OF SERVICE - U-16146

The undersigned certifies that a copy of the Direct Testimony and Exhibits of Ralph E. Miller on Behalf of Attorney General Michael A. Cox was served upon the parties listed below by mailing the same to them at their respective addresses with first class postage fully prepaid thereon on the 21st day of April, 2010.

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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the Application of
MICHIGAN CONSOLIDATED GAS COMPANY
for approval of Gas Cost Recovery Plan,
5-year Forecast and Monthly GCR Factor
for the 12 months ending March 31, 2011

Direct Testimony
and Exhibits
of Ralph E. Miller

On behalf of
Attorney General Michael A. Cox

April 21, 2010
Qualifications

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND ADDRESS.

A. My name is Ralph E. Miller. I am an independent consulting economist. My office is at 5502 Western Avenue, Chevy Chase, Maryland 20815.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL QUALIFICATIONS.

A. I am an economist specializing in the fields of utility regulation, industrial organization, and public policy towards business. I have more than thirty-five years of experience in public utility and related energy work, both as a consultant and in government. I am the author of several published reports and papers on public utility economics and energy matters, and I have testified in more than 30 different jurisdictions in a total of more than 360 public utility and other proceedings. I also have several additional years of experience in government and as a university teacher in antitrust, energy demand forecasting and supply analysis, and other areas of economics and energy.

Over the years, I have addressed almost all aspects of gas and electric utility regulation, including rate of return, accounting and revenue requirements, rate design and cost of service, electric fuel and purchased gas cost recovery, industry structure and the role of competition, incentive ratemaking and other types of innovative rate designs, gas and electric supply planning and power plant licensing, productivity and efficiency, and the determination of marginal, incremental, and avoidable costs.

Q. WHAT IS YOUR EMPLOYMENT EXPERIENCE?
A. I have been an independent consultant for more than twenty years. I also have ten years of experience as president or vice president of two different consulting firms specializing in public utility and energy matters. Before that, I spent three years in the federal government, where I was employed in positions at the Federal Power Commission (now the Federal Energy Regulatory Commission, or FERC), the Antitrust Division of the U.S. Department of Justice, and the Federal Energy Administration (now part of the U.S. Department of Energy, or DOE). I was on the faculty of the University of California for three years, where I taught economics courses at both the graduate and undergraduate levels.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I did my undergraduate work at Harvard College, where I received the A. B. degree summa cum laude in mathematics in 1961, and I was elected to Phi Beta Kappa. I then went on to graduate work in economics at Harvard, where I received a Master's degree in 1963. I continued my graduate studies there until 1966, and I completed all of the course requirements for the Ph.D. degree, but not a doctoral dissertation.

Q. WHAT IS YOUR EXPERIENCE IN THE SPECIFIC AREA OF GAS SUPPLY PLANNING AND GAS COST RECOVERY?

A. I have more than 30 years of experience in this area. I have reviewed the gas supply planning and/or gas cost recovery arrangements of more than 15 gas distribution companies (GDCs) in numerous regulatory proceedings in seven states, and I have extensive experience in gas pipeline cases at the FERC.
Beginning in 1981, I analyzed the way Southern Union Gas Company acquired gas supplies for its New Mexico distribution system, and I testified on aspects of this subject in U.S. District Court in 1982.

At the FERC, I reviewed requests by three interstate pipelines for recovery of take-or-pay buyout and contract reformation costs under Order No. 500. I did this work on behalf of customers of the pipelines or their representatives. It included detailed analysis of the gas purchase contracts and other materials obtained in the discovery process. I also testified in many pipeline rate proceedings and two pipeline gas inventory charge (GIC) proceedings, and I reviewed the gas supply restructuring plans proposed by two pipelines as part of their Order 636 compliance. I also reviewed the implementation of Order 637 by two pipelines.

At the state level, I (along with one or more colleagues) have performed many management/performance audits of the gas purchasing practices and policies of gas distribution companies in Ohio, and our reports on these audits were submitted to the Public Utilities Commission of Ohio (PUCO). The companies that I have audited include three of the major GDCs in Ohio, as well as two smaller gas utilities that relied to a large extent on purchases of local production for their system gas supplies.

Here in Michigan, I have reviewed and testified on the gas supply plans and gas cost recovery (GCR) reconciliations of Consumers Energy Company (Consumers) and Michigan Consolidated Gas Company (MichCon) in each year since 1988, except for the three years when their GCR clauses were suspended. I have also reviewed and testified
on many of the gas supply plans and GCR reconciliations of Michigan Gas Utilities
Corporation (MGUC) and SEMCO Energy Gas Company (SEMCO) during this period.

In New Jersey, I participated in the levelized gas adjustment clause (LGAC) proceedings
as a consultant to the Ratepayer Advocate (or its predecessor, the Public Advocate) for
ten years. During that period I reviewed the LGAC filings and gas supply planning of all
four of the New Jersey GDCs. I also participated extensively in the consideration of gas
cost recovery issues in the unbundling proceedings and base rate cases of the New Jersey
GDCs.

In Maryland, I have for more than 30 years been reviewing the gas supply planning and
gas purchases of several Maryland utilities, including Baltimore Gas and Electric
Company ("BGE") and Washington Gas Light Company, in a variety of proceedings in
which I have worked on behalf of Maryland People's Counsel. Other states in which I
have done similar work include Pennsylvania, Arizona, Nevada, and Utah.
Prepared Direct Testimony

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been asked by the Michigan Department of Attorney General to make an independent analysis of MichCon’s GCR plan for the period April 2010 through March 2011. This testimony presents a report of that analysis.

Q. WHAT TOPICS ARE YOU ADDRESSING IN YOUR TESTIMONY THIS YEAR?

A. I am addressing three topics this year. The first is MichCon’s fixed price purchase guidelines for its gas commodity purchases. The second and third topics both relate to MichCon’s purchases of commodity gas supplies from its affiliates. The second part of my testimony addresses affiliate purchases generally. The specific subject of this second part of my testimony is MichCon’s purchases from DTE Energy Trading, a gas and electric power marketing company affiliated with MichCon. The third part of my testimony addresses MichCon’s purchases from MichCon Gathering Company (MGAT), a MichCon affiliate that delivers some of its own gas to MichCon at the outlet of a gathering system that it operates in the northern part of the Lower Peninsula.

In addition to addressing these three major topics, I begin my testimony with brief comments about three other subjects that I do not address in detail: MichCon’s proposal to recover some financing costs through the GCR process; MichCon’s use of the “hinge fit” method to determine normal weather for purposes of its GCR plan; and MichCon’s planned storage utilization.
Q. WHAT PRINCIPAL CONCLUSIONS AND RECOMMENDATIONS HAVE YOU DEVELOPED FROM YOUR ANALYSIS OF THE THREE MAJOR TOPICS IN YOUR TESTIMONY?

A. The principal conclusion that I have reached in my analysis of MichCon’s fixed price purchase guidelines is that the Commission should not in this proceeding approve the completely new guidelines presented in Exhibit A-8. The Commission should instead authorize MichCon to continue using the fixed price purchase guidelines it approved last year in Case No. U-15701, but only through March 31, 2011, and with one relatively minor change that I recommend. The Commission should not approve any guidelines for entering into new fixed price purchase contracts after March 31, 2011 until it has received a report and recommendations from the collaborative being organized to address fixed price purchasing.

The principal conclusion that I have reached in my analysis of MichCon’s affiliate purchasing practices is that the Commission should cap the quantity of MichCon’s purchases from affiliates at 1% or 1.5% of MichCon’s total purchases. This cap is needed to prevent the affiliate purchase opportunity from providing a contrary or perverse financial incentive for MichCon to pay higher than necessary prices to unaffiliated suppliers. This cap would not apply to affiliate purchases that receive prior approval. It applies especially to affiliate purchases that are not included in MichCon’s GCR plan.
My principal recommendation relating to the MGAT situation is that the Commission should require MichCon to purchase at its fair market value the gas that MGAT owns and delivers to MichCon. I also show that the fair market value is most appropriately determined from the published index prices for monthly or daily gas purchases at MichCon’s city gate, not from MichCon’s Jurisdictional Rate, which is the pricing method that MichCon has used in the past for its purchases from MGAT.

Q. HAVE YOU ANALYZED THE PROPOSAL BY MICHCON WITNESS EDWARD J. SOLOMON TO RECOVER SOME FINANCING COSTS THROUGH THE GCR PROCESS?

A. No, not in any detail. I found in a preliminary review that I could not understand how Mr. Solomon proposed to determine exactly which financing costs would be eligible for inclusion in the GCR process, and in what amounts. I was also unable to understand the way Mr. Solomon proposed to coordinate recoveries through the GCR process with the working capital allowance that MichCon is claiming in its pending rate case, U-15985. I therefore recommend that the Commission not approve this proposal unless MichCon clarifies the way it would operate and makes it less complex. At that point, it would become appropriate to evaluate the proposal on its substantive merits, to determine whether it is appropriate.

Q. HAVE YOU ANALYZED THE HINGE FIT METHOD THAT MICHCON WITNESS GEORGE H. CHAPEL USES TO DETERMINE THE NORMAL DEGREE-DAYS FOR MICHCON’S LOAD FORECAST IN THIS PROCEEDING?
A. Yes, I have reviewed Mr. Chapel’s testimony and exhibits on the hinge fit method, and I have examined the testimony of MichCon witness Robert E. Livezey on this topic in MichCon’s rate case, U-15985. I also engaged in discovery relating to the hinge fit method.

Q. DO YOU HAVE A RECOMMENDATION WHETHER THE COMMISSION SHOULD ACCEPT THE HINGE FIT METHOD FOR DETERMINING THE NORMAL WEATHER CONDITION IN THIS GCR PROCEEDING?

A. No, I have not addressed that issue in my analysis of the hinge fit method. I do have some concerns about the way MichCon has implemented the hinge fit method for GCR purposes, but I am not presenting those concerns unless and until the hinge fit method itself gains Commission approval. If the Commission approves the hinge fit method, either in MichCon’s rate case or in this GCR proceeding, then I would expect to address those implementation concerns in a subsequent proceeding.

Q. WHAT ARE YOUR COMMENTS ABOUT MICHCON’S PLANNED STORAGE UTILIZATION?

A. MichCon’s planned storage utilization is inconsistent with paragraph 6.a of the settlement agreement in Case No. U-15628, which the Commission approved in its March 5, 2009 order in that proceeding. The referenced paragraph provides that MichCon will use—i.e., cycle 70 Bcf of storage capacity under normal weather conditions starting in the 2010-2011 GCR year, which is the GCR plan year for the present proceeding. However, MichCon’s normal weather operational plan in Exhibit A-
14 indicates that MichCon plans to cycle only 67 Bcf under normal weather conditions.

This 67 Bcf is the total of the planned withdrawals from November through March in column (E) on page 6 of Exhibit A-14. It can also be calculated more readily by comparing the planned March 31 inventory of 9,200 MMcf in column (F) to the planned inventory of 76,200 MMcf at the end of October, when the winter withdrawal cycle begins.

Company witness Barbara J. Goodwin attempts to minimize this deviation from the approved U-15628 settlement by claiming at page BJG-15 of her testimony that the operational plan includes “3 Bcf of normal weather purchases in excess of normal weather requirements,” and that these excess purchases are part of MichCon’s protection for colder-than-normal (CTN) weather. This claim is nonsense.

MichCon’s normal weather requirements are shown in columns (C, D, and E) on page 1 of Exhibit A-14. MichCon’s planned normal weather purchases are columns (F, G, and H) on the same page. Ms. Goodwin labels them as “supply,” but they are actually the planned purchases, not MichCon’s total supply. This can be seen immediately by noticing that the requirements in columns (C, D, and E) in the winter months far exceed the “supply” quantities in columns (F, G, and H) for the same months. The difference between the requirements and the “supply”/purchase quantities on page 1 is the planned storage activity that Ms. Goodwin reports on page 6 of Exhibit A-14, but Ms. Goodwin does not explain this relationship.
This analysis demonstrates that MichCon’s planned winter purchases fall far short of
MichCon’s planned winter requirements, and the difference is MichCon’s planned
storage withdrawals. Any increase in the planned purchases is therefore just a shift in
the composition of the planned Total Supply mix (with “Total Supply” capitalized to
distinguish it from Ms. Goodwin’s use of “supply” to mean only purchases) to include
more purchase volume and less cycling of storage. And that is the inconsistency with the
U-15628 settlement.

If the additional 3 Bcf of planned purchases in the normal weather operating plan in
Exhibit A-14 is needed only as CTN protection, then the normal weather operating plan
should be modified to show only the purchases that MichCon would make if the actual
weather turns out to be normal. And if MichCon would make that additional 3 Bcf of
purchases even if the actual weather did turn out to be normal, then it is false to
characterize this 3 Bcf as CTN protection or purchases in excess of normal weather
requirements.

Ms. Goodwin also seeks to justify the additional 3 Bcf of normal weather purchases by
claiming that they were presented and approved in MichCon’s 2009-2010 GCR plan in
Case No. U-15701. That claim is irrelevant to the question whether this additional 3 Bcf
is consistent with the U-15628 settlement. The U-15628 settlement agreement was not
developed until after MichCon had already filed its GCR plan for 2009-2010, and the U-
15628 settlement provision at issue is explicitly applicable “Beginning in the 2010-2011
GCR year”.
Q. SHOULD MICHCON’S GCR PLAN BE MODIFIED TO BE CONSISTENT WITH THE U-15628 SETTLEMENT?

A. Yes, the Commission should modify MichCon’s filed plan to make it consistent with the U-15628 settlement. The appropriate modification is to remove 0.6 Bcf (600 MMcf) from MichCon’s planned “supply”/purchases for each month from November through March in column (F) on page 1 of Exhibit A-14. This change is appropriate because Ms. Goodwin testifies that the additional 3 Bcf at issue and in violation of the U-15628 settlement was added ratably to the planned “supply”/purchases for those months. The Commission should also warn MichCon that it is not likely to accept the costs for the remainder of the 5-year forecast period of the present proceeding unless MichCon modifies its storage utilization to be consistent with the U-15628 settlement or provides adequate justification for any deviations.

Q. IS YOUR TESTIMONY ACCOMPANIED BY EXHIBITS?

A. Yes. I selected Exhibits AG-1 and AG-2 to accompany this testimony. They are copies of documents obtained from MichCon in the discovery process in Case No. U-15451-R.

MichCon’s Fixed Price Purchase Guidelines

Q. WHAT ARE MICHCON’S FIXED PRICE PURCHASE GUIDELINES?

A. Company witness Eric W. Clinton presents MichCon’s proposed Fixed Price Purchase Guidelines in Exhibit A-8 and explains them at pages 5-17 of his testimony. These guidelines present a completely new strategy for making fixed price purchases. Under
the proposed new strategy, MichCon would enter into fixed price contracts for 75% of its projected total requirements for each 12-month GCR year (April through March), and it would acquire these fixed price contracts during a 24-month period ending three months before the beginning of the GCR year. The 75% target is not a cap on the quantity of fixed price purchases, but a requirement—thus it is both a cap and a floor for the fixed price purchase quantity. MichCon’s proposed plan is to acquire the fixed price contracts to meet this 75% target on a fixed time schedule, acquiring slightly more than 3% of its projected annual requirements in each of the 24 months ending three months before the beginning of each GCR year. And MichCon is proposing to make these purchase these fixed price contracts on this rigid schedule without regard to the prices it must pay to acquire them.

So far as I am aware, the Commission has never approved a fixed price purchasing strategy that requires a gas utility to have 75% or even 50% of its total annual GCR requirements under fixed priced contracts before the GCR year even begins, or to meet a fixed price purchase requirement of this magnitude without regard to the cost of doing so.

Q. WHAT IS THE RECENT HISTORY AND CURRENT STATUS OF MichCon’S FIXED PRICE PURCHASE GUIDELINES?

A. MichCon has had fixed price purchase guidelines for many years, but these guidelines have been changed from time to time. For the past several years, the guidelines have used the Quartile Index Method (QIM) as the only basis for making fixed price
purchases more than seven months before the beginning of a GCR year. Under the QIM, MichCon did not make fixed price purchases unless the available fixed prices were at or below benchmarks established in the QIM. MichCon’s guidelines for the past years also included various short-term strategies for making fixed price purchases during a GCR year and in the last few months before it began. These short-term guidelines came into play only if MichCon had not yet met the short-term purchase guidelines with QIM purchases.

The Commission’s November 12, 2009 order in Case No. U-15701, MichCon’s GCR plan for 2009-2010, approved MichCon’s use of the guidelines that the Company had proposed in that proceeding. Company witness Clinton states at page EWC-5 of his testimony that MichCon will continue to operate under those U-15701 guidelines until it receives an order in the present proceeding approving new guidelines.

Q. SHOULD THE COMMISSION APPROVE MICHCON’S PROPOSED NEW FIXED PRICE PURCHASE GUIDELINES IN EXHIBIT A-8?

A. No. If the Commission approves fixed price purchase guidelines for MichCon, it should not approve the guidelines that MichCon presents in Exhibit A-8. The Commission should instead approve guidelines based on those it adopted in its November 12, 2009 order in U-15701, but the Commission should now restrict MichCon’s reliance on these guidelines to contracts entered into by March 31, 2011, which is the last day of the GCR annual period addressed in this case. The Commission should not in the present proceeding approve relying upon any fixed price purchase guidelines beyond March 31,
The Commission should instead wait for a report and any recommendations that may be forthcoming from the collaborative effort now being organized pursuant to prior MPSC orders, including specifically the order in U-15701. There is ample time for the collaborative to meet, conduct its business, and present any report and recommendations it may develop by October or November of this year (2010). These results would then be available for MichCon and the other Michigan gas utilities to use in formulating their GCR plans for 2011-2012, which are due to be filed in December 2010. The Commission can then use the report and recommendations of the collaborative, together with those GCR plans for 2011-2012, as a basis for its consideration of fixed price purchase guidelines to be effective after March 31, 2011. The Commission may also wish to establish a deadline, perhaps in October or November of this year (2010), for receiving a report and recommendations from the collaborative or from the Staff if the collaborative is unable to agree on a report.

Q. **WHY SHOULD THE COMMISSION WAIT FOR A REPORT FROM THE COLLABORATIVE BEFORE CONTINUING ANY FIXED PRICE PURCHASE GUIDELINES THAT WOULD REMAIN EFFECTIVE FOR NEW CONTRACTS ENTERED INTO AFTER MARCH 31, 2011?**

A. There are several reasons. One is that the collaborative can reflect a pooling of the expertise and experience of all four large Michigan gas utilities and an opportunity for the Staff, the other parties, and ultimately the Commission to address gas purchasing strategies of all four in a common framework. I am not suggesting that all four utilities should follow the same fixed price purchasing strategy guidelines. Instead, in my
opinion considering the purchasing strategies of all four in a common framework is likely to lead to adoption of a better set of guidelines for each of them—consistent with the requirement in MCL 460.6h(6) to minimize GCR costs of gas sold as well as other relevant factors. It is worth noting that MichCon’s proposed new strategy is completely different from the fixed price purchasing strategy long used by Consumers. MichCon’s most recently approved guidelines also differ markedly from Consumers’, especially for near-term purchases affecting the current GCR year. The collaborative—not the present MichCon GCR plan proceeding—is the first appropriate place to compare different strategies in a search for desirable new approaches.

The collaborative will also provide an opportunity for a deeper and more extensive analysis of alternative gas purchasing strategies than is possible in a GCR plan proceeding. All GCR plan cases are processed simultaneously and statutorily must primarily address each immediate GCR plan year. Gas purchasing strategy guidelines, in contrast, should relate primarily to longer term goals, so there is no urgency to complete the work on them before this and parallel GCR plan cases must be decided. This observation is especially pertinent to MichCon’s proposed new guidelines, which differ markedly from anything the Commission has ever approved.

If the Commission limits the applicability of any fixed price purchase guidelines approved in the present proceeding, it will be sending an appropriate signal that it considers the work of the collaborative to be very important. If the Commission approves fixed price purchase guidelines to be applied to contracts executed after March 31, 2011 and until superseded, the Commission will instead be sending a message that
there is no need for a thorough review of gas purchasing strategies. Approving

guidelines without a March 31, 2011 time limit would signal (1) that parties should
continue with business as usual, which emphasizes differences in GCR plans and
sacrifices long-term policy concerns, and (2) that a more comprehensive review is
unnecessary even though the Commission has previously encouraged collaborative
reviews.

Q. SHOULD THE COMMISSION MODIFY THE GUIDELINES FOR MichCon
THAT IT APPROVED IN CASE NO. U-15701?

A. Yes. Any new guidelines approved by the Commission should limit Second Quartile

purchases under the QIM to quantities that will leave MichCon’s fixed price coverage at

no more than 30% of total requirements. If MichCon has already acquired fixed price

contracts for 30% of its projected total requirements for any future GCR year, the
guidelines should not allow any further purchases for that future GCR year at Second
Quartile prices. This restriction on additional Second Quartile purchases would apply
even if some (or perhaps all) of the 30% had been acquired at First Quartile prices.

However, MichCon could continue making First Quartile purchases above 30% of
projected total requirements in accord with the other provisions of the guidelines
approved in U-15701.

Q. WHY SHOULD THE COMMISSION MAKE THIS CHANGE?

A. MichCon’s fixed price purchases under its guidelines in effect for the past several years
have increased the purchased gas costs for MichCon’s GCR customers by hundreds of
millions of dollars, compared to the costs MichCon would have incurred if it had not
made any fixed price purchases. This result indicates that fixed price purchases are a
problem, because hundreds of millions of dollars of additional gas purchase costs of are
far too high a price to pay for the GCR factor stability allegedly achieved by an extensive
fixed price purchasing program. This problem has occurred in part because the caps on
MichCon’s total fixed price purchase quantity for each GCR year are far higher than the
fixed price purchase quantities needed to achieve a reasonable measure of GCR factor
stability. The cap for fixed price purchases in the Year 1 of the QIM is now 60% of
MichCon’s projected total requirements for Year 1.

When the QIM was first introduced in response to the testimony of Staff witness Robert
Ozar, it was presented as a program to encourage fixed price purchases at times when
prices were favorable. Conditions in the natural gas market have now changed to the
extent that Second Quartile prices are no longer favorable purchasing opportunities.
Second Quartile purchases should therefore be capped at levels that can be justified
entirely on the grounds that some level of fixed price purchases is needed for GCR factor
stability. The levels that the Commission has found to be justified on that basis are the
Long Term Milestone Defaults in Section 4 of the guidelines approved by the
Commission in Case No. U-15701. Under these guidelines, the last and highest of the
Long Term Milestone Defaults is fixed price coverage of 30% by the beginning of each
GCR year. If MichCon reaches this milestone with purchases under the QIM, it should
then stop making further QIM purchases at Second Quartile prices and continue QIM
purchases only at First Quartile or Below First Quartile prices.
MichCon’s proposed new guidelines in Exhibit A-8 would move in the opposite
direction from the change I recommend, because they would require additional fixed
price purchases, and they give no regard to price. MichCon would therefore end up
making fixed price purchases at Third Quartile and even Fourth Quartile prices. The
proposed new guidelines would thus exacerbate the problem of incurring excessive
purchased gas costs for fixed price purchases that are not needed to achieve reasonable
gas cost stability.

Q. IF THE COMMISSION ADOPTS YOUR RECOMMENDED MODIFICATION
TO THE GUIDELINES IT ADOPTED IN CASE NO. U-15701, WILL THAT
ADDRESS ALL OF YOUR CONCERNS ABOUT MichCon’S GUIDELINES?

A. No, it will not. I recommended much more extensive changes to the guidelines in my
testimony in U-15701, and I continue to believe that much more extensive change—but
not necessarily the specific changes I recommended in U-15701—is warranted. In the
present proceeding, I am recommending changes that I consider important and urgently
needed. My current recommendations are also tailored to result in minimal
modifications of the guidelines adopted in U-15701, because I understand that there is
limited value in repeating the same recommendations and views that the Commission
declined to accept last year, especially when other avenues are opening up in the
collaborative. I expect to present a variety of other approaches for consideration in the
collaborative on fixed price purchase guidelines.
MichCon’s Commodity Purchases from Its Affiliates

Q. DOES MichCon’s FILING IN THIS PROCEEDING INCLUDE ANY PLANS TO PURCHASE COMMODITY GAS SUPPLIES FROM ANY OF MichCon’S AFFILIATES?

A. I am not aware of any indication in MichCon’s application or in the testimony or exhibits of the Company’s witnesses to indicate that MichCon plans to purchase commodity gas supplies from any of the Company’s affiliates.

Q. WHY, THEN, HAVE YOU IDENTIFIED AFFILIATE PURCHASES AS AN ISSUE IN THIS PROCEEDING?

A. Affiliate purchases are at issue because there is good reason to believe that MichCon in fact plans to purchase some commodity gas supplies from affiliates during the GCR plan and 5-year forecast periods (April 2010 through March 2011, and continuing to March 2015), despite the absence of any notice of such intention in the Company’s GCR plan filing. This view is based on MichCon’s actions in the past. For many years, going back to 2004, MichCon’s GCR plans have not indicated any intention to purchase commodity gas supplies from affiliates, but MichCon in fact began to make affiliate purchases in 2007, and its affiliate purchases have been increasing since then. In the GCR reconciliation for the 12 months ended March 2009 (U-15451-R), MichCon purchased more than 4 million Dth from affiliates, and these affiliate purchases were more than 2% of MichCon’s total purchases in that GCR period. That 2008-2009 GCR period is the latest for which I have affiliate purchase information, because MichCon objected to the
AG’s interrogatory seeking similar information about the GCR period ended March 2010. The Company’s objection claims that information about MichCon’s actual past purchases from its affiliates is irrelevant to the present proceeding because it is outside the GCR plan period for the current proceeding.

Q. HAVE YOU ADDRESSED THE AFFILIATE PURCHASE ISSUE IN OTHER RECENT MichCon GCR PROCEEDINGS?

A. Yes, I addressed this issue in MichCon’s GCR reconciliation for the 12 months ended March 2009, Case No. U-15451-R. There I focused primarily on adjustments to MichCon’s GCR cost of gas for excessive amounts that MichCon paid to its affiliates for purchases actually recorded in that reconciliation period, but I also identified appropriate prospective remedies to place my recommended purchase cost adjustments in the context of a comprehensive approach to the affiliate purchasing issue. My testimony in the present proceeding is similar to and consistent with my recommendations in U-15451-R. Here I focus on remedies to be applied prospectively, but I also discuss MichCon’s actual purchases from its affiliates in the past few years. I do so to identify the specific issues presented by MichCon’s affiliate purchasing practices. This discussion of MichCon’s past actions is necessary to limit and frame these issues because MichCon has provided no information about its intended purchases from affiliates in the GCR plan and 5-year forecast periods of this proceeding.

Q. WHAT IS THE NATURE OF MichCon’S AFFILIATE PURCHASES SINCE 2007?
A. These affiliate purchases have been of two types. Some of MichCon’s purchases have been from its affiliate DTE Energy Trading (“DTE ET”). DTE ET is a gas and electric power trading company. MichCon purchased some of its commodity gas supplies from DTE ET in what appears to be essentially the same way that MichCon purchased the vast majority of its commodity gas supplies from unaffiliated suppliers, but with one exception. The one exception is that MichCon made only one fixed price purchase from DTE ET during the 2007-2009 GCR periods, and the quantity was less than one-fifth of MichCon’s total purchases from DTE ET, whereas MichCon used fixed price contracts for a much larger fraction of its total supply.

MichCon’s other affiliate purchases have been from MichCon Gathering Company (“MGAT”). MichCon’s arrangements with MGAT are sui generis, unlike any of MichCon’s other purchases in the past several years. I discuss them in a separate part of my testimony.

Q. IS THERE ADDITIONAL EVIDENCE THAT MichCon EXPECTS TO CONTINUE PURCHASING GAS FROM AFFILIATES IN THE PLAN AND FORECAST PERIOD FOR THE PRESENT PROCEEDING?

A. Yes. Company witness Eric W. Clinton describes MichCon’s commodity acquisition process at pages 20-21 of his direct testimony. In MichCon’s GCR reconciliation proceeding for 2008-2009, the AG asked how MichCon selects the suppliers from which it requests price quotations, and how DTE ET fits into that process. Exhibit AG-1 is a copy of MichCon’s response, which MichCon identified as U-15451-R, AGMC-
3.31/245. That description of the supplier selection process is similar to the one in Mr. Clinton’s testimony. It concludes as follows:

DTE Energy Trading is treated in the same manner as any other [sic] non-affiliate supplier.

MichCon provided that response very recently, in April 2010. It is therefore reasonable to assume that DTE ET is still on MichCon’s short list of creditworthy suppliers, and that MichCon is continuing to seek price quotes from DTE ET for some of its commodity purchases.

Q. WHY ARE MICHCON’S PURCHASES FROM ITS AFFILIATES IMPORTANT?

A. Purchases from affiliates are important for (at least) two reasons that I have identified. One is that they present a possible opportunity for MichCon to abuse the GCR process by paying an inappropriately high price to its affiliates and then recovering the inappropriately high purchase costs from its customers. This type of abuse can occur if MichCon gives preference to an affiliate in making purchase transactions. As I shall explain in my separate discussion of the MGAT issues, MichCon has been giving a discriminatory preference to MGAT during the past several years. The Commission should modify MichCon’s filed GCR plan to require that any purchases from MGAT shall be on non-preferential terms.

MichCon’s purchases from affiliates are also important because they may create a financial incentive for MichCon to incur higher costs for its purchases from unaffiliated
suppliers, which is a financial incentive for MichCon to inflate—or at least fail to try to
control or minimize—its total cost of purchased gas.

Q. **HOW DO PURCHASES FROM AFFILIATES CREATE A FINANCIAL INCENTIVE FOR MICHCON TO INCUR HIGHER COSTS FOR ITS OTHER PURCHASES?**

A. This contrary financial incentive affecting all of MichCon’s other purchases is,
paradoxically, a consequence of the regulatory concern about the first problem, which is
the possibility that MichCon may be giving a preference to its affiliates. By incurring
costs that are higher than necessary for all of its purchases—including purchases from
unaffiliated suppliers—MichCon can purchase gas from DTE ET at prices that are
favorable to DTE ET, but without giving any preference to DTE ET. And, of course, the
unaffiliated suppliers will not object to receiving unnecessarily favorable treatment from
MichCon.

Q. **IS THIS A REALISTIC CONCERN IN MICHCON’S PRESENT SITUATION?**

A. Yes. MichCon used index-based pricing for all but one of its purchases from DTE ET
during the 2007-2009 GCR periods. One of the purchases was at the index price itself
(called “flat”). MichCon paid a premium for each of its other purchases from DTE ET,
with the premiums ranging from $0.0025 (i.e., 0.25¢) per Dth to $0.04 (i.e., 4¢) per Dth.
MichCon sought to justify the pricing of these purchases on the basis that the DTE ET
price matched (and in one instance, beat) the best price quotation offered to MichCon by
an unaffiliated seller for the same supply.
The problem with this arrangement is the absence of any assurance that the price quotations used by MichCon as benchmarks for the purchases from DTE ET were the best deals available to MichCon. Even if the benchmark quotes are all of the quotes that MichCon obtained at the time of the DTE ET offer for exactly the same supply as offered by DTE ET, there is no assurance that MichCon would have accepted the best of the benchmark offers absent the offer from DTE ET, because MichCon had a variety of other options. MichCon might have solicited additional price quotations if it was unhappy with the first two or three offers other than from DTE ET. MichCon might have chosen instead to purchase the gas at a receipt point on a different pipeline, or for a different length of contract term (several months instead of just one, or one instead of several). MichCon also had the option of simply waiting a few hours or even a day or two, and then trying the market again. All of these alternatives are ways that MichCon might have attempted to obtain a lower cost than by accepting the offer from its affiliate, DTE ET.

Q. WHAT CHANGE IN MichCon’S PURCHASED GAS COSTS MIGHT BE EXPECTED TO RESULT FROM A DIFFERENT TREATMENT OF MichCon’S PURCHASES FROM AFFILIATES LIKE DTE ENERGY TRADING?

A. If one looks only at MichCon’s actual purchases from DTE ET in 2007-2009, it is unlikely that MichCon could have saved even 5¢ ($0.05) per Dth by ignoring those offers and making other purchases, perhaps in different places or for different terms as I have suggested. The total amount of the savings depends upon the quantity of gas that MichCon purchases from DTE ET. For the 3.3 million Dth that MichCon purchased
from DTE ET in the 2008-2009 GCR reconciliation, the possible savings would therefore be at most $165,000 per year, based on 5¢ ($0.05) per Dth.

Prospectively, the impact could be larger if the Commission takes no action, because it appears that MichCon’s purchases from DTE ET are growing. The 3.3 million Dth that MichCon purchased from DTE ET in 2008-2009 is more than triple the quantity that MichCon purchased the prior year, April 2007 through March 2008. And for the three previous years, from April 2004 through March 2007, MichCon reported in its GCR reconciliation filings that it did not make any affiliate purchases at all.

The cost impact of MichCon’s affiliate purchases could be much greater if they have a wider effect on MichCon’s commodity purchasing practices, as I have indicated is likely, beyond the specific deals that MichCon actually makes with DTE ET. It is not unreasonable to expect that a more thorough attempt by MichCon to minimize its commodity purchase costs—which would make it more difficult for DTE ET to compete, and offer DTE ET less favorable profit opportunities on transactions with MichCon—might yield average savings of 1¢ ($0.01) or even 2¢ ($0.02) on all of MichCon’s commodity purchases. With an annual purchase volume of about 150 million Dth, savings of this magnitude would be $1.5 million or perhaps as much as $3 million per year.

Q. **HOW SHOULD THE COMMISSION ADDRESS THESE CONCERNS?**

A. I have two recommendations. The first is that the Commission should limit the allowable quantity of MichCon’s purchases from its affiliates like DTE ET to 1% or
perhaps 1.5% of MichCon’s total purchases from all sources. If MichCon wishes to exceed this limit, it should present its proposed affiliate purchase contracts to the Commission for advance approval, and purchase quantities approved in advance would not count against this cap.

My second recommendation is that the Commission should not allow MichCon to recover from its customers any amounts higher than the index price of its purchases from its affiliates. MichCon should still be required to demonstrate that the price paid to an affiliate is at least as favorable as the best offer available from an unaffiliated seller, as it did in its GCR reconciliation in U-15451-R. The dual requirements in this second recommendation are necessary to provide for the situations in which competing offers are available at discounts off the index, rather than premiums, as has occurred for purchases at some pipeline receipt points in some months.

The second recommendation would also effectively prevent MichCon from making fixed price purchases from its affiliates, because the recoverable amount would still be limited to the index price, and MichCon is unlikely to want to bear the risk that the index price might turn out to be lower than the contracted fixed price. The exclusion of affiliates from bidding on MichCon’s fixed price purchases is appropriate because it is essentially impossible for the Commission to verify that a specific fixed price purchase was the best deal available to MichCon. Affiliate purchases should be limited to those made at a fair market price, and reference to the published indexes is one of the best methods available at present for identifying a fair market price.
Q. WHY IS IT IMPORTANT FOR THE COMMISSION TO IMPOSE A CAP ON THE QUANTITY OF MichCon’s PURCHASE FROM ITS AFFILIATES?

A. A quantity cap is important because the Commission cannot detect and therefore cannot prevent (or remedy) all of the ways MichCon can favor its affiliates in the purchase of natural gas, not even with the price cap that I have recommended. The imposition of a quantity cap serves to limit the amount of excess cost that MichCon can incur by purchasing gas from its affiliates. More important, if the Commission imposes a quantity cap in addition to a price cap, as I am recommending, the combination may dissuade MichCon from looking to provide opportunities for it to make purchases from affiliates on terms favorable to the affiliates. This combination would thus limit sharply the contrary financial incentive for MichCon to refrain from minimizing its total purchased gas costs.

Q. WHY DO YOU RECOMMEND THAT THE CAP BE SET AT 1% OR 1.5% OF MichCon’s TOTAL ANNUAL PURCHASES?

A. A cap of 1% or 1.5% is low enough to prevent the contrary incentive of benefitting its affiliate from overwhelming the positive incentive that the Commission has placed in the GCR process to encourage MichCon to keep its GCR cost of gas as low as feasible. The positive incentive is that MichCon is not permitted to recover its entire cost of purchased gas in each GCR reconciliation. The amount that MichCon does not recover in the GCR reconciliation process is the cost of Company use gas and lost and unaccounted-for gas (“LAUF”), the latter net of gas-in-kind (GIK) received from transportation shippers.
using the MichCon system. In recent years, the quantity of Company use plus net LAUF has typically been between 3% and 3.5% of total purchases. The cost ascribed to these volumes and excluded from recovery in the GCR process is the quantity of Company use plus net LAUF, multiplied by MichCon’s average cost of purchased gas per Mcf in each GCR reconciliation period, which MichCon calls its “Jurisdictional Rate.” MichCon has a direct financial incentive to minimize these excluded costs, because its revenue does not depend directly upon the amount of these excluded costs. One of the ways that MichCon can reduce the amount of these excluded costs is by reducing its average cost per Mcf for purchased gas. MichCon then retains the benefit of about 3% to 3.5% of the savings in its total cost of purchased gas.

Purchases from affiliates offset this positive incentive for MichCon to minimize its cost per Mcf for purchased gas. If MichCon purchased 5% of its total gas supply from affiliates, and if the average price paid to the affiliates was the same as the average price of all of MichCon’s purchases, then it would be financially advantageous for DTE Energy (MichCon’s parent company) to have MichCon pay a higher average cost for its purchased gas. MichCon itself would have to bear about 3% to 3.5% of the higher purchased gas costs, because they would appear in its cost of Company use and LAUF gas. But MichCon’s affiliates would gain 5% of the higher gas costs if the affiliates were supplying 5% of MichCon’s requirements, and if their prices reflected the prices MichCon paid to unaffiliated suppliers.

Capping MichCon’s purchases from affiliates at 1% or 1.5% of MichCon’s total requirements ensures that DTE Energy (encompassing MichCon and its affiliates) does...
not gain from a general increase in the cost of all of MichCon’s purchased gas supplies. It is important that the affiliate share of MichCon’s total purchases be much less than the 3% to 3.5% representing Company use and LAUF. The reason is that MichCon has been allowed to recover the cost of Company use and LAUF in its base rates. Revenue recovery there has been established in general rate cases, and it has been prospective only, but higher purchased gas costs eventually lead to larger recoveries for Company use and LAUF. The long-term effect of excluding 3% to 3.5% for Company use and LAUF is therefore less than the long-term effect of allowing MichCon to purchase 3% of its total supply from affiliates. Also, MichCon’s rate case filing in Case No. U-15985 includes a proposed true-up of its Company use and LAUF gas expense. Any movement in that direction would weaken the positive incentive for MichCon to minimize its gas costs, making it even more important to restrict the quantity of MichCon’s affiliate purchases to ensure that MichCon does not experience a direct financial gain by paying higher prices for all of its gas purchases.

Q. IF THE COMMISSION ADOPTS YOUR RECOMMENDATIONS AND, IN CONSEQUENCE, DTE ENERGY TRADING AND OTHER MICHCON AFFILIATES ARE NO LONGER WILLING TO SELL GAS TO MICHCON, WOULD THAT HAVE AN ADVERSE EFFECT ON MICHCON’S CUSTOMERS?

A. No. If MichCon had not made any purchases from DTE ET during the entire 12-month period of the GCR reconciliation in U-15451-R, and instead purchased the lowest price offer from an unaffiliated seller, the total cost would have been only $6,400 higher for the entire year. And this cost is an upper bound on the effect of a withdrawal of DTE
ET. MichCon could instead have sought additional bids for the supplies it actually
purchased from DTE ET, or waited a few hours or a day or two, or purchased gas at
some other receipt point or for a different contract term. Any one of these alternatives
might have yielded savings much larger than $6,400 for the year.

Q. ARE YOUR RECOMMENDED AFFILIATE PURCHASE RESTRICTIONS FAIR
   TO MichCon AND ITS AFFILIATES?

A. Yes. MichCon does not use a formal RFP or other competitive solicitation process for
   its commodity gas purchases. Instead, MichCon solicits a few—perhaps three or four—
bids or offers by telephone from selected suppliers (not the same suppliers for each
purchase). MichCon then may accept one or perhaps more of the offers, or perhaps
   none. The entire solicitation and acceptance process takes very little time, measured in
   minutes or perhaps hours. It is fair and reasonable for the Commission to limit the
   participation of MichCon’s affiliates in this process because the process is informal, not
   entirely transparent, and cannot be directly overseen by the Commission.

Q. IN HIS REBUTTAL TESTIMONY IN CASE NO. U-15451-R, PAGE 6, COMPANY
   WITNESS CLINTON CLAIMED THAT MichCon’S COMMODITY
   PURCHASING PROCESS IS “TRANSPARENT” AND “COMPETITIVE,”
   REFERRING SPECIFICALLY TO MichCon’S PRACTICE OF SOLICITING AT
   LEAST THREE VERBAL BIDS FOR EACH PURCHASE. DO YOU AGREE
   THAT MichCon’S PURCHASING PROCESS IS TRANSPARENT?
A. No. The process of selecting the best bid from among the three or four bids received or solicited by MichCon is reasonably transparent, but that is only the penultimate stage in a longer process. The early stages are not transparent, and neither is the final stage. As Exhibit AG-1 indicates, the purchasing process begins when MichCon chooses a “specified product” to purchase. The product specifications include “volume, delivery period, and receipt point,” and MichCon has not explained how they are determined, so this part of the process is not transparent. MichCon then “selects a group of suppliers”—typically at least three, according to Mr. Clinton’s testimony at page 20 of the present proceeding—and solicits verbal bids from them. But MichCon’s description of the bidder selection process is a series of vague generalities, and the process is not transparent. All we have is the result, and even there the supplier “identities” are redacted in MichCon’s filings and responses to interrogatories, leaving just a symbolic designation (A, B, C, etc.) except for DTE ET, which MichCon has identified by name.

After the bids are received, the process again becomes murky, because MichCon “may … bid a lower price [than any of the offers] or reject the offer price and continue to survey the market.” Again there is no evidence of how or why this part of the purchase decision was made. We see the result if MichCon accepts one of the bids, but MichCon has not provided information about the occasions when it rejected all the offers and continued to survey the market, and it has not provided specific criteria for rejection of bids that would enable the Commission or interested parties to review such decisions.

This lack of transparency means that neither the Commission nor the parties to MichCon’s GCR proceedings can possibly make an affirmative evaluation of the
efficacy of MichCon’s commodity purchasing activities by examining the available
information about the bid solicitations and the purchases that result from them.

Q. DO YOU HAVE ANY AFFIRMATIVE EVIDENCE THAT MichCon HAS
FAILED—EITHER BY DESIGN, OR EVEN JUST BY LACK OF SUFFICIENT
EFFORT—TO OBTAIN THE BEST AVAILABLE ARRANGEMENTS FOR ANY
OF ITS COMMODITY GAS PURCHASES?

A. No, I do not, and that is precisely the point of my concern that allowing unlimited
purchases from affiliates may vitiate the financial incentives for MichCon to make a
strong effort to minimize its costs of purchased gas. Except for serious instances of
negligence or abuse, it is impossible for the Commission to detect a lack of effort to
minimize purchased gas costs. That is precisely the reason for preserving the direct
financial incentive for MichCon to minimize its purchased gas costs. And the only way
to preserve that direct financial incentive is to limit MichCon’s purchases from its
affiliates, thereby limiting the opportunity for MichCon to provide benefits to its
affiliates by allowing itself to incur higher gas purchase costs than are necessary.

Q. ARE THERE EXCEPTIONS TO YOUR RECOMMENDATION THAT
MichCon’S PURCHASES FROM AFFILIATES SHOULD CAPPED AT 1% TO
1.5% OF ITS TOTAL PURCHASE VOLUME?

A. Yes. I have already stated one exception, which is that MichCon should be permitted to
submit proposed affiliate purchase contracts to the Commission for prior approval, and if
approved those contracts would not count against the cap. This exception would apply
specifically to MichCon’s purchases from MGAT, which I shall address in the next part of my testimony.

A second exception is purchases that MichCon arranges on the InterContinental Exchange, or ICE. My understanding is that ICE is a trading platform in which bidders do not know the identity of a counterparty until a deal is made. In this situation, there is little opportunity for MichCon to convey benefits to an affiliate such as DTE ET by allowing itself to incur higher gas costs than are necessary. I would therefore recommend an addition to the otherwise applicable cap on affiliate purchases for any affiliate purchases arranged using ICE. The maximum amount of this addition should be the lesser of 10% of MichCon’s purchases on ICE or 1% of MichCon’s total purchases. This addition will provide a reasonable opportunity for MichCon to gain experience using ICE without unnecessarily interfering with its acceptance of deals with DTE ET when they appear on ICE. This addition to the cap should also be subject to review and, if necessary, modification after a year or two of experience.

**Purchases from MichCon Gathering Company (MGAT)**

**Q.** WHAT IS THE SOURCE AND NATURE OF THE GAS THAT MICHCON PURCHASES FROM ITS AFFILIATE MICHCON GATHERING COMPANY (MGAT)?

**A.** MGAT owns and operates the Antrim Expansion Project (AEP), which is a gathering system in the northern part of the Lower Peninsula. The AEP gathered approximately 65
Bcf per year during the two-year period from April 2007 through March 2009, and it delivered that gas to MichCon at the Kalkaska-MichCon interconnect.

Most of the gas gathered by the AEP is owned by the producers of that gas, or by other shippers that have purchased the gas from the producers. After that gas is delivered to MichCon at the outlet of the AEP, MichCon provides a further transportation service, redelivering that gas to end-user customers on the MichCon distribution system or to interconnects with pipelines for onward transportation.

However, MGAT itself owns any gains or losses in gas volume that occur on the AEP. These gains or losses are the AEP equivalent of the LAUF (lost and unaccounted-for) gas on MichCon’s own system, except that for some unexplained reason the AEP can and does experience gains instead of losses. These gains and losses are the difference between the measured quantity of gas delivered off the AEP to MichCon and the measured quantity of gas delivered into the AEP by the producers using the AEP to gather their gas. Since 2004, the AEP has been experiencing only gains, not losses, and these net volumetric gains on the AEP are the gas that MichCon has been purchasing from MGAT. In the past three years, ending March 2009, these volumes have been in the range from about 700,000 Mcf per year to 900,000 Mcf per year. I have no information about more recent MGAT activity because MichCon has objected to the AG’s interrogatories seeking such information, claiming it is irrelevant because it is outside the GCR plan and 5-year forecast period of the present proceeding.
Q. HOW HAS MICHCON ACCOUNTED FOR THE GAS ITS HAS RECEIVED FROM MGAT?

A. MichCon records the net quantity of gas received from MGAT each month in its Exchange Gas account. That account appears explicitly in each of MichCon’s GCR reconciliations as a part of the GCR cost of gas. The Exchange Gas account also includes imbalances at MichCon’s interconnects with its pipeline suppliers and several other categories of gas, besides the gains or losses on the AEP. From January 2001 through March 2004, there were gains in some months and losses in others, and the net total for the 39 months from January 2001 through March 2004 was a net gain of only 251,945 Mcf. During this period, MichCon did not purchase any gas from MGAT, but merely continued to accumulate the gains and losses in its Exchange Gas account.

Since April 2004, the AEP has experienced only monthly gains, not any losses, and the MGAT balance in MichCon’s Exchange Gas account began growing. MichCon therefore began to purchase the MGAT gas balance in its Exchange Gas account from time to time. The first two purchases were 885,776 Mcf in June 2005 and 211,911 Mcf in December 2005. The next purchase was a further 786,598 Mcf that had accumulated from December 2005 through March 2007, but MichCon did not make this purchase until December 2007. MichCon then began purchasing the MGAT deliveries on a regular schedule corresponding to its GCR reconciliation periods (April of one year through March of the next year). MichCon would accumulate the MGAT deliveries in its Exchange Gas account during the 12 months of the GCR reconciliation period and then purchase the accumulated quantity. MichCon purchased the MGAT deliveries for
the 12 months ended March 2008 in September 2008, and it purchased the deliveries for
the next 12-month period, ended March 2009, promptly as of March 31, 2009.

Q. WHAT PRICES DID MICHCON PAY FOR ITS PURCHASES FROM MGAT?

A. The prices that MichCon paid for gas delivered by MGAT were based on the so-called
“Jurisdictional Rate.” The Jurisdictional Rate is MichCon’s average cost per Mcf for all
of its GCR purchases during a GCR reconciliation period (or “GCR year”). It is
calculated and presented in each of MichCon’s GCR reconciliations. However, the
Jurisdictional Rate for the complete GCR year is not and cannot be known exactly until
the end of the GCR year, when all of the purchases for that GCR year are known.
MichCon therefore develops an estimate of the Jurisdictional Rate while the GCR year is
in progress, and it changes that estimate as gas prices change or new information
becomes available.

Q. HAS MICHCON EVER PRESENTED OR EVEN MENTIONED ITS
ARRANGEMENTS FOR PURCHASING GAS FROM MGAT IN A GCR PLAN?

A. No. I have reviewed each of MichCon’s GCR plan case filings since the August 2001
filing in Case No. U-13060, for the calendar year 2002 GCR period, and I did not find
any mention of purchases from MGAT. The absence of any mention of MGAT in these
GCR plans is significant because MichCon did not purchase any gas from MGAT until it
began (or resumed) those purchases in June 2005.
I mention the possibility that MichCon may have resumed (rather than begun) making purchases from MGAT in June 2005 because it appears that MichCon may have purchased the net Exchange Gas balance of MGAT deliveries as of December 31, 2000. However, MichCon’s GCR clause was suspended for the three-year period from January 1999 through December 2001, so there were no GCR filings in which a December 2000 purchase would have appeared.

Q. WHAT ARE THE ISSUES RELATING TO MICHCON’S TREATMENT OF GAS RECEIVED FROM MGAT DURING THE GCR PLAN AND 5-YEAR FORECAST PERIOD OF THE PRESENT PROCEEDING?

A. I have identified two issues relating to MichCon treatment of the gas it receives from MGAT. The first is whether MichCon should continue to treat the gas received from MGAT as an exchange included the GCR process, accumulate it in the Exchange Gas account for an unspecified length of time, and then make an \textit{ex post facto} decision about how best to dispose of the accumulated MGAT volumes. The second and more important issue is the price that MichCon should pay for these deliveries, if and when it purchases them and includes them in its GCR cost of purchased gas.

Exhibit AG-2 provides additional information about the issues in MGAT situation. It is a copy of pages 922-929 from 2,769 pages of documents that MichCon produced in Case No. U-15451-R in response to an interrogatory from the Attorney General, which MichCon identified as U-15451-R, AGMC-3.26/238. This same 8-page document was admitted to the record in Case No. U-15451-R as Exhibit AG-8.
Pages 922-924 of 2769 in Exhibit AG-2 are an analysis of the MGAT situation prepared by MichCon, apparently in October 2007. The first paragraph identifies the “Issue” that MichCon has been accumulating the “found” gas on the MGAT system, carrying it in MichCon’s Exchange Gas account, and needs to “eliminate” this accumulation. The document then proceeds to examine three alternative ways for MichCon to treat the gas it receives from MGAT. One alternative is a Direct Sale of Gas by MGAT. Under this alternative, MGAT would act like the producers and shippers using the AEP. It would itself sell to third parties the gas it delivers to MichCon, and MichCon would merely be the conduit for redelivering that gas to the third party purchasers. The other two alternatives are a “Cashout Mechanism” and the “Jurisdictional Rate.” They are two different methods for MichCon to purchase the gas it receives from MGAT. The difference between the Cashout Mechanism and the Jurisdictional Rate is the price that MichCon would pay to MGAT for these purchases.

Q. **WHY IS MICHCON’S USE OF ITS EXCHANGE GAS ACCOUNT TO RECORD AND ACCUMULATE THE GAS IT RECEIVES FROM MGAT AN ISSUE APPROPRIATE FOR THE PRESENT PROCEEDING?**

A. It is an issue because MichCon has abused this process in the past by using *ex post facto* pricing to purchase the gas accumulated in the Exchange Gas account at unreasonably high prices, thereby giving an unjust preference to its affiliate MGAT and charging unreasonably high prices to the GCR cost of purchased gas. Commission action is needed to prevent MichCon from continuing to abuse the Exchange Gas account in the GCR plan and 5-year forecast period of the present proceeding.
Q. HOW HAS MICHCOn ABUSED THE EXCHANGE GAS ACCOUNTING FOR ITS RECEIPT OF GAS DELIVERED BY MGAT?

A. MichCon has abused the Exchange Gas accounting in two ways. One was to purchase the MGAT delivery volumes accumulated in the Exchange Gas account at MichCon’s current monthly Jurisdictional Rate in effect at the time of the purchase—not at the time the gas was delivered—and to make those purchases at times when the Jurisdictional Rate was unusually high. The second form of abuse was to change the price determination method without notice or justification, and to do so in a way that yielded a higher price for MGAT.

Q. WHEN DID THE FIRST OF THESE TWO ABUSES OCCUR?

A. It occurred throughout the period from January 2001 through November 2005. As shown on Page 927 of 2769 in Exhibit AG-2, MichCon allowed the MGAT deliveries to accumulate in the Exchange Gas account from January 2001 through May 2005, a period when the Jurisdictional Rate was persistently increasing. But when the Jurisdictional Rate decreased in June 2005, MichCon promptly purchased the entire accumulation of 885,776 Mcf at the June 2005 Jurisdictional Rate of $7.41 per Mcf. This purchase price was much higher than any possible measure of the reasonable value of almost all the gas that MGAT had delivered since January 2001, which MichCon had allowed to accumulate until it could purchase it at a high price.

Then something unexpected happened. Along came hurricanes Katrina, Rita, and Wilma in the late summer and fall of 2005, and gas prices rose far above those experienced even
in the first half of 2005. So did MichCon’s Jurisdictional Rate, after remaining at $7.41 per Mcf in June, July, and August. MGAT continued delivering gas to MichCon during the second half of 2005 because the hurricanes did not interfere with production in Michigan, and that gas had a very high market value. But by December 2005, gas production in the Gulf Coast producing area was beginning to recover and gas prices were heading back down again. In that December 2005 situation, MichCon purchased the 211,911 Mcf of MGAT deliveries that had accumulated in just the six months since MichCon’s prior purchase in June 2005. By making a second purchase so soon after the June 2005 purchase, MichCon was able to pay $10.00 per Mcf for that 211,911 Mcf. This purchase insulated that 211,911 Mcf from the loss in value that was then occurring as gas prices fell when gas production recovered from the hurricanes. The timing of these two purchases—one for all the MGAT volumes accumulated over a period of more than four years, and the next only six months later—demonstrates clearly that MichCon was using the Exchange Gas treatment of the MGAT deliveries to pay preferentially high prices to MGAT and charge these high purchased gas costs to its GCR customers.

Q. **HOW DID MICHCON CHANGE ITS METHOD FOR DETERMINING THE PRICE IT PAID TO MGAT?**

A. After December 2005, MichCon again continued to let gas delivered by MGAT accumulate in the Exchange Gas account. MichCon did not purchase any of the accumulated MGAT volumes until December 2007, but that purchase included only the volumes accumulated through the end of March 2007, and MichCon used a different method to determine the price paid to MGAT for those volumes. The price that
MichCon selected for this next purchase was again the Jurisdictional Rate—but not the Jurisdictional Rate at the time of the purchase itself, which is the method MichCon had used in June and December 2005. In December 2007, the current Jurisdictional Rate was $7.75 per Mcf. MichCon decided to use instead the Jurisdictional Rates applicable to the GCR years in which it had received the MGAT deliveries. By changing its method for determining the price to be paid to MGAT, MichCon was able to pay higher prices to its affiliate and increase the costs charged to the GCR. Under its new pricing method, MichCon paid the much higher rate of $9.4737 per Mcf for the 143,257 Mcf that it had received from MGAT from November 2005 through March 2006, and the slightly higher rate of $7.7991 for the 643,341 Mcf it had received from MGAT in the 2006-2007 GCR year (April 2006 through March 2007). This purchase is documented on Page 929 of 2769 in Exhibit AG-2.

Q. HAS MICHCON EVER ADOPTED A DEFINITIVE POLICY FOR ITS TREATMENT OF THE MGAT DELIVERIES?

A. I do not know. But if MichCon has adopted such a policy, it has never described that policy or even stated its existence in any GCR plan or GCR reconciliation proceeding, unless perhaps MichCon did so in a GCR proceeding in the 1990s. And any such statement in the 1990s would clearly be irrelevant now because MichCon has changed its policy towards the MGAT deliveries several times since then, as I have demonstrated.

Q. IS THIS ABSENCE OF A DEFINITIVE POLICY A REASON FOR COMMISSION ACTION?
A. Yes. I recommend the following actions.

- The Commission should modify MichCon’s filed GCR plan to include a definitive treatment for any gas that MichCon may receive from MGAT during the GCR year addressed in this proceeding, April 2010 through March 2011.

- The definitive treatment that the Commission should adopt is a requirement for MichCon to purchase all of the gas volume gains across the AEP, and to do so at the fair market value of the gas at the time it is delivered to MichCon.

- The Commission should also prescribe the fair market value of each month’s deliveries to MichCon as the published MichCon city gate index price for that month, less 5¢ ($0.05) per Dth.

- If there is a volume loss across the AEP in some month, MichCon should cover the resulting shortage in MGAT’s deliveries and charge MGAT a price equal to the higher of the MichCon city gate index price for that month, plus 5¢ ($0.05) per Dth, or the GCR factor charged by MichCon for its GCR sales in that month.

The Commission should also allow MichCon or any other party to seek a change in this prescribed treatment in any future GCR plan proceeding, but the prescribed treatment should continue to apply after March 2011 until modified pursuant to Commission order.

Q. WHY SHOULD THE COMMISSION MODIFY MICHCON’S GCR PLAN TO INCLUDE A DEFINITIVE TREATMENT FOR ANY GAS RECEIVED FROM MGAT?

A. Definitive treatment in the GCR plan is needed to prevent MichCon from waiting until after the GCR year is completed and then using hindsight to decide what treatment of the MGAT deliveries yields the most advantage to its affiliate, which is the pattern of MichCon’s past actions, as I have demonstrated. Establishment of a definitive treatment
in the GCR plan will also avert the disputes that are likely to arise in the GCR reconciliation proceeding if there is no prescribed treatment in the GCR plan.

Q. IS IT FAIR FOR THE COMMISSION TO ESTABLISH A PRESCRIBED TREATMENT OF THE MGAT DELIVERIES WITHOUT RECEIVING A PROPOSAL BY MichCon?

A. Yes. The deliveries from MGAT are one of MichCon’s “expected sources and volumes of its gas supply” in the language of MCL 460.6h(3), and they belong in the GCR plan. MichCon could have presented its proposed treatment of these volumes in its filing this year or in either of its two previous GCR plans, going back to Case No. U-15042 filed in December 2007, when MichCon had already begun “adjusting its purchases [of other gas supplies] to allow for [the gas expected from MGAT].” (See Exhibit AG-2, Page 924 of 2769.) MichCon’s failure to address this issue should not give rise to a claim that it is unfair for others to do so.

Q. WHY SHOULD THE DEFINITIVE TREATMENT PRESCRIBED BY THE COMMISSION BE FOR MichCon TO PURCHASE ALL OF THE GAS VOLUME GAINS ACROSS THE AEP?

A. Requiring MichCon to purchase these gains is appropriate and fair to MichCon because that is precisely what MichCon has been doing with all of the gas delivered by MGAT since at least January 2001.
Q. WHY SHOULD THE DEFINITIVE TREATMENT REQUIRE PURCHASE OF THE MGAT VOLUMES AT THEIR FAIR MARKET VALUE?

A. The fair market value of the MGAT deliveries is the price that MGAT could obtain if it sold that gas to some purchaser other than MichCon in an arm’s-length transaction. It is also the price that MichCon could obtain if it sought to obtain a similar supply from some other vendor. If MichCon paid a price higher than fair market value, it would be giving a preference to its affiliate, and that would be improper.

Q. WHY SHOULD THE FAIR MARKET VALUE OF THE MGAT DELIVERIES BE MEASURED AT TIME OF DELIVERY, RATHER THAN AT SOME OTHER TIME?

A. The fair market value of the MGAT deliveries should be measured at the time MGAT delivers the gas to MichCon because that is when these deliveries are recorded as entering the GCR process. MichCon’s past practice has been to record the MGAT deliveries as Exchange Gas receipts, as I have explained, and then wait until some later date to “dispose” of these Exchange Gas volumes by purchasing them. If MichCon is allowed to measure the fair market value of gas in the Exchange Gas account at some time other than the time of receipt, it can choose a valuation date that is unfairly preferential to MGAT. That is exactly what MichCon did when it purchased all of the gas it received from MGAT from January 2001 through May 2005 at the high value of gas delivered in June 2005, as I have explained.
This practice is an abuse because MichCon had effectively been storing the gas received from MGAT in storage capacity dedicated to serving its GCR and GCC customers, but MichCon conveyed the increase in the value of that stored gas to MGAT, not to the customers. Valuation of the MGAT deliveries as of the month of receipt avoids this abuse.

Q. HOW DID YOU DETERMINE THAT THE FAIR MARKET VALUE OF THE GAS PROVIDED BY MGAT IN EACH MONTH IS THE PUBLISHED INDEX PRICE FOR THAT MONTH AT THE MichCon CITY GATE DELIVERY POINT, LESS 5¢ PER DTH?

A. The fair market value of pipeline quality natural gas depends upon several factors. Among the most important are the time of delivery, the delivery location, and security of supply. I determined the fair market value of the gas that MGAT delivers to MichCon by examination of these factors.

The time of delivery is important because gas delivered in the winter is generally expected to have higher value than gas delivered during the summer. More generally, gas prices change markedly from month to month, and even from day to day, so the fair market value depends upon when the gas is delivered. I therefore based the fair market value of the gas delivered by MGAT in each calendar month on an index price for that month.

The delivery location is important because the movement of gas from one place to another involves costs. Exhibit A-9 shows the projected (future) prices for gas supplies
delivered at each of the locations where MichCon purchases a major part of its supply. I chose the MichCon city gate location because that is where MGAT delivers its gas to MichCon.

Supply security considerations are the reason the appropriate price is the published price index for monthly or first-of-the-month purchases, not some forward or futures price established far in advance of the delivery month. The current monthly or spot price is appropriate because the MGAT supply is not a secure supply, and MGAT would therefore be unable to sell it in a forward market at a fixed price. An alternative and also acceptable measure of the current monthly price would be the Monthly Index Price determined in accord with tariff provision E14.4.B in the Transportation Service section of MichCon’s tariff, Sheet No. E-19.00. This Monthly Index Price is the average of the published daily index prices for the month, rather than the first-of-the-month price.

The absence of supply security is also the reason I recommend deducting 5¢ per Dth from the monthly index price to determine the fair market value of the MGAT deliveries. The monthly index price reflects the value of gas delivered under standard NAESB contracts, which include a supply security provision relating to a specified contract quantity. For the MGAT deliveries, in contrast, MGAT delivers whatever gas it happens to have, with no quantity obligation, but MichCon is obligated to take whatever gas MGAT delivers. MichCon thus provides what might be called “purchaser security”, which is the equivalent of a take-and-pay obligation and the exact opposite of supply security. It has a market value that I judge to be 5¢ ($0.05) per Dth, and this value entitles MichCon to a discount of 5¢ off the published index price for secure supplies.
The combination of these three factors thus led me to the conclusion that the fair market value of the gas delivered by MGAT is the published monthly index price for gas delivered at a MichCon city gate, less a discount of 5¢ ($0.05) per Dth.

Q. WHY SHOULD THE FAIR VALUE OF MICHCON’S PURCHASES FROM MGAT BE BASED ON THE FAIR VALUE OF PIPELINE QUALITY GAS?

A. The fair market value of MGAT’s deliveries is properly based on the fair market value of pipeline quality gas because MGAT’s deliveries to MichCon are of pipeline quality. In contrast, the gas that MGAT receives as inputs to the AEP are not of pipeline quality, and gas on the AEP is processed to bring it up to pipeline quality standards. I therefore mentioned pipeline quality to emphasize that I am addressing only the value of the MGAT deliveries to MichCon at the outlet of the AEP, not the value of gas received by MGAT or the gas in the gathering and processing activity that occurs on the AEP upstream of its outlet to MichCon.

Q. WHAT IS THE BASIS FOR YOUR VIEW THAT THE MGAT DELIVERIES ARE NOT A SECURE SOURCE OF SUPPLY?

A. At page EWC-23 of his testimony in Case No. U-15451-R, MichCon witness Eric W. Clinton refers to the MGAT deliveries as a “surplus on MichCon’s system.” In its response to the interrogatory identified as MCAMC-1.34/48 in the same GCR reconciliation proceeding, MichCon provided the following statement:

The MGAT deliveries were not anticipated in MichCon's filed plan due to the unpredictable nature of the gains and losses at the Kalkaska-MichCon meter.
MichCon cannot count on MGAT surpluses in its operational planning, particularly during critical months.

In contrast to the MGAT deliveries, a secure supply is one that is predictable, and that MichCon can count on in its operational planning.

Q. IF MGAT EXPERIENCES A VOLUME LOSS ACROSS THE AEP IN SOME MONTHS, WHY SHOULD MICHCON COVER THE RESULTING SHORTAGE IN MGAT’S DELIVERIES?

A. MichCon should cover the shortages in MGAT deliveries due to any volume losses across the AEP because that is what MichCon did in the past, whenever such shortages occurred. If MichCon wanted to change that policy, it should have informed the Commission of its intent to make such a change in a GCR plan or other appropriate proceeding.

Q. WHY SHOULD MICHCON CHARGE MGAT FOR THESE SHORTAGES AT A PRICE EQUAL TO THE HIGHER OF THE MICHCON CITY GATE INDEX PRICE FOR THAT MONTH, PLUS 5¢ ($0.05) PER DTH, OR THE GCR FACTOR CHARGED BY MICHCON FOR ITS GCR SALES IN THAT MONTH?

A. If MGAT again begins to experience losses across the AEP, then MichCon will again be providing a balancing and gas supply service for MGAT, not just purchasing the production volumes that MGAT happens to have available for sale because of recurring volume gains on the AEP. In that situation, it is appropriate for MichCon to charge its affiliate the higher of its own (MichCon’s) book cost or the fair market value of the gas it
provides to cover the shortages in MGAT’s deliveries. I use MichCon’s GCR factor charged each month as a proxy for MichCon’s book cost. The MichCon city gate index price plus 5¢ ($0.05) per Dth is the price I recommend as the fair market value. The premium of 5¢ above the index is appropriate for sales by MichCon to MGAT for the same reason that a discount of 5¢ is appropriate for MichCon’s purchases from MGAT—the quantities are uncertain, and MichCon has an obligation to deliver whatever gas MGAT requires.

Q. HAS THE PRICING OF MICHCON’S PURCHASES OF THE MGAT DELIVERIES BEEN ADDRESSED IN ANY OTHER GCR PROCEEDINGS?

A. Yes, it has been addressed in Case No. U-15451-R, MichCon’s GCR reconciliation for 2008-2009. I testified there, and my pricing recommendations there were the same as my recommendations here. The hearings in U-15451-R had been completed when my direct testimony here in Case No. U-16146 was filed in April 2010, but no decision or other resolution had been reached.

MichCon also disclosed in Case No. U-15042-R, its GCR reconciliation for 2007-2008, that it had used the Jurisdictional Rate to price its December 2007 purchase of MGAT’s deliveries from December 2005 through March 2007. However, the merit of using the Jurisdictional Rate for this purpose was not addressed. I testified about the December 2007 purchase, but only to dispute MichCon’s claim that the recording in December 2007 of MichCon’s purchase of the prior GCR years’ (2005-2007) deliveries from MGAT had no effect on the GCR cost of gas in the U-15042-R reconciliation for 2007-
2008. I failed to notice the much more important question whether the Jurisdictional Rate was or would have been appropriate even if used in a more timely fashion, and I did not address that issue until the next year, in U-15451-R. The U-15042-R GCR reconciliation was eventually settled, and the settlement agreement (which the Commission approved) made no mention of the dispute about MichCon’s purchase of the MGAT deliveries.

MichCon did not disclose its June or December 2005 purchases of MGAT deliveries in its GCR reconciliation filing where those purchases were (or should have been) recorded, Case No. U-14401-R, for the 2005-2006 GCR year. Staff may have audited them, but I was unaware of them at the time and did not become aware of them until MichCon disclosed them three years later in the course of the litigation in U-15451-R, and there was no mention of them in the U-14401-R record, PFD, or Commission order.

Q. WOULD IT BE APPROPRIATE TO USE MichCon’S JURISDICTIONAL RATE, WHICH REFLECTS MichCon’S AVERAGE COST OF PURCHASED GAS, TO PRICE MichCon’S PURCHASES FROM MGAT?

A. No, it would not be appropriate. The appropriate price is the fair market value of MGAT’s deliveries to MichCon, and the Jurisdictional Rate differs from the fair market value in several important ways. The only possible justification for using the Jurisdictional Rate would be to price the purchases at the lower of cost or market, and to use the Jurisdictional Rate as a proxy for cost in this arrangement. I am not recommending this “lower of cost or market” pricing method in this situation because I
would not require that MGAT receive a price lower than the fair market value of its gas
deliveries to MichCon if MichCon happens to have a Jurisdictional Rate average cost
that is below the current market price of gas.

Q. HOW DOES MICHCON’S JURISDICTIONAL RATE DIFFER FROM THE FAIR
MARKET VALUE OF THE GAS THAT MGAT DELIVERS TO MICHCON?

A. One very important difference is that the Jurisdictional Rate includes the cost of
MichCon’s fixed price purchases. The fair market value of the MGAT deliveries, in
contrast, is a monthly (or daily) index price with a small adjustment for the absence of
supply security. For the past few years, MichCon’s fixed price purchases have cost an
average of more than $1.00 per Mcf more than purchases at monthly index prices, and
this cost differential has added more than $0.50 per Mcf to MichCon’s Jurisdictional
Rate. Based on the current NYMEX futures prices, this large differential will continue
through the current GCR plan year and into the 5-year forecast period. The inclusion of
fixed price purchases is thus causing the Jurisdictional Rate to exceed the fair market
value of the MGAT deliveries by at least $0.50 per Mcf.

Another difference is that the Jurisdictional Rate reflects the costs of MichCon’s
purchases at all the locations shown in Exhibit A-9, not just the MichCon city gate
location that I recommend as indicating the fair market value of the MGAT deliveries.
The index prices at the other locations are different from those at MichCon’s city gate,
and purchases at other locations also involve transportation costs. The seasonal and
monthly patterns of purchase quantities also differ from the pattern of monthly deliveries
by MGAT, and that too causes the Jurisdictional Rates to differ from the fair market value, because the index prices vary from month to month.

Q. **WOULD IT BE APPROPRIATE FOR MichCon TO PAY MGAT A PRICE REFLECTING, AT LEAST IN PART, THE COSTS OF MichCon’S FIXED PRICE PURCHASES?**

A. No, it would be entirely inappropriate. A fixed price contract requires the seller to deliver a specified quantity of secure supply at a specified future date, and part of the value of the fixed price contract is the security of that specified quantity of future supply. But security of supply is something that MGAT cannot offer to MichCon, as I have explained. It would be unjust and unreasonable for MichCon to pay MGAT a price reflecting the supply security and other perceived advantages that MichCon expects from its fixed price contracts, when MGAT cannot possibly offer those same advantages in its deliveries.

Q. **IS THERE ANOTHER REASON WHY THE COMMISSION SHOULD NOT ALLOW MichCon TO USE ITS JURISDICTIONAL RATE TO PRICE ITS PURCHASES FROM MGAT?**

A. Yes. If MichCon is allowed to use its Jurisdictional Rate to price purchases from MGAT, then MichCon will have a direct financial incentive to make its Jurisdictional Rate higher, so that it can pay a higher price to its affiliate MGAT. This incentive is a problem because the Jurisdictional Rate is MichCon’s actual average cost of purchased gas, and the Commission surely does not want to provide a financial incentive for
MichCon to incur a higher average cost of purchased gas. This contrary financial
incentive is the same as the problem that arises when MichCon uses the prices of its own
transactions with unaffiliated suppliers as the benchmark for the prices it pays to its
affiliate, DTE Energy Trading, as I have previously explained.

Q. DOES THIS CONCLUDE YOUR PREPARED DIRECT TESTIMONY?

A. Yes, it does.
Question: How does MichCon decide which suppliers to solicit bids from for a specific purchase? How does MichCon decide whether to solicit a bid from DTE Energy Trading for a specific purchase?

Answer: MichCon will select a group of suppliers for a purchase based on factors including but not limited to supplier diversity, suppliers who are historically active market participants at a specific receipt point, supplier performance history, supplier's ability to alternate receipt points, and creditworthiness. MichCon will then call these suppliers and ask them what their offer (ask) price is for a specified product in terms of volume, delivery period, and receipt point. MichCon may then accept the offer price or bid a lower price or reject the offer price and continue to survey the market.

DTE Energy Trading is treated in the same manner as any other non-affiliate supplier.
Question: Provide all documents in MichCon's possession relating to the developments described by Ms. Schmidt from page 4 of her rebuttal, line 18, through page 5, line 4. Also provide any documents demonstrating MichCon's view that use of the Jurisdictional Rate would prevent abuses, as described by Ms. Schmidt at page 5, lines 6-11. Include any documents that indicate when these decisions were made, in the period between December 2005 (when the process began) and December 2007, when MichCon made the first purchase using this new approach.

Answer: Please see attachment AGMC-3.26/238.
Michigan Consolidated Gas Company

Treatment of MGAT Found Gas

Issue: There is consistently found gas on the MGAT system. Ownership of this gas can accurately be assigned to MGAT. Currently, MichCon is carrying a balance for this gas as “Exchange Gas” at the current Jurisdictional rate. The current balance of this gas needs to be eliminated. Three methods are proposed for resolving the imbalance:

- Direct Sale of Gas by MGAT:
  - No risk of disallowance to MichCon.
  - No filing necessary to implement the sale.
  - Would need to determine if existing balance can be sold without regulatory risk.
- Cashout Mechanism:
  - No risk of disallowance of costs to MichCon once approved.
  - Filing would be necessary to implement. Regulatory has not identified any issues that would interfere with the approval of such a filing.
  - Filing could signal producers on MGAT system to request new rates.
  - Could sell existing balance using cashout mechanism.
- Jurisdictional Rate
  - This method has been used in the past.
  - Potential risk of GCR disallowance
  - Filing as an issue either as part of the GCR Plan or Reconciliation would be necessary to ensure recovery.
  - Until an affirmative Commission order was issued approving this treatment, recovery would be at risk.
  - It would be possible to include in the GCR without identification as a separate issue.
  - Existing balance could be sold using this method.

This discussion does not include the business risk associated with each of these alternatives such as administrative costs, income certainty, etc. It also reflects our current understanding of the issues.

A detailed examination of the issues and each method is presented below.

MGAT Background Info:
Found Gas: The source of the found gas is unclear. It is possible it could result from differences in meter measurements that are within acceptable accuracy tolerances. In U-12342, when rates were set for MGAT, lost/found gas was included in the Gas-in-kind Retainage of 0.12% (0.06% of the total was attributed to lost gas). Treatment of revenues arising from found gas would need to be
addressed in a rate case. Until rates are reset, MGAT would retain all revenue attributed to lost/found gas.

MichCon’s Potential treatment of found gas:

Although currently only found gas is occurring on MGAT’s system, it is possible that lost gas could occur in the future. Any method used to dispose of this gas needs to accommodate both of these events. If MGAT was not an affiliate, this would be like any other imbalance (ANR, etc) and we would keep a running balance until the imbalance was eliminated. However, if the imbalance kept going only one way, we would eventually have to resolve the imbalance. This is not an imbalance resulting from the same sort of actual/estimated heat value, like pipeline imbalances.

Current Balance: Currently there is approximately a 1.2 Bcf balance of found gas on MichCon’s books. If MichCon did not purchase this gas MichCon would have to adjust its S&D to purchase this volume of gas from another source. The current MichCon S&D assumes MichCon will purchase the MGAT gas directly. This assumption was developed upon the recommendation of Regulatory.

Direct Sale of found gas by MGAT: This is the most straightforward method of dealing with the found gas. MGAT would find a buyer for the found gas and sell it directly to that buyer. There would be no risk of recovery to MichCon. This method does not provide a way for MGAT to deal with lost gas. It might be possible to provide a mechanism like the TBQ in timing the sale of this gas (provide the volume of imbalance by the middle of the following month, 2nd month, with gas being removed from the system during the month following that, 3rd month). It is possible questions could arise regarding the fact that MichCon has been carrying this balance with no penalty or cost to MGAT. The existing balance could be sold outright at a market rate or possibly to MichCon using the Jurisdictional rate.

It could be reasonable to clear up the existing imbalance using a Jurisdictional rate purchase that ran the costs through the GCR. This could be supported because it would be a continuation of past treatment of these volumes. I would anticipate seeing testimony along the lines of “While this treatment was appropriate while MGAT was a wholly owned subsidiary and the volumes were nominal, the combination of MGAT being a separate entity combined with the increase in the volumes has lead MichCon to treat these volumes separately on a going forward basis.” I would also anticipate the volumes would be “dated” and the appropriate jurisdictional rate be used for each years’ volumes.

Cashout: Using the cashout method, MichCon would buy the found gas (or sell gas to replace lost gas) under a cashout mechanism. The current cashout mechanism is meant to be used by the nominating agents. MGAT differs because the producers on the MGAT system are the nominating agents and are
assumed to be delivering 100% of what they nominate with MGAT being responsible for any differences. The imbalance is attributable to MGAT, which is not a nominating agent. It is unclear what the % to be used in calculating the imbalance would be, since MGAT is not the nominating agent. It could be the total nominations for the shippers using its system. It seems likely this could be approved without any major issues. It has the benefit of being very similar to a program we offer non-affiliated companies which should minimize concerns regarding preferential treatment of an affiliate. Once approved, this method would have almost no regulatory risk in terms of GCR recovery.

- This mechanism could be the current mechanism, altered to accommodate the specific MGAT situation.
- Alternatively, a separate cashout mechanism could be filed that would apply solely to MGAT

If this mechanism was selected, the existing balance could be purchased using this mechanism, although the specific pricing for volumes would most accurately be determined using historical data.

**Purchase at Jurisdictional rate**

This gas has been treated, properly, as exchange gas up to this time. If MichCon purchased this gas, it could reasonably be purchased at the jurisdictional rate. Currently, MichCon is adjusting its purchases to allow for this balance of gas. If this gas did not exist, MichCon would have to purchase additional gas to take its place. The jurisdictional rate is the average rate MichCon paid for gas it purchased. It is reasonable to assume MichCon would have paid the same amount for any additional gas it would have purchased had this gas not been available (fixed price gas may not fit this logic). Affiliate issues should be minimal because MichCon is purchasing gas this gas at the average it paid to all of its non-affiliated suppliers. Presumably, this is the amount it would pay to any supplier, regardless of affiliation. However, if we use this argument, we need to be prepared to defend why we don’t offer this same benefit to other, non-affiliated companies (such as the companies that are covered by the Cash Out provision).
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<tr>
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<td>(697,360)</td>
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<td>(47,531)</td>
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<td>(47,531)</td>
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<td>(78,658)</td>
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<td></td>
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Total: $1,349,084.15

Note: This is not the final version.
### Exhibit AG-2

**Attachment:** AGMC-3.26/238  
**Case No.:** U-15451-R  
**Respondent:** J. C. Schmidt  
**Page:** 927 of 2769

<table>
<thead>
<tr>
<th>Year</th>
<th>January</th>
<th>February</th>
<th>March</th>
<th>April</th>
<th>May</th>
<th>June</th>
<th>July</th>
<th>August</th>
<th>September</th>
<th>October</th>
<th>November</th>
<th>December</th>
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<tbody>
<tr>
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<td>Preliminary Balance</td>
<td>Monthly (Gain)/Loss</td>
<td>Purchased</td>
<td>(Gain) Loss Purchased</td>
<td>(Gain) Loss Purchased</td>
<td>Net Not yet purchased</td>
<td>Jurisdictional Rate</td>
<td>Purchase Rate</td>
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<td>32,156</td>
<td>33,120</td>
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<td>37,384</td>
<td>38,450</td>
<td>39,516</td>
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<tr>
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<td>2005</td>
<td>(7,017)</td>
<td>29,282</td>
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<td>31,212</td>
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<td>34,186</td>
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<tr>
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<td>35,252</td>
<td>36,318</td>
<td>37,384</td>
<td>38,450</td>
</tr>
</tbody>
</table>

**Note:** The table above provides a summary of financial transactions from January 2001 to December 2020. The data includes preliminary balances, monthly changes (Gain)/Loss, purchased amounts, and jurisdictional rates. Purchase rates vary from $4,500 to $4,900, with some entries indicating a $4,300 rate.
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<th>Amount</th>
<th>$</th>
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<td>September</td>
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<td>1,357,211</td>
<td>(98,179)</td>
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(85,180) $ 7,7600
(78,049) $ 7,7600
(86,179) $ 7,7600
Deal Date: 12/12/2007  
Marketer: Robert Lawshe  
Company: MichCon Gathering Company  
Address:  

<table>
<thead>
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<th>Supplier Status</th>
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<tbody>
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</tr>
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<td></td>
</tr>
<tr>
<td>WOB</td>
<td></td>
</tr>
<tr>
<td>HUBZone</td>
<td></td>
</tr>
<tr>
<td>SDVOSB</td>
<td></td>
</tr>
<tr>
<td>VOSB</td>
<td></td>
</tr>
<tr>
<td>LARGE</td>
<td></td>
</tr>
<tr>
<td>OTHER</td>
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</table>

Supplier Approved by Risk Mgmt. Date: NA  
Fixed Price Approved by Risk Mgt. Date: NA  
Physical Delivery Intended: Yes X | No  
For Physical Sale to GCR Customer: Yes X | No  

Rate:  
Estimated Cost: $6,374,654.63  
as of 12/12/2007  

<table>
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<td>vis</td>
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<tr>
<td>Total Rate</td>
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<td>Spread</td>
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</tr>
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<td>Rate Index</td>
<td></td>
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</tr>
</tbody>
</table>

Pipeline | Location | Quantity | MMBtu | Monthly | Term  | Start | End  | Price  | Deal #  
----------|----------|----------|-------|---------|-------|-------|-------|--------|---------|


Purpose of Transaction:  
Settlement of imbalance at MichCon - AEP Interconnect.

COMPLETED  
(circle one)  
Gas Supply  Planning & Control  Planning Analysis

Signature:  
[Signature]

Comments: See special provisions attached.