



Gas Cost Recovery (GCR) Plan and Factors

Energy Regulatory Partnership Program
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Act 304 provides that the Commission:

“May incorporate a gas cost recovery clause in the rates or rate schedule of a gas utility but is not required to do so.”

All of the regulated gas utilities in Michigan have gas cost recovery clauses.

Act 304 applies only to the commodity
portion of the customers' bills
(i.e., the portion that covers the cost of gas)

The cost to distribute the gas is determined
in a rate case proceeding.

Sample Consumers Energy Gas Bill

RATE 250 05-01 TO 05-31

GAS CHARGES

CUSTOMER CHARGE		\$8.50
DISTRIBUTION CHARGE	25 CCF @ 0.186130	\$4.65
GAS COST RECOVERY CHARGE	25 CCF @ 0.828840	\$20.72
TOTAL GAS		\$33.87
SALES TAX		\$3.38
TOTAL CURRENT BILL DUE ON OR BEFORE 06/21/07		\$87.82

The “heart” of Act 304 provides:

“A utility shall annually file . . . a complete gas cost recovery plan describing the expected sources and volumes of gas supply and changes in the cost of gas anticipated over a future 12 period.”

Five-year Forecast

In addition to the GCR plan, the gas utility:

“shall file contemporaneously . . . a 5-year forecast of the gas requirements of its customers, its anticipated sources of supply, and projections of gas costs.”

Why separate the commodity from the distribution rates?

- The gas utility does not earn a profit on the gas it sells.
- The cost of gas is essentially a “pass through” from the utility to the customer.
- The cost of natural gas is VERY volatile thus, price adjustments during the year help keep over and under recoveries in line.

The GCR Plan

The utilities consider:

- How much gas do we need?
- What is our gas purchasing strategy?
- How much is gas going to cost the customer per unit (best estimate)?
- How are we going to supply our customers on the coldest day of the year?

Michigan is Unique! (somewhat)

Gas utilities are able to take advantage of the fact that Michigan has a large amount of underground storage available.

Most other states either have NO storage or have to rent storage from other states.

How is storage significant?

The availability of storage allows Michigan gas utilities to purchase gas anytime during the year. Natural gas tends to be less expensive during the summer (although that's less true now because summer demand is higher) so Michigan has a natural hedge in gas purchasing.

GCR Plan Process

Act 304 provides:

“The plan shall be filed not less than 3 months before the beginning of the 12-month period covered by the plan.”

A full contested case is held – anyone with an interest may intervene in the case including the Attorney General, individual customers or residential and business consumer advocacy groups.

The Commission's Job

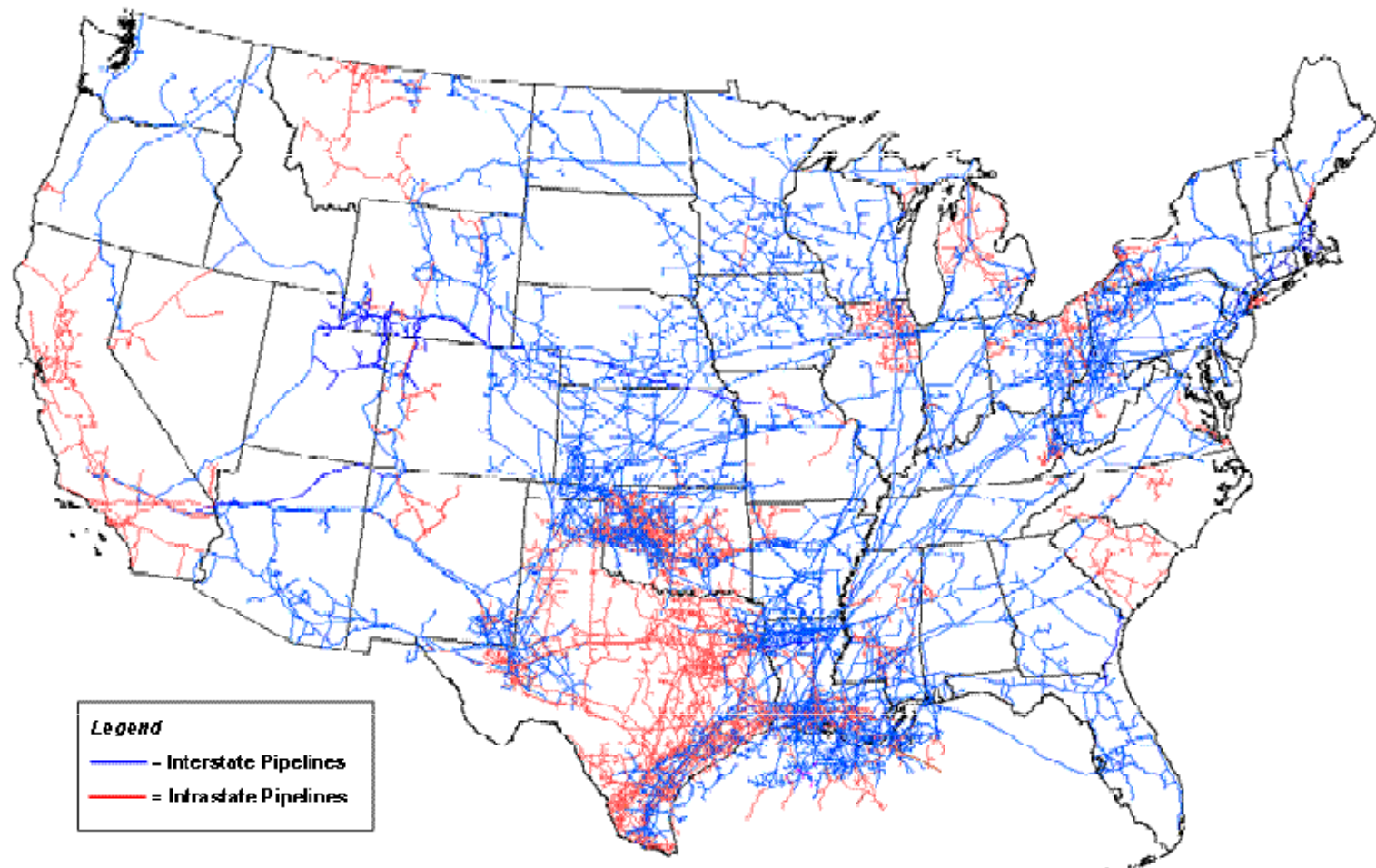
- Review the plan, factors, and forecast
- “Evaluate the reasonableness and prudence of the decisions underlying the GCR plan”
- “Approve, disapprove, or amend the GCR plan” and factors.
- Indicate on the basis of present evidence whether there are costs in the 5-year forecast that may not be recoverable.

Commission Order Approving a GCR Plan

- The Commission approves the GCR plan*
- The Commission approves a “base GCR factor”
- The Commission approves a method for adjustment of the GCR factor**
- The Commission may comment on the 5-year forecast

OH NO!!

I've submitted my plan, I've
set my factors, and then
everything went crazy in the
gas market!!



Source: Energy Information Administration, Office of Oil & Gas, Natural Gas Division, Gas Transportation Information System

August - September 2005

- Hurricanes Katrina and Rita hit the Gulf Coast of Texas, Mississippi and Louisiana
- GCR plans and factors for most utilities were approved or were about to be approved
- Natural gas prices nearly doubled from July '05 to October '05

Act 304 addresses this contingency . . .

Not less than 3 months before the beginning of the 3rd quarter of the GCR plan year . . . Or 6 months after the plan was filed, the utility may file a revised GCR plan case and revised factors for the remainder of the year.

Next . . .

After the plan is submitted and approved, the gas utility is expected to follow the plan as long as it is reasonable and prudent to do so.

GCR Reconciliation Process

After the plan year has ended, Act 304 provides:

“not less than once a year and not later than 3 months after the end of 12-month period covered by a gas utility’s GCR plan, the Commission shall commence a proceeding, to be known as a gas cost reconciliation”

Purpose of the GCR-R

Again, Act 304 provides that the gas cost recovery reconciliation (GCR-R) is conducted as a contested case.

The purpose of the GCR-R is to determine the amount of the over or under recovery AND to assess the “reasonableness and prudence of expenditures and amounts collected pursuant to the clause.”

If GCR costs are higher than revenues collected . . .

- The Commission FIRST looks to see if the excess costs resulted from actions that were contrary to the approved GCR plan.
- If so, then the evidentiary burden SHIFTS to the gas utility to show “by clear and convincing evidence” that its actions were reasonable and prudent.
- If the company fails to make the requisite showing, the additional cost may be disallowed.

Example

Utility A had an approved GCR plan that provided both monthly purchase “targets” and monthly storage volumes based on normal weather.

Gas prices were exceptionally high, and early in the winter there were concerns that the weather may be colder than normal . . .

Utility A met both its purchase and storage targets for November – January.

But January turned out to be the warmest January on record . . . By the end of the month Utility A was almost 100% OVER its storage target . . . (AND had spent a lot of \$\$ on very expensive gas.)

Given the very high storage volumes by the end of January, the Commission determined that it was not reasonable and prudent for the company to continue to meet its purchase targets in February and March.

A portion of the February and March purchases were therefore disallowed.

If the gas utility's gas purchases were consistent with the approved GCR plan, the Commission:

“shall authorize a utility to recover costs incurred for gas sold . . . in excess of the amounts recovered . . . only if the utility demonstrates that the expenses were reasonable and prudent.”

The GCR-R Math (Simplified)

\$ Total paid for gas
- \$ Disallowed gas costs

\$ Total gas expense
- \$ Total revenues from customers

\$ Total over/under recovery

Refund/Collection for over/under recovery

Act 304 provides that if the gas utility over recovers (i.e. the customers pay too much):

“The commission shall determine a rate of interest for excess recoveries . . . equal to the greater of the average short-term borrowing rate . . . Or the authorized rate of return on the common stock of the gas utility during the same period.”

Short-term borrowing rate vs Authorized RoR on common equity

Short-term borrowing rates are 4-5%

Authorized rates of return on common
equity are closer to 10-11%

Refund/Collection for over/under recovery (cont'd)

Act 304 also provides that if the gas utility under recovers (i.e. the customers pay too little):

“The Commission shall determine a rate of interest for insufficient recoveries . . . equal to the average short-term borrowing rate available to the gas utility during the appropriate period.”