

**STATE OF MICHIGAN**

BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of )  
**MICHIGAN GAS UTILITIES CORPORATION** )  
for authority to increase retail natural gas rates. )  
\_\_\_\_\_ )

Case No. U-15990

DIRECT TESTIMONY OF

VALERIE H. GRACE

FOR

MICHIGAN GAS UTILITIES CORPORATION

July 1, 2009

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**QUALIFICATIONS  
OF  
VALERIE H. GRACE  
PART I**

1 **Q. Please state your name, business address and position.**

2 A. My name is Valerie H. Grace. My business address is Integrys Business Support,  
3 LLC ("IBS"), 130 E. Randolph Dr. Chicago, IL 60601. I am Manager, Gas  
4 Regulatory Services in the Regulatory Affairs Department of Integrys Energy Group,  
5 Inc. ("Integrys"). Both IBS and Michigan Gas Utilities Corporation ("MGUC") are  
6 wholly-owned subsidiaries of Integrys. Integrys resulted from the February 21, 2007  
7 merger between WPS Resources Corporation ("WPSR") and Peoples Energy  
8 Corporation ("PEC").

9

10 **Q. For whom are you providing testimony?**

11 A. I am providing testimony on behalf of MGUC.

12

13 **Q. Briefly describe your educational and business experience.**

14 A. In 1980, I graduated from Illinois State University with a Bachelor of Science degree  
15 in Business Administration. In 1988, I received a Master of Management Degree  
16 from Northwestern University. I began my employment at The Peoples Gas Light  
17 and Coke Company ("Peoples Gas") in the Gas Supply Planning Department in  
18 1980. Since then, I have been employed in various positions and levels of

1 responsibility at Peoples Gas including the Rates Department, the Office of the  
2 Chairman, the Executive Office of the Customer Relations Division and the Gas  
3 Transportation Services Department. I have also been employed by PEC, the parent  
4 company of Peoples Gas and North Shore Gas Company ("North Shore Gas") and a  
5 wholly-owned subsidiary of Integrys, as Director of Strategic Development. I have  
6 been in my present position since the merger between PEC and Integrys (formerly,  
7 WPSR) in February, 2007.

8  
9 **Q. Have you previously testified before any regulatory agency?**

10 A. Yes, I have filed testimony or have testified before the Illinois Commerce  
11 Commission ("ICC") for Peoples Gas and North Shore Gas in several gas charge  
12 reconciliation proceedings, proceedings related to customer choice, the merger  
13 proceeding involving PEC and Integrys (ICC Docket No. 06-0540), and general rate  
14 increase proceedings (ICC Docket Nos. 07-0241/07-0242 (cons.) and (ICC Docket  
15 Nos. 09-0166/09-0167 (cons.))

**VALERIE H. GRACE  
DIRECT TESTIMONY  
PART II**

1 **Q. What is the purpose of your pre-filed direct testimony?**

2 A. The purpose of my pre-filed direct testimony is to address the economic feasibility  
3 and design for a primary decoupling mechanism for MGUC, known as the Revenue  
4 Decoupling Mechanism ("RDM"), as well as an alternative decoupling mechanism, a  
5 Straight Fixed Variable ("SFV") rate design for applicable rate classes.

6

7 **Q. Please identify the exhibits, which you are sponsoring.**

8 A. I am sponsoring the following exhibits:

9 Exhibit A-9 (VHG-1), Schedule G1, RDM Baseline

10 Exhibit A-9 (VHG-1), Schedule G2, RDM Illustration

11 Exhibit A-9 (VHG-1), Schedule G3, Fixed and Variable Cost Summary

12 Exhibit A-9 (VHG-1), Schedule G4, Alternative Decoupling Proposal

13

14 **Q. Were these exhibits prepared by you or under your direction?**

15 A. Yes, they were.

16

17 **Q. Please describe Exhibit A-9 (VHG-1), Schedule G1, RDM Baseline.**

18 A. Exhibit A-9 (VHG-1), Schedule G1, RDM Baseline, reflects, for each applicable rate  
19 group, the derivation of the baseline that would be used to determine annual  
20 adjustments under the RDM, assuming the distribution charges proposed in this  
21 proceeding.

22

23

24

1 **Q. Please describe Exhibit A-9 (VHG-1), Schedule G2, RDM Illustration.**

2 A. Exhibit A-9 (VHG-1), Schedule G2, RDM Illustration, reflects, for each applicable rate  
3 group, an illustration of the symmetrical operation of the RDM, assuming that per  
4 customer revenues would be 2% higher or lower than the baseline proposed in this  
5 proceeding.

6

7 **Q. Please describe Exhibit A-9 (VHG-1), Schedule G3, Fixed and Variable Cost**  
8 **Summary.**

9 A. Exhibit A-9 (VHG-1), Schedule G3, Fixed and Variable Cost Summary, reflects for  
10 the Residential rate class, a breakdown of the revenue requirement into fixed and  
11 variable cost classifications.

12

13 **Q. Please describe Exhibit A-9 (VHG-1), Schedule G4, Alternative Decoupling**  
14 **Proposal.**

15 A. Exhibit A-9 (VHG-1), Schedule G4, Alternative Decoupling Proposal, reflects, for the  
16 applicable rate class, a proposed SFV rate design, which MGUC believes is a  
17 feasible alternative approach for decoupling.

18

19 **Primary Decoupling Proposal - RDM**

20 **Q. Please describe the purpose of MGUC's proposed RDM.**

21 A. MGUC's RDM is a decoupling mechanism that will separate (or decouple) MGUC's  
22 volumetric sales levels from its revenues, thereby allowing MGUC the opportunity to  
23 earn its Commission approved revenue requirement. The RDM is a symmetrical  
24 true-up mechanism that will adjust for each applicable rate group, on a per customer  
25 basis, for sales volumes that are above or below the approved sales level for the rate  
26 group that is used to determine the volumetric distribution charges approved by the  
27 Commission, exclusive of Gas Supply Acquisition Charges. The symmetrical design

1 of the RDM will result in a bill charge if the rate group's usage is below the approved  
2 sales level, and a bill credit if the rate group's usage is above the approved sales  
3 level.

4

5 **Q. Why is MGUC proposing a decoupling mechanism?**

6 A. Section 89(6) of the Clean, Renewable, and Efficient Energy Act, 2008 PA 295 ("Act  
7 295"), allows the Commission to authorize a natural gas provider that spends a  
8 minimum of 0.5% of total revenues, including natural gas commodity costs in a year,  
9 on Commission-approved energy optimization programs, to implement a symmetrical  
10 revenue decoupling true-up mechanism or an alternative mechanism if the  
11 Commission determines that the alternative mechanism is reasonable and prudent. I  
12 am advised that MGUC meets this criterion. Moreover, the Commission's January  
13 13, 2009 Order in MGUC's last general rate case proceeding, Case No. U-15549,  
14 directed MGUC to submit a decoupling proposal in its next rate case, stating "...the  
15 Commission may consider and approve a revenue decoupling mechanism at any  
16 time under its general ratemaking authority." The Commission's Order directed  
17 MGUC to present testimony on the economic feasibility, possible design and one or  
18 more proposals for rate decoupling, which will facilitate the speedy transition to  
19 decoupled rates.

20

21 **Q. Is MGUC's proposed RDM a partial or full decoupling mechanism?**

22 A. MGUC's proposed RDM is a full decoupling mechanism. Full decoupling means it  
23 would compute an adjustment for all changes in usage per customer above or below  
24 the sales level approved in MGUC's most recent general rate case proceeding.  
25 Such usage changes could arise from customer conservation, increased customer  
26 usage, or weather variations. A partial decoupling mechanism is typically one that

1 would compute adjustments for either conservation or weather related changes in  
2 customers' usage, but not both.

3

4 **Q. Why is MGUC proposing a full rather than a partial decoupling mechanism?**

5 A. Act 295 provided for a symmetrical decoupling mechanism. A partial decoupling  
6 mechanism that would compute adjustments only for conservation related usage  
7 changes would be asymmetrical and therefore, would not be consistent with the  
8 language in the Act. Such a decoupling mechanism would also not fully align the  
9 interests of MGUC and its customers, as it would not provide bill credits to customers  
10 if their usage is greater than the usage level approved by the Commission. A partial  
11 decoupling mechanism would also be more complicated to compute, administratively  
12 burdensome, and may cause disputes about the appropriate quantification of usage  
13 changes and affected sales volumes. MGUC believes that a full decoupling  
14 mechanism, such as its proposed RDM, would be consistent with Act 295, simple to  
15 compute, align the interests of MGUC and its customers, and would minimize  
16 debates related to quantifying sales levels or changes in usage.

17

18 **Q. Please identify the applicable rate classes for the RDM.**

19 A. RDM adjustments will be determined separately for three different rate groups.  
20 These three rate groups and the rate classes that will be included within each group  
21 are as follows:

- 22 1. Residential,
- 23
- 24 2. Residential Multiple Family Dwelling, Meter Classes I and II, and Small  
25 General Service, and
- 26
- 27 3. Residential Multiple Family Dwelling, Meter Classes III and IV.
- 28

29 The RDM would be applicable to sales, aggregated transportation and customer  
30 choice customers (excluding Gas Lighting customers) served under these rate

1 classes. Within each of the three rate groups, sales, aggregated transportation and  
2 customer choice customers will be billed the same RDM adjustment.

3

4 **Q. Please describe how the RDM will operate.**

5 A. Distribution revenues are determined by multiplying volumetric sales volumes times  
6 a distribution charge, exclusive of the Gas Supply Acquisition Charge. MGUC's  
7 proposed RDM will consider only changes in volumetric distribution revenues,  
8 exclusive of Gas Supply Acquisition revenues, on a per customer basis.  
9 Adjustments under the RDM will be determined annually and will be calculated by  
10 taking the difference between: (1) baseline annual calendar year distribution  
11 revenues per customer for the rate group approved in MGUC's most recent general  
12 rate case proceeding, and (2) actual annual calendar year distribution revenues per  
13 customer for the rate group. This difference will be multiplied by the average number  
14 of customers that were used to establish charges in the most recent general rate  
15 case proceeding to determine the dollar amount that will be collected from, or  
16 refunded to, customers. The amount will be recovered or refunded, on a per  
17 estimated Mcf basis, over a 12-month period. Each year after the initial year of the  
18 RDM, MGUC would determine any over- or under- collection of the RDM and roll that  
19 amount, including interest, into the determination of the RDM adjustment for the  
20 subsequent year. Exhibit A-9 (VHG-1), Schedule G1 reflects MGUC's proposed  
21 methodology for establishing the baseline for each rate group, assuming the charges  
22 proposed in this proceeding. Exhibit A-9 (VHG-1), Schedule G2 illustrates the  
23 symmetrical operation of the RDM under two different scenarios assuming a change  
24 in distribution revenues of 2% from the baseline of each rate group. Page 1 reflects  
25 a refundable scenario resulting from an increase in revenues per customer and Page  
26 2 reflects a recoverable scenario resulting from a decrease in revenues per  
27 customer. Columns A through D on both pages reflects the baselines derived in

1 Exhibit A-9 (VHG-1), Schedule G1. Columns E through K illustrate the calculation of  
2 the RDM adjustments.

3

4 **Q. Why is it necessary to determine the RDM on a per customer basis?**

5 A. It is necessary to determine the RDM on a per customer basis to filter out any  
6 changes (increase or decrease) in the number of customers that would differ from  
7 those levels supporting the revenues approved by the Commission in a general rate  
8 case proceeding. Doing so will not only isolate the changes in usage and related  
9 distribution revenues for the number of customers that were used to determine the  
10 revenues approved in a general rate case proceeding; it will recognize the additional  
11 costs incurred by MGUC to provide service to new customers. These costs include  
12 the addition of new services and meters as well as other expenses to serve new  
13 customers joining the system. This approach will allow MGUC to continue to recover  
14 the cost of connecting new customers. Moreover, it will also prevent MGUC from  
15 recovering revenues for load losses associated with customers leaving the system.

16

17 **Q. Why does MGUC propose three different rate groups rather than individual rate  
18 classes to calculate RDM adjustments?**

19 A. Each rate group includes rate classes that have identical distribution charges,  
20 excluding gas supply acquisition charges that apply only to sales customers. MGUC  
21 proposes to calculate the RDM adjustment for three rate groups rather than  
22 individual rate classes to simplify the calculation of adjustments for, and the  
23 operation of, the RDM.

24

25 **Q. Why does MGUC propose that sales, aggregated transportation and customer  
26 choice customers within the same rate class are billed the same RDM  
27 adjustment?**

1 A. Sales, aggregated transportation and customer choice customers within the same  
2 rate class are billed the same distribution charges, net of gas supply acquisition  
3 charges. Also, other than a 12-month minimum stay requirement, customers can  
4 freely migrate between sales, aggregated transportation and customer choice  
5 services. As MGUC does not want to create a situation where RDM causes one  
6 service to be more favorable or unfavorable than another, MGUC is proposing that  
7 the RDM adjustments apply to all customers within the same rate class.

8

9 **Q. How would the RDM be reviewed and implemented each year?**

10 A. MGUC would file a RDM reconciliation application with the Commission each year by  
11 March 31 requesting refund or recoveries of any amounts arising from the RDM for  
12 the previous calendar year. After Notice and the opportunity for a hearing, and after  
13 a Commission Staff audit, the amount to be refunded or recovered would be  
14 determined, and the Commission would issue an order authorizing any refund or  
15 recovery. MGUC would refund or recover the amounts over a 12-month period.

16

17 **Q. What interest rate would apply to the RDM reconciliation amounts?**

18 A. As the enabling legislation, Act 295, calls for a symmetrical decoupling mechanism,  
19 MGUC proposes that the short-term debt rate be applied to both under- and over-  
20 collections to retain such symmetry.

21

22 **Q. Would the proposed RDM offer any benefits to MGUC and its customers?**

23 A. Yes, it would. The proposed RDM would fully decouple MGUC's volumetric sales  
24 levels from its revenues, thereby allowing MGUC the opportunity to earn its  
25 Commission approved revenue requirement. MGUC's customers would benefit from  
26 bill credits that would arise from the operation of the mechanism.

27

1 **Q. Is it economically feasible to implement MGUC's proposed RDM?**

2 A. Yes, it is. Adjustments computed under MGUC's proposed RDM would be easily  
3 derived from sales volumes, customers, charges and a baseline approved by the  
4 Commission in a general rate case proceeding as well as actual data experienced by  
5 MGUC. Also, the proposed mechanism reflects a consolidation of rate classes into  
6 rate groups that would make the proposed mechanism simple to calculate,  
7 implement and administer.

8

9 **Alternative Decoupling Proposal – Monthly Service Charge**  
10 **Q. Why is MGUC presenting an alternative decoupling proposal?**

11 A. As mentioned previously in my testimony, the Commission directed MGUC to submit  
12 one or more proposals for revenue decoupling. MGUC believes that a Straight Fixed  
13 Variable ("SFV") rate design, or a flat monthly "Service Charge" to recover fixed  
14 costs, is a feasible alternative to decouple rates.

15

16 **Q. What is a SFV rate and why is MGUC making such a proposal?**

17 A. A SFV rate would assign all fixed costs to fixed charges and all variable costs to  
18 variable charges. As 98% of MGUC's costs for sales customers are fixed, and 100%  
19 of MGUC's costs for transportation customers are fixed, MGUC believes that its  
20 proposed Service Charge, which would assign all fixed costs to a flat fixed monthly  
21 charge for sales and transportation customers and a small volumetric charge for  
22 sales customers only, is appropriate. This is akin to the symmetrical decoupling  
23 mechanism described above because changes in per customer usage would not  
24 significantly affect MGUC's recovery of its Commission-approved revenue  
25 requirement. Exhibit A-9 (VHG-1), Schedule G3, Fixed and Variable Cost Summary,  
26 shows, for the Residential rate class, the derivation of the fixed and variable cost  
27 percentages cited above.

28

1 **Q. Why is MGUC proposing a small volumetric charge for sales customers, but**  
2 **not for transportation customers?**

3 A. As discussed in the pre-filed direct testimony of Mr. David J. Tyler, the Gas Supply  
4 Acquisition component is appropriate for sales customers, but not for transportation  
5 customers. Under a SFV rate design, sales customers would continue to be  
6 responsible for the Gas Supply Acquisition cost component, which would be applied  
7 to each Mcf of gas delivered. As the Gas Supply Acquisition component does not  
8 apply to transportation customers, their Service Charge would reflect only a flat  
9 monthly fee.

10

11 **Q. Would the alternative decoupling proposal apply to the same rate classes**  
12 **subject to the RDM?**

13 A. No, it would not. At this time, MGUC continues to support the RDM for its non-  
14 Residential rate classes, and is only proposing an alternative decoupling mechanism  
15 for its Residential rate class, which represents a relatively homogeneous group of  
16 customers. The same Service Charge would apply to Residential rate sales,  
17 aggregated transportation, and customer choice customers. Exhibit A-9 (VHG-1),  
18 Schedule G4, Alternative Decoupling Mechanism, shows the derivation of MGUC's  
19 proposed monthly Service Charge of \$24.37 (line 9). This charge is derived by  
20 taking the revenues that would arise from the rate design proposals made by Mr.  
21 Tyler for Residential rate customers, excluding revenues arising from Residential  
22 Gas Lighting charges, the Gas Supply Acquisition Charge, and the proposed  
23 monthly Enhanced Administration charge for the Aggregation of Accounts Option for  
24 transportation customers, and dividing the resulting amount by the annual number of  
25 Residential rate customers. The proposed Service Charge is based on the revenues  
26 arising from Mr. Tyler's proposed rate design, rather than the full cost of service,  
27 because Mr. Tyler, while proposing to move the Residential rate class closer to cost,

1 does not set rates at the full cost of service. If the Residential rate class was set at  
2 cost, the monthly Service Charge would be \$26.50, as derived and shown on Exhibit  
3 A-9 (VHG-1), Schedule G4, line 18.

4  
5 **Q. Would the proposed monthly Service Charge offer any benefits to MGUC and**  
6 **its customers?**

7 A. Yes, it would. MGUC's proposed monthly Service Charge would decouple MGUC's  
8 volumetric sales levels from its rates for its Residential rate class, thereby allowing  
9 MGUC the opportunity to earn its Commission approved revenue requirement, while  
10 eliminating the need for any computed adjustments, reconciliations or filings with the  
11 Commission. Note that the annual revenue of \$292.44 ( $\$24.37 \times 12$ ), which would  
12 result from the proposed monthly Service Charge is equivalent to the annual revenue  
13 of \$292.47 that would result from the monthly customer charge proposed by Mr.  
14 Tyler and the RDM baseline shown in Exhibit A-9 (VHG-1), Schedule G1, column D,  
15 line 5 ( $\$12.50 \times 12 + 142.47$ ), but without any adjustments that would need to be  
16 computed, reconciled and filed with the Commission. The Service Charge would  
17 result in a simple rate design for Residential rate customers, and would essentially  
18 provide equal monthly billing for the non-GCR portion of a customer's bill. This  
19 would be especially beneficial to customers during the winter period when gas  
20 usage, gas prices and resulting bills are typically at their highest. A monthly Service  
21 Charge would also send the appropriate price signal to customers about the fixed  
22 cost nature of the distribution service provided by MGUC. The gas cost portion of  
23 the customers' bill will continue to send the proper price signal about the market  
24 driven nature of gas costs. Finally, a fixed flat Service Charge would be similar to  
25 flat charges that customers have become accustomed to paying for internet,  
26 telephone, cable and waste delivery services.

27

1 **Q. If this SFV rate design would avoid the need for adjustments and true-ups, why**  
2 **not propose it for all the rate groups?**

3 A. As I stated, the Residential rate class is relatively homogenous. As a result, the  
4 proposed Service Charge is a practical alternative. While there are commonalities  
5 within the other rate groups, there may also be differences that would require further  
6 analysis. Until such analysis is conducted, MGUC supports the implementation of  
7 the RDM for these rate groups.

8

9 **Q. Is it economically feasible to implement MGUC's alternative proposal, a**  
10 **monthly Service Charge for its Residential rate class?**

11 A. Yes, it is. MGUC's proposed monthly Service Charge would be based on costs  
12 approved by the Commission in a general rate case proceeding. Also, the proposed  
13 Service Charge, which would not require the computation of any adjustments or  
14 regular filings for Residential customers with the Commission for decoupling, is  
15 simple to implement and administer.

16

17 **Q. Is MGUC providing a tariff sheet which reflects the alternative decoupling**  
18 **proposal for the Residential rate class?**

19 A. Yes. A tariff sheet which reflects the charges arising from the alternative decoupling  
20 proposal for the Residential rate class is being sponsored by Mr. Tyler.

21

22 **Q. Does this complete your pre-filed direct testimony?**

23 A. Yes, it does.