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STATE OF MICHIGAN

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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| 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 |

PREPARED TESTIMONY AND EXHIBIT

OF WILLIAM G. ALDRICH

ON BEHALF OF THE

MICHIGAN PUBLIC SERVICE COMMISSION STAFF

Date: February 14, 2001

PREPARED TESTIMONY OF WILLIAM G. ALDRICH

CASE NO. U-12762

PART I - QUALIFICATIONS

Q. Please state your name and business address.

A. My name is William G. Aldrich. My business address is 6545 Mercantile Way, P.O. Box 30221, Lansing, Michigan 48909.

Q. By whom are you employed, and in what capacity?

A. I am employed by the Gas Division of the Michigan Public Service Commission Staff. My current position is Gas Cost of Service Specialist for the State of Michigan.

Q. What is your employment history with the Commission Staff?

A. In 1976, I joined the Commission Staff as an auditor in the Audit Section of the Gas Division. In that position, I participated in numerous audits of gas utilities, and testified before the Commission on a wide variety of rate case accounting issues. In 1979, I transferred to the Rate and Tariff Section of the Gas Division as a tariff analyst and an auditor. In that capacity, I testified before the Commission on rate design issues in numerous contested rate cases, was involved in the implementation of Act 304 of 1982, conducted many GCR reconciliation audits, and testified on GCR-related issues in both GCR plan cases and GCR reconciliation cases. In 1985, I was promoted to my current position. In July, 1994, I was reassigned to the Auditing and Tariff Section of the Gas Division.

Q. What are your duties as Gas Cost of Service Specialist?

A. As Gas Cost of Service Specialist, I am the State of Michigan's expert on the technical, economic, and regulatory aspects of the cost of service of the state's natural gas utilities, and the costs of serving the residential, commercial, and industrial customers of those utilities. My primary areas of responsibility include the determination of the costs of serving different classes of customers, natural gas utility rate design in rate case proceedings, and the administration of Commission approved rates.

Q. What is your educational background?

A. I graduated from Michigan State University in 1976 with a B. A. degree in Business Administration, with a major in Accounting. I have attended the NARUC Annual Regulatory Studies Program. In 1988, I attended the Gas Distribution Engineering course presented by the Institute of Gas Technology. This course concentrated on distribution system capacity design, while also covering such topics as pipeline construction and maintenance, leak detection, corrosion control, and pressure regulation.

DIRECT TESTIMONY OF WILLIAM G. ALDRICH
CASE NO. U-12762
PART I I

Q. Please explain the purpose of your testimony in this case.

A. The purpose of my testimony is to present Staff's concerns about MichCon's proposals in this case.

Q. Please briefly explain Staff's concerns.

A. MichCon is proposing to replace its current three-year gas customer choice program scheduled to run through March 31, 2002 including a fixed $2.95 per Mcf gas rate scheduled to expire on December 31, 2001, with a new program that would commence with the April 2001 billing cycle. Among other things, the new program would replace the current $2.95 per Mcf fixed gas cost rate with a $5.17 per Mcf GCR factor, offset by cash-out profits and potential refunds as outlined on MichCon's Exhibit A-3 (DMS-3). Staff is concerned that under MichCon's proposal, MichCon sales customers (GCR customers) and gas customer choice customers (GCC customers) will almost surely pay more for gas than they would if MichCon's current three-year customer choice program is continued through its original expiration date. In Staff's view, any proposal that does not guarantee that MichCon customers would not be adversely impacted by the new program should be rejected by the Commission.

Q. Have you prepared any exhibits to support your testimony?

A. Yes, I have. I have prepared a one-page exhibit identified as Exhibit S-10 (WGA-1), entitled "Michigan Consolidated Gas Company-Staff Revised Sample Refund Calculation".

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Q. Please explain the purpose of your exhibit.

A. The purpose of this exhibit is twofold. First, in the column entitled "Corrected MichCon Base Case", I have attempted to correct and update the "base case" numbers shown on MichCon's Exhibit A-_3_(DMS-3). Second, in the column entitled "Staff Base Case", I have illustrated how Staff believes the refund calculation should be adjusted to ensure that customers do not pay more than $2.95 per Mcf for April - December 2001 billed volumes.

Q. Please explain the corrections and updates that you have made in the "Corrected MichCon Base Case" column.

A. I have corrected lines 2 and 3 of Exhibit A-_3_(DMS-3) to reflect the gas sold volumes and the average GCR cost of gas for April-December 2001 as shown in MichCon's GCR case, Case No. U-12766. These changes would eliminate the $1 million potential refund that was shown on Exhibit A-_3_(DMS-3). I have also updated the Line 11 "January 1999 - March 2001 Gross Margin" to reflect the answer to RRC's First Discovery Request, Question 18a and to reflect the estimated gross margin for January-March 2001 derived by me from Case No. U-12766 information. Based on these sources, the "January 1999 - March 2001 Gross Margin" would be $66 million, rather than the $45 million shown on Exhibit A-_3_(DMS-3).

Q. What is wrong with the corrected and updated MichCon sample refund calculation?

A. MichCon's calculation is an "apples to oranges" comparison. MichCon compares the cost increase to <u>GCR customers only</u> with the cash-out amount that is refunded to <u>both GCR customers and GCC customers</u> to determine if an additional refund is necessary. If the total cash-out refund is equal to or higher than the increased cost to GCR customers, then MichCon would make no additional refund. My exhibit column "Corrected MichCon Base Case" illustrates how this "apples to oranges" comparison results in higher costs to customers. Line 8 shows a gross cost increase to GCR customers of $176 million, offset by $181 million of cash-out refunds. However, only $148 million of the cash-out refund would go to GCR customers; the other $33 million would go to GCC customers. With only $148 million of refunds to offset $176 million of increased costs, MichCon's GCR customers would pay $28 million over the $2.95 per Mcf cost of gas. Likewise, MichCon's approach completely ignores the higher prices that GCC customers will pay if MichCon's new program is approved.

Q. How would Staff revise the refund calculation to correct this problem?

A. Staff's calculation adds the GCC customer volume of 18 Bcf to the 82 Bcf of GCR customer volume, thereby providing an "apples to apples" comparison between increased customer costs and cash-out refunds. Staff's approach would result in a $33 million additional refund under MichCon's "base case" scenario.

Q. Would this revision to the refund calculation that you have just described ensure that GCR and GCC customers would pay no more than $2.95 per Mcf?

A. Yes, based upon MichCon's projections. However, under certain pricing and weather conditions, the additional refunding of MichCon's January 1999 - March 2001 gross margin on gas purchases might be insufficient to offset the higher gas costs incurred by GCR and GCC customers. MichCon's proposal to withdraw more inexpensive LIFO gas to cover a shortfall might not be possible if weather conditions are unfavorable, or if withdrawals would jeopardize the reliability of service, or if MichCon has overestimated the number of customers that will switch to alternative suppliers in April - December 2001. In Staff's view, the only way to ensure that GCR and GCC customers will not be responsible for higher gas bills is for MichCon to guarantee that GCR and GCC customers as a class will not pay more than $2.95 per Mcf for their April 2001 - December 2001 billed gas volumes, adjusted for credits received during April 2001 through March 2002.

Q. Is it fair to require MichCon to provide a guarantee of $2.95 per Mcf gas through December 2001?

A. Yes, it is. Customers now have that guarantee with the current three-year customer choice program. Why should they have to risk higher gas prices with the new program? Moreover, absent a price guarantee, MichCon could still profit from its participation in the current three-year customer choice program, without any downside risk since the worst that MichCon could do would be to break even. A price guarantee would balance MichCon's profit potential with a counterbalancing loss potential, supplying a symmetry of risk and reward that would provide MichCon with incentives to keep gas costs as low as possible.

Q. If MichCon's sample refund calculation is revised as Staff has recommended by including the additional gas costs paid by GCC customers (see Exhibit S-10 (WGA-1), and if MichCon is required to guarantee all of its GCR and GCC customers would pay no more than $2.95 per Mcf for April - December 2001 billed sales, adjusted for credits received during the period April 2001 through March 2002, would Staff support the application in this case?

A. Yes. Staff's changes would correct the deficiencies in MichCon's case, while leaving intact the benefits of expanded customer choice and eliminating a huge January 2002 price spike.

Q. Does this conclude your testimony?

A. Yes.