Request No. DTE 6-26 (Gas):
Refer to the pre-filed testimony of J.L. Harrison at 45. Please explain the meaning of lines 14-17 (i.e., the sentence starting with "If marginal cost. . .").

Response:
Marginal cost based pricing received a resurgence of theoretical and practical support in the decade of the 1970's period. Economists advocated marginal cost based pricing using raw, unadjusted marginal costs on which to base prices. Theorists argued that economic efficiency was maximized when the prices charged to all customers matched their marginal costs to service. However, revenues resulting from such prices never matched the utility's revenue requirements, established on the basis of conventional rate of return economics. A number of alternatives were proposed to adjust the marginal costs produced by the marginal costs studies to generate marginal cost-based prices that would generate the appropriate level of revenues. The two most commonly advocated approaches were the "Equally-proportional method" and the "Inverse Elasticity method". The referenced section of direct testimony refers to the assumption that pricing would be based on marginal cost data without adjustment, i.e. the raw marginal unit costs produced by the marginal cost study.

Person Responsible: James L. Harrison