100

STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

In the matter of the application of Michigan) Consolidated Gas Company to terminate) the suspension of its Gas Cost Recovery) Clause and establish a cashout mechanism) ______________________________)	Case No. U-12762

22

TESTIMONY OF FRANK J. HOLLEWA

ON BEHALF OF

THE RESIDENTIAL RATEPAYER CONSORTIUM

February 14, 2001

101

TESTIMONY OF

FRANK J. HOLLEWA

MPSC CASE NO. U-12762

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

A. My name is Frank J. Hollewa. I am an independent energy consultant doing business as EPEC (Energy Planning and Engineering Consultants). My office is at 6182 Grovedale Court, Suite 100, Alexandria, Virginia 22310.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL AND EMPLOYMENT EXPERIENCE.

A. I was employed by Washington Gas Light Company for 33 years. At the time of my retirement, I held the position of Senior Vice President of Distribution, Gas Supply and General Services. The responsibilities of this position included the repair, installation and maintenance of all transmission and distribution facilities; system design; system control; gas supply planning; gas acquisition; peak shaving plants; storage field; total energy facilities; Federal Energy Regulatory Commission (FERC) related matters; interface with interstate pipelines; general structures maintenance and improvements; fleet acquisition and maintenance; and interface with three (3) local Public Service Commissions in Maryland, Virginia and the District of Columbia relating to operating matters. The total scope of my position encompassed approximately 50% of all employees at Washington Gas Light. Much of my knowledge and experience was obtained on the job at Washington Gas Light.

I was employed there in 1963 at the age of 19 as a union grade clerk in the Gas Supply Department. As my knowledge and responsibilities increased, I moved to Staff Assistant; Staff Supervisor; Assistant to the Vice President, Gas Supply; and in 1982, at the age of 38, I became Vice President, Gas Supply. At that time, the Gas Supply Department had more than 250 employees and represented approximately 10% of the Company manpower.

During the past 25 years, I have participated as an expert witness in approximately 20 formal rate proceedings at the Maryland Public Service Commission ("PSC"), District of Columbia PSC, Virginia State Corporation Commission, and the FERC. I am well known throughout the gas industry and have participated as a speaker and panelist at numerous industry gatherings. I was on the Board of Directors of Associated Gas Distributors ("AGD") and Gas Industry Standards Board ("GISB") as well as a member of the Institute of Gas Technology ("IGT") Task Force on Gas Quality at the time of my retirement.

For the past five years, I have operated EPEC consulting. During that time, I have participated in numerous cases for the New Jersey Division of the Ratepayer Advocate, the Ohio Consumers' Counsel, the West Virginia Consumer Advocate Division, and the Michigan Residential Ratepayer Consortium.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been retained by the Residential Ratepayer Consortium ("RRC") to make an independent analysis and evaluation of the Application of Michigan Consolidated Gas Company ("MichCon" or "the Company") (1) to terminate the suspension of its Gas Cost Recovery clause, (2) to establish gas purchase contract cash-outs and gross margin refund mechanisms, and (3) to decrement storage.

Q. WHAT DOCUMENTS HAVE YOU REVIEWED IN YOUR ANALYSIS AND EVALUATION?

A. I have reviewed the Company's Application, filed on 12/15/00; the testimony of Don M. Stanczak, filed on 1/10/01 in support of the Application; MichCon's filings in Case Nos. U-11682, U-12050 and U-12761; the MPSC's order in Case No. U-12550 and the 9/22/00 MPSC Staff Report regarding natural gas customer choice; and the Company's responses to data requests from the RRC and other parties.

Q. PLEASE SUMMARIZE THE COMPANY'S CURRENT POSITION ON THE NATURAL GAS CUSTOMER CHOICE PROGRAM.

A. Items 3 thru 6 of MichCon's Application present the hypothesis that the "customer choice program" would be negatively impacted by continuation of the $2.95 fixed price for the last nine months in 2001. Further, the Company suggests that terminating suspension of its GCR Clause is necessary for achieving the Commission's goal of greater program uniformity, to foster competition between LDCs and alternative suppliers, and to remove a deterrent for customer migration to alternative suppliers. Witness Stanczak represents that during year one of the program (4/99 thru 3/00), customer participation "essentially reached" the first year cap of 75,000 total customers; for year two, the number of customers participating in the program declined to less than 50,000; and for year three, no new customer enrollments have been received and customer participation is expected to decline significantly from the current level of about 50,000 customers.

Q. PLEASE SUMMARIZE YOUR FINDINGS ON MICHCON'S CUSTOMER CHOICE PROGRAM.

A. The first document I reviewed was the Company's 4/21/98 Application in Case No. U-11682 to implement an Experimental Three (3) Year Gas Customer Choice program. The following elements of that Application are pertinent to this proceeding:

1. An annual participation cap was established for year one of 75,000 customers; 150,000 customers in year two; and 225,000 customers in year three plus an annual volume cap for commercial customers of 10 Bcf, 20 Bcf, and 30 Bcf, respectively. Also, there was to be an 18-week enrollment period from 1/01 thru 5/15 of each plan year. *See* Page 6 of the Application. (The MPSC's Order in Case No. U-12050 changed the enrollment period for the second year to 11/01/99 thru 2/28/00.)
2. The Company proposed to suspend its GCR clause, fix its gas commodity rate at $2.95, and made the following declarations:
   a. "A stable gas commodity rate will provide customers who choose MichCon as their natural gas supplier with price certainty, an easy means of comparing alternative gas supply offers, and afford the Company the purchasing and operational flexibility necessary to support customer choice."
   b. "In proposing a fixed gas commodity rate of $2.95 per Mcf, MichCon recognizes it will also assume significant risks."
   c. "If 225,000 customers elect alternative suppliers, MichCon will be at risk for about 20% of its approximately $50 million in firm interstate pipeline capacity costs."

d. "MichCon will permit customers who initially choose third-party suppliers to return to MichCon sales service at the proposed fixed-gas commodity rate of $2.95 per Mcf plus existing non-gas rates irrespective of prevailing market prices."

e. "MichCon will assume the risk of purchasing gas supplies on the open market at rates in excess of the fixed $2.95 per Mcf gas commodity rate."

f. "MichCon is at risk for all gas commodity costs during the three year Experimental Program."

g. "MichCon will be exposed to considerable risks previously mitigated by the GCR process. Specifically, a fixed-gas commodity rate of $2.95 per Mcf shifts the risk of volatile natural gas prices from its sales customers to MichCon. The Company will not increase charges for gas even if the natural gas market place supports significantly higher gas prices." (*See* pages 13-16 of the Application).

The second document I reviewed was the customer choice presentation made to the MPSC Staff dated, 11/23/99, which was part of MichCon's response to the RRC's discovery question number 2. The following excerpts from the document are pertinent to this proceeding:

1. "More than 98% of the Choice Customers have three-year contracts." Page 5.
2. 84% of 1,400 participants surveyed indicated that a key reason for participating in the gas customer choice program was to "save money". Page 10.
3. The reasons customers gave for switching to an alternative supplier included: personal visits by the suppliers, misled or tricked by the suppliers, and use of MichCon brand name by the suppliers. Page 11.

4. The specific reasons customers gave for leaving MichCon included "High prices or rates":
   - "There is nothing wrong with MichCon. Just the opportunity to save money."
   - "(I) would have stayed with MichCon if (the Company) was willing to match (the price)." Page 12.
5. 72% of the 1,400 persons surveyed reported that "lower prices, guaranteed savings, rebates, or a special rate" were key reasons for choosing an alternative supplier. Page 13.

The third set of documents I reviewed was the Company's responses to data requests. The following discovery responses are pertinent to this proceeding:

1. RRC's First Discovery Request, Question 2:

   Mr. Stanczak provided a table showing Gas Customer Choice (GCC) program participation by month with the associated volumes. The GCC Program was initiated on 4/01/99. 5/99 was the first reported month and it showed 61,500 residential customers with an associated volume of 8.6 Bcf plus 8,500 commercial customers with an associated volume of 10.0 Bcf. As of 12/99, the residential customers had dropped to 48,900 with an associated volume of 6.8 Bcf and values were the same for commercial customers. As of 4/00 (the end of the enrollment period for year two), residential customer enrollment had dropped to 47,600 with an associated volume of 6.4 Bcf and 8,300 commercial customers with an associated volume of 11.1 Bcf . By 12/00, the residential customers had dropped to 41,800 (5.7 Bcf) and commercial had dropped to 6,100 (8.2 Bcf).

There is no explanation for the drop of approximately 15,000 residential customers by the end of the first year of the program, other than Mr. Stanczak's testimony at page DMS-7, lines 2-4 in which he states "attrition due to customer movement and customer termination for non-payment steadily reduced the number of participants throughout year one." I extrapolated based on the actual data for 5/99 that, if pricing had not become a factor, there should be for the 3-year program approximately 195,000 residential customers participating with an estimated volume of 27 Bcf and 30,000 commercial customers participating at the cap of 30 Bcf.

2. ABATE'S First Discovery Request, Question 2:

Mr. Stanczak provided the NYMEX strip for 4/17/98 as representative of published market prices available on 4/21/98 when MichCon filed its application in Case No. U-11682. The average price for the period 4/99 thru 3/00 was $2.37 plus $0.14 basis for adjusting NYMEX to the MichCon City Gate would have resulted in a delivered price of $2.51. The same calculation for the period 4/00 thru 3/01 would have resulted in a delivered price of $2.49.

3. RRC's First Discovery Request, Question 4:

Mr. Stanczak provided the following response:

"During the first year of the program, alternative suppliers generally offered customers fixed-price contracts below MichCon's fixed rate of $2.95 per Mcf. Most of these residential customers were offered a fixed rate of $2.80 per Mcf (5% savings) or $2.65 per Mcf (10% savings). Commercial customers were able to negotiate fixed rates ranging from $2.35 per Mcf (30% savings) to $2.84 per Mcf (4% savings). However, most of these commercial customers were near $2.60 per Mcf (12% savings). During the second year of the program, most customers continued to pay the above-mentioned fixed prices because they had signed multi-year contracts with the alternative supplier."

4. RRC's First Discovery Request, Question 18:

Mr. Stanczak provided the most current available calculation of the gas sales margin with an estimate of $45 million for 1999 and $25 million (unaudited) for 2000.

Q. PLEASE ~~YOU~~ SUMMARIZE YOUR CONCLUSIONS ABOUT MICHCON'S GAS CUSTOMER CHOICE PROGRAM.

A. Based on the information presented above, I conclude that there is incontrovertible evidence that:

- MichCon was fully cognizant of the risk associated with suspending its GCR Clause and charging a fixed gas commodity price for the three years covered by its GCC program;
- MichCon protected itself during the first two years of the program by entering into fixed-price contracts which resulted in gas sales margins approximating $70 million;
- alternative suppliers also entered into fixed-price contracts or financial hedging as a result of the $2.95 fixed price to compete and offer savings to GCC program participants;
- GCC customers realized savings that have been and continue to be in most cases incremental to savings by GCR customers;
- the success of the enrollment period during the first year of the program was the direct

result of price differentials -- not an overwhelming desire to change suppliers or for any other reason.

MichCon's sales customers are currently in a position where most of them (especially commercial) did not or could not avail themselves of the incremental savings achieved by choice customers in 1999 and 2000 because of enrollment limits in the GCC program. However, they are now in a position where the selection of a supplier (choice) is far less important than the continuation of a fixed price that is extremely advantageous and beneficial to them. Can any logical person believe that a survey of customers would be necessary to determine whether choice at $5.00 per Mcf is preferable to a fixed price of $2.95 from MichCon? Why would anyone want choice simply for the sake of choice?

It is my conclusion that it is self-serving for the Company and/or the marketers to claim that:

- the $2.95 fixed price is a deterrent to choice;
- that irreparable damage may be done to the GCC program because no new customers are participating because of price: and
- that the suspension of MichCon's GCR Clause should be terminated to coincide with the reinstatement of Consumers Energy Company's GCR Clause in order to foster competition and develop greater uniformity among customer choice programs.

The transition to customer choice is expected to cover years, not months. Experience in other states supports the conclusion that this is a slow process, especially for residential customers. The harm to MichCon's customers that will result from the early termination of the MichCon's GCR Clause suspension outweighs any result that may flow from placing marketers in the position to "compete" with MichCon by increasing customer gas charges, thereby offering customers "choice". As will be shown later in this testimony, terminating the suspension of MichCon's GCR Clause shifts all the risk of gas price increases for the balance of 2001 onto MichCon's customers. That belies the representations and breaks the pledge made by MichCon in its Application in Case No. U-11682.

Q. PLEASE SUMMARIZE YOUR REVIEW OF THE COMPANY'S PROPOSED CASH-OUT OF FORWARD-PRICED NATURAL GAS CONTRACTS AND THE GROSS MARGIN REFUND MECHANISM.

A. Paragraph 8 of MichCon's Application states that the Company has contracted for significant quantities of natural gas to be delivered on or after April 1, 2001 at prices well below today's current forward prices and that these contracts will cause MichCon's GCR factor to be lower than the market price for natural gas through December 2001. This, the Company states, will preclude marketers from competing for sales customers in this period. To correct this "impediment", MichCon proposes to cash out those forward priced natural gas contracts and pass the proceeds through to ***all*** customers, including those choice customers currently served by alternative suppliers, via a temporary volumetric credit. Mr. Stanczak explains this proposal in his testimony, provides examples of the cash-out mechanism, and states that the market value of the contracts MichCon proposes to cash out is approximately $181 million based on the NYMEX estimates reflected in Case No. U-12766. (Page DMS-10, Lines 11-13).

Q. PLEASE SUMMARIZE YOUR FINDINGS ON MICHCON'S PROPOSED CASH-OUTS AND GROSS MARGIN REFUND MECHANISM.

A. The following discovery responses by the Company are pertinent to the proposed cash-outs and the gross margin refund mechanism:

1. <u>RRC's First Discovery Request, Question 47:</u>

   Mr. Stanczak provided the NYMEX strip as of 1/26/01 which resulted in an average of $5.75 for the April thru December 2001 period. He also provided the gross value of cash-outs using this strip to be $265 million, and correctly pointed out that a precise response is not possible due to the continuous changes in the market price for natural gas. This response also corrected the contract price for December from the $2.45 shown on DMS-2 to $2.30.

2. <u>RRC's Second Discovery Request, Question 58:</u>

   This question was an attempt to find the source of the NYMEX estimate shown on Exhibits DMS-1 and DMS-2 for the April thru December 2001 period. The response simply refers to the footnotes on both Exhibits. While the response is technically accurate because the same estimated 2001 NYMEX prices are used in Case No.

   U-12766, it does not lend any credibility to the accuracy of the estimate. There is simply no NYMEX strip between 12/15/00 (Application) and 1/10/01 (Stanczak Testimony) that bears any resemblance to the estimated 2001 NYMEX prices used in Case No. U-12766. Later in this testimony I refer to the NYMEX estimate shown on Exhibits DMS-1 and DMS-2 for the April thru December 2001 period as "NYMEX prices of unknown origin".

3. <u>ABATE Discovery Question 3</u>:

The Company's response states: "For 2001, MichCon has approximately 115 Bcf of fixed price gas under contract."

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS ON MICHCON'S PROPOSED CASH-OUTS AND GROSS CASH REFUND MECHANISM.

A. MichCon's entire testimony and exhibits relating to cash-outs and the gross refund mechanism obfuscate the fact that GCR customers will pay more for gas during the April thru December 2001 period if the Company's proposal is approved. Even if volumetric credits are applied to customer bills during this period, customers will pay more. In response to RRC discovery question 50, Mr. Stanczak supplied data that showed that the monthly consumption profile for a typical residential heating customer was 68.3 Mcf in the April through December period. He also indicated that the projected credit using the gross value amount of cash-outs from his Exhibit DMS-2 would be approximately $1.00 per Mcf. Based on the Company's proposal, a customer would pay a $5.17 per Mcf GCR factor for the 68.3 Mcf consumed in this period for a cost of $353.11. This amount would be offset by a credit of $68.30 (68.3 x $1.00) for a net cost of $284.81. If that same customer paid $2.95 per Mcf in this period, his or her total gas bill would be $201.49. The $284.81 is an increase of $83.32 or 41% more than the customer would pay if the $2.95 were continued through December 2001.

According to Mr. Stanczak's testimony at page 12. Lines 24-25 and page 13, lines 1-9, no funds from the Company's gross margin refund mechanism would be available for distribution to customers until April 2002.

Another flaw in MichCon's proposal is that Mr. Stanczak's exhibits are based on the use of NYMEX prices of unknown origin. They bear no relationship to real NYMEX prices for the period covered by the Company's Application.

Also, MichCon makes a major assumption that over 200,000 customers will become choice customers during the April - December period in time to reduce purchase requirements for sales and storage injections. The reduction in purchase volumes for sales would be approximately ~~23~~ 12 Bcf based upon 193 Bcf of annual purchase volumes without termination of the $2.95 fixed price (explained below). The Company also relies on the associated storage injection of 21.6 Bcf by Choice customers to get below the 55 Bcf level at the end of year 2000 and set the stage for decrementing storage. The assumption of a competitive market is entirely dependent upon the commodity price of gas during this period. Based upon the NYMEX strip provided by the Company as of 1/26/01, it is very unlikely that an alternative supplier could provide much in the way of savings to entice customers in such large numbers so quickly. The risks of accepting the Company's price and migration projections can best be evaluated by comparison to no risks under the continuation of the $2.95 fixed price.

If MichCon's application is not approved, the Company will incur a net loss of $12 million using the NYMEX prices of unknown origin and $96 million using the 1/26/01 NYMEX strip, even under optimal conditions (no purchases of very high commodity gas in January through March 2001). The Company's response to RRC discovery question 2 revealed that the total choice volumes as of 12/00 were approximately 13.9 Bcf, and an assumption of continued erosion would result in an approximate average volume of 12 Bcf for 2001. The total normal sales for MichCon is estimated at 205 Bcf for 2001 less 12 Bcf contributed by choice customers or 193 Bcf of gas purchase requirements for 2001. The following calculations assume that there are no cash-outs of fixed-price contracts, the $2.95 fixed-price continues for all of 2001 and is not terminated, and that MichCon is able to avoid any gas purchases in January thru March by use of fixed-price contracts and additional storage withdrawals only:

1. The annual gas costs to GCR customers would be approximately $569 million ($2.95 times 193 Bcf).
2. Purchase by MichCon of 115 Bcf at a delivered price for fixed gas price contracts of $2.40 (average price of $2.26 plus the same $0.14 NYMEX basis is added since location and delivery means are unknown) would equal $276 million plus purchase of the 78 Bcf balance in the April thru December period at a delivered price of $4.81 (average NYMEX from Exhibit DMS-2 plus $0.14 basis) would be $375 million or a total of $651 million. This $82 million of additional gas costs would be offset by $45 million from gross margins in 1999 and $25 million from gross margins in 2000 resulting in a net loss of $12 million.
3. Purchase of the 78 Bcf balance at a delivered price of $5.89 (average NYMEX from MichCon's response to RRC discovery question 47 plus $0.14 basis) would be $459 million or a total of $735 million. This $166 million of additional gas costs would be offset by $70 million from gross margins resulting in a net loss of $96 million.

Q. WHAT IS YOUR CONCLUSION WITH RESPECT TO MICHCON'S CASH-OUT OF FORWARD-PRICED NATURAL GAS CONTRACTS AND ITS GROSS MARGIN REFUND MECHANISM?

A. My conclusion is that Mr. Stanczak is correct only when he states that the rates customers would pay absent the $2.95 fixed price and utilization of the Company's proposals will depend on a number of variables (Page DMS-12, lines 5-10). He is incorrect when he states that there is a high probability that customers will not pay more than the $2.95 per Mcf rate during the last nine months of 2001 (Page DMS-13, lines 10-14).

Q. WHAT ARE YOUR COMMENTS AND CONCLUSIONS RELATING TO THE PROPOSED VOLUMETRIC CREDIT TO *ALL* OF MICHCON'S GAS SALES RATE SCHEDULE CUSTOMERS?

A. It is not logical to penalize GCR customers with the loss of a $2.95 fixed price ***and*** the sharing of cash-out dollars with existing choice customers.

Q. PLEASE EXPLAIN.

A. Earlier in my testimony it was shown that:

- MichCon reported to the MPSC Staff that "More than 98% of the choice customers have three-year contracts".
- The Company's response to RRC discovery question 4 reported that residential choice customers achieved 5-10% savings and commercial customers achieved 12% savings in the first year and "during the second year of the program, most customers continued to pay the above-mentioned fixed prices because they had signed multi-year contracts with the

alternative supplier". Therefore, my conclusion is those existing choice customers should be excluded from the credit because they have paid, and presumably continue to pay, less than the $2.95 fixed price.

Q. PLEASE SUMMARIZE YOUR FINDINGS AS THEY RELATE TO THE COMPANY'S PROPOSAL FOR DECREMENTING STORAGE.

A. The following discovery responses made by the Company are pertinent to MichCon's proposal for decrementing storage:

1. MPSC Staff's First Discovery Request, Question 1:

   The Company's response stated: "MichCon's actual 2000 storage decrement was approximately 23.8 Bcf".

2. RRC's Second Discovery Request, Question 57(g):

   The Company's response provided a Table listing the actual storage inventory by month for the past 17 years. This Table reveals that the highest inventory level for October was achieved in 1999 at 96.8 Bcf compared to 84.7 Bcf for 2000 (accounting for 12.1 Bcf of the decrement). Further, the withdrawals in November and December of 1999 amounted to 17.9 Bcf for a balance of 78.9 Bcf at year-end (approximately equal to the highest inventory level) compared to withdrawals in November and December of 2000 amounting to 29.6 Bcf for a balance of 55.1 Bcf at year-end (the lowest annual inventory level on the Table). The November and December 2000 withdrawals were the highest on the Table and exceeded the 17.9 Bcf withdrawal in 1999 by 11.7 Bcf, accounting for the balance of the 23.8 Bcf decrement in 2000.

3. RRC's Second Discovery Request, Question 57(c):

The Company's response provided MichCon's LIFO storage layers at December 31, 2000. These layers cover the period from 1965 to "Pre-1956" and total 105.8 Bcf. The year-end total of 55.1 Bcf for 2000 places MichCon at the 1965 layer. All layers are $0.40 or below and confirm Mr. Stanczak's Testimony on Page DSM-15, line 16.

4. RRC's Second Discovery Request, Question 57(d):

The Company's response provided MichCon's plan for storage activity during 2001-2002 for normal weather and colder-than-normal weather. The normal weather plan shows a storage balance of 49.8 Bcf for year-end 2001 amounting to a storage decrement of 5.3 Bcf. The colder-than-normal plan shows a storage balance of 46.0 Bcf for year-end 2001 amounting to a storage decrement of 9.1 Bcf.

5. MPSC Staff's First Discovery Request, Question 2(b):

The Company's response provided MichCon's estimate for the split between storage volumes by month for GCR and GCC customers in 2001 and 2002 under colder-than-normal conditions. The pertinent figures are 65 Bcf for GCR and 21.6 Bcf for GCC as of 10/31/01 and 57.1 Bcf for GCR and 28.2 Bcf for GCC as of 10/31/02. The storage decrement is 9.1 Bcf (same as above) for 2001 and an additional storage decrement of 5.2 Bcf for 2002.

6. New Power's First Discovery Request, Question 2:

The Company's response was "No" to the question of whether GCC customers would benefit from decrementing storage to the same extent as traditional sales customers.

7. RRC's Second Discovery Request, Question 57(i):

In response to a request for any economic consequences to GCR customers in the future caused by decrementing storage, the Company response was that MichCon "does not expect economic consequences to GCR customers from cycling storage as a result of customers choosing an alternative gas supplier".

8. RRC's Second Discovery Request, Question 59(c):

The Company's response provided "MichCon's annual LIFO rates, which were $2.72 per Mcf for 1999 and $2.86 per Mcf for 2000".

9. Attorney General's First Discovery Request, Question 6:

The Company's response provided MichCon's LIFO storage layers at December 31, 1999 and December 31, 2000. This data reveals that the 1999 layer of 7.6 Bcf at $2.71 was removed, but would have no economic consequences to GCR customers since it was established during the suspension period. All of the layers between 1998 back to 1990 were removed with a total of 14.1 Bcf, a WACOG of $2.80 versus the $2.86 LIFO rate and would represent approximately $850,000 in gas cost reductions. The 1965 layer was reduced from 4.8 Bcf in 1999 to 2.0 Bcf in 2000. The $2.86 LIFO rate less the 1965 storage layer rate of $0.36 would represent approximately $7 million in gas cost reductions. ~~Before MichCon's GCR Clause was suspended,~~ The total storage decrement was 16.9 Bcf in 2000 amounting to approximately $7.8 million.

119

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AS THEY RELATE TO MICHCON'S PROPOSAL FOR DECREMENTING STORAGE.

A. My first conclusion is that the only way possible to achieve a decrement of storage from the 55.1 Bcf level experienced at the end of 2000 is to have an amount greater than 13 Bcf assigned to GCC customers and/or withdrawn during November and December (historic filling level is 87 Bcf minus normal withdrawals of 19 Bcf in November and December equals 68 Bcf less 55 Bcf in 2000 equals 13 Bcf). With the continuation of the $2.95 fixed price, it is estimated that approximately 6 Bcf of storage inventory will be GCC gas compared to the 21.6 Bcf estimated under the Company's 4/01/01 termination plan. Therefore, under the continuation of the $2.95 fixed-price scenario, it is impossible to decrement storage below 55 Bcf without jeopardizing the system integrity for Design Day purposes. Even under a 4/01/01 termination scenario in which the Company achieves approximately 50% of its projections for GCC customers, an additional withdrawal in excess of colder-than-normal would be required to achieve a storage decrement.

My second conclusion is that the refund associated with decrementing storage creates a "Catch-22" scenario for the Company. If the Company was correct in its estimate of customers converting to GCC, then a storage decrement of 5.3 Bcf would occur in normal weather and 9.1 Bcf in colder-than-normal weather. Assuming the same average prices for April thru December based on the 1/26/01 NYMEX strip plus $0.14 basis equals $5.89 less approximately $0.37 for the next LIFO layers would result in savings of gas costs amounting to between $29 million ($5.52 times 5.3 Bcf) and $50 million ($5.52 times 9.1

Bcf). The unanswered question is how this credit would be given to traditional sales customers without creating a deterrent to competition in 2001 or 2002. Even this offset would be well short of the $96 million net loss expected in 2001 if the termination of the $2.95 fixed gas commodity charge is not approved.

My third conclusion relates to the economic consequences to GCR customers in the future. If decrementing storage in 2001 is used to mitigate increased gas costs and insure the $2.95 fixed-price equivalent in 2001, this would result in the loss of future credits since these low-cost LIFO layers can only be used once. Therefore, waiting until 2002 or later to decrement storage as a result of GCC will be a future offset to gas prices. Also, a storage decrement of 16.9 Bcf has already occurred in 2000 amounting to $7.8 million.

There is nothing presented by the Company that explains how this will be treated and presumably is part of the gross margin realized in 2000.

In summary, my conclusion regarding the proposal for decrementing storage is that it is virtually impossible to decrement storage absent the termination of the GCR suspension. Also, it is unlikely that decrementing storage could occur if only half of the Company's estimate for migration to choice occurred in what is represented as a competitive market. Further, there is the question of how any credit for decrementing storage would be given to traditional sales customers without creating a deterrent to competition in 2001 or 2002; and how the storage decrement of 16.9 Bcf amounting to $7.8 million which has already occurred will be handled.

Q. WHAT IS YOUR OVERALL RECOMMENDATION WITH RESPECT TO MICHCON'S APPLICATION IN THIS CASE?

A. The Michigan Public Service Commission should reject the Company's Application and require continuation of the $2.95 gas commodity rate through December 2001. In my opinion, the value of the fixed $2.95 rate for the majority of MichCon's customers outweighs the policy concerns underlying the Company's proposals for jump starting its gas customer choice program in April 2001 for a minority of its customers.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.