

**IN THE TENNESSEE REGULATORY AUTHORITY  
NASHVILLE, TENNESSEE**

**IN RE:**

**DOCKET FOR THE COLLECTION  
OF DATA AND COMMENTS  
RELATING TO HOME ENERGY  
CONSERVATION MATTERS IN  
TENNESSEE**

**DOCKET NO. 06-00309**

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**COMMENTS OF THE CONSUMER ADVOCATE & PROTECTION DIVISION  
OF THE OFFICE OF THE ATTORNEY GENERAL**

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The Consumer Advocate welcomes the initiative of the Chairman and the Authority in addressing the needs of low-income natural gas consumers. While the Consumer Advocate has some concerns regarding issues underlying some of the funding mechanisms that have been discussed, we are generally supportive of a pilot program for weatherizing low-income households. The Consumer Advocate has reviewed the Chairman's *Motion* in this docket filed on July 6, 2007, the comments made by directors on the *Motion* on July 9, 2007 and the individual comments filed by Atmos Energy Corporation ("Atmos"), Chattanooga Gas ("CGC"), and Nashville Gas Company ("Nashville Gas").<sup>1</sup> Following much consideration, the Consumer Advocate submits the following comments.

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<sup>1</sup> For purposes of brevity, Atmos, CGC and Nashville Gas will at times be referred to collectively as the "Industry".

## **I. THE STRUCTURE AND DEVELOPMENT OF THE PILOT PROGRAM(S)**

### **A. The Importance of Uniformity of Purpose, Design and Scope**

The Consumer Advocate appreciates and respects the efforts of the Industry in devising proposals and sensible methods to implement and meet the needs of a conservation program. Although the Industry appears united on the fundamental goal of conservation, the respective comments filed by each represent a diverse set of views in regards to the particulars of how a pilot program would function. The Consumer Advocate would opine that uniformity of design and purpose are crucial. One company expressed the desire for one united conservation program rather than three separate company designed projects.<sup>2</sup> The Consumer Advocate would echo this sentiment.

An ad hoc approach may not produce the results we desire. Some uniformity is needed in the scope, design, intent, tools and goals of the pilot program(s) while allowing the companies some room for innovation to cope with limitations or exploit advantages. Even sophisticated regulated utilities such as those represented by the Industry may falter on their own in this endeavor. They are not in the business of administering social programs and may not possess the skills to efficiently and effectively create a conservation program from scratch. A blueprint of some sort for the Industry to follow would likely aid the companies in the implementation of a program and in measuring the benefits to low-income consumers. Uniformity in some degree may also ease the burden of the Authority's staff in monitoring the program.

### **B. Potential Resources for the Industry**

The majority of the filed comments of the Industry reflect a desire to include non-profit

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<sup>2</sup> *Comments of Nashville Gas*, p. 10 (August 8, 2007)

organizations in the administration of weatherization projects.<sup>3</sup> The Consumer Advocate is supportive of including non-profits in the administration of a pilot program if they possess the experience, civic responsibility, competence and means to do so. The State of Tennessee already employs and entrusts a series of approved non-profit organizations for the administration of LIHEAP funds. In administering LIHEAP funds, these non-profits have had to account for expenditures and worked within the guidelines and strings expressly attached to those funds. Generally, most of these organizations, which are spread across the state, have experience with local contractors that carry out the work of weatherization. These organizations also have experience in overseeing the weatherizing of the households of low-income consumers. Rather than reinvent the wheel, a weatherization program implemented by a company should at the very least consider consulting or partnering with these organizations as Atmos and CGC have proposed.<sup>4</sup> Doing so may significantly reduce the role of and any burden upon the Industry.

While a weatherization program may provide a form of relief to some low-income consumers, a pilot program must include a mechanism to record measurable results if it is to graduate to a grander scale. The Consumer Advocate cannot stress enough the importance of the ability to measure the benefit gained by low-income participants from weatherization efforts. Compiling and recording accurate and raw data from the specific households served by weatherization efforts will give the Authority and the General Assembly a true measure of the merits of the program. There is some indication that this may be a challenge for some in the

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<sup>3</sup> *Comments of Atmos*, p. 2 (August 8, 2007); *Comments of CGC*, p.4 (August 8, 2007).

<sup>4</sup> Atmos and CGC have both proposed working with non-profit organizations that administer LIHEAP funds on behalf of the state and that may already have experience overseeing the weatherization of low-income homes.

Industry.<sup>5</sup> The Consumer Advocate would respectfully suggest that billing and gas use data for specific households participating in the program could be preserved over the course of two or more heating seasons. In essence, we need “before weatherization” data and “after weatherization” data to ascertain the actual and normalized results of the pilot’s conservation efforts.<sup>6</sup>

To ease the burden of compiling and comparing such data, the Industry may wish to consider making efforts to partner with one or more of the public and private universities and colleges located within their respective service areas. Such partnerships may yield the assistance of professors and graduate students in the fields of energy, statistics and/or other related studies to insure an extensive evaluation of raw data and prevent any sense of strain on a company’s resources. However, the Authority may wish to suggest some form of guidance or impose requirements on the methods of data recording, reconciliation and reporting formats.

### **C. Additional Time May be Needed to Address The Mechanics And Details of the Program and Potential Collateral Issues That May Arise**

Nashville Gas has raised the point of whether a program can be successfully implemented in the time allotted in view of the company’s experience in North Carolina.<sup>7</sup> This may well be a pivotal factor for the success of the program. The Consumer Advocate shares parallel concerns in the face of an approaching deadline in that there are a host of details which have not been addressed. It is the minute details, not the broad policy statements, that will impact individual

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<sup>5</sup> *Comments of Atmos*, p. 3-4 (August 8, 2007).

<sup>6</sup> *Comments of CGC*, p.4 (August 8, 2007).

<sup>7</sup> *Comments of Nashville Gas*, p. 10 (August 8, 2007).

low-income households on a range of issues such as whether a family will or will not qualify for the program due to their status as tenant, to what degree a home is weatherized and how the Authority can accurately assure the success of the program.

One particularly important subject already commented upon is the process or mechanism that will be employed by the Industry or its agent to measure the benefit gained by participating low-income households. Another example is whether landlords will contribute to the weatherization of the low-income homes selected for the program.<sup>8</sup> Weatherization will raise in some degree the value of the property owned by a landlord which may concern legal principles of equity.<sup>9</sup> Ownership issues may arise with landlords if energy efficiency appliances are installed, replacing older appliances. In addition, participating low-income families may move during the pilot program period which may cause confusion in measuring gas usage. While these are not the primary concerns of the Consumer Advocate in this matter nor is it an exclusive list of possible matters that may arise, the administrators of the program(s) may be forced to sort out such issues on the spot. The Authority should consider what collateral issues may arise in this endeavor and be prepared to give guidance.

## **II. DECOUPLING MECHANISMS ARE NOT JUST AND REASONABLE**

A common thread within the comments of the Industry is their perceived need for a decoupling mechanism. The concept of decoupling has been discussed often by the Task Force

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<sup>8</sup> Census data shows that home ownership is often out of the reach of low-income families and thus many reside as tenants. Home-ownership should not necessarily be a requirement for low income households to qualify for the program.

<sup>9</sup> An additional concern and perhaps an unintended consequence may be whether a landlord increases the amount of rent due to the increased value of the property from weatherization.

and described in its Reports to the Authority. While the Consumer Advocate has no objections to open and public discussion of the subject, this proceeding has in many ways been used as a proxy to tout a mechanism that is not in the public interest. One can only surmise from the discussions and comments made before the Authority that the Industry is leveraging any commitment to long term conservation programs with the implementation of decoupling mechanisms.<sup>10</sup>

In response, the Consumer Advocate would briefly comment as follows.

**A. The Need for Decoupling Mechanisms in this State is in Doubt And Dispute**

A trend in the decline of per customer usage has been around since the 1980s.<sup>11</sup> Yet despite decades of conducting business in the face of a decline in usage per customer, the Industry has not suffered any financial hardship attributable to the trend. Furthermore, the perceived need for decoupling will be further diminished as time goes on. The American Gas Association (“AGA”) has forecasted that the annual average between the years 2001 through 2020 for the declining trend in usage per customer will be 0.5 percent annually.<sup>12</sup> This represents a significant amelioration. The AGA has attributed the forecasted moderation in the decline in usage per customer to factors such as the modest gains that will be made in the development of increased furnace efficiency, that most of the older and less efficient units have already been replaced and that new homes with more efficient energy features will be 5 percent larger and thus

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<sup>10</sup> *Comments of Nashville Gas*, p.3-6 (August 8, 2007); *Comments of Atmos*, p. 5-6 (August 8, 2007); *Comments of CGC*, p. 6-7 (August 8, 2007).

<sup>11</sup> *Forecasted Patterns in Residential Natural Gas Consumption, 2001-2020*, American Gas Association, EA2004-04 (September 21, 2004).

<sup>12</sup> *Id.*

will increase the heating load required by the household. Space heating accounts for 3/4 of residential consumption.<sup>13</sup>

On a national level, the issue of decoupling has been framed in the context of an absolute necessity for conservation. The Industry's position in chief is that decoupling is the way to circumvent the "disincentive" of a company from supporting conservation efforts as current rate design requires the Industry to remain dependent on steady volumes to recoup a minority portion of their fixed costs.<sup>14</sup> However, the disincentive argument takes only a narrow and microscopic view rather than the proper wide scope required for the regulation of rate of return monopolies. Decoupling mechanisms do not merely account for losses attributed to conservation, rather they function as a "catch all" that indemnifies stockholders for all "margin" lost on a per customer average no matter the cause. This shifts a significant amount of business risk from the stockholders to the shoulders of consumers. Sound regulatory policy is not created with broad strokes on a canvas, but with careful and cautious analysis. Before implementing or endorsing a radical departure from rate-making, regulators must carry out an in-depth analysis of all factors rather than isolate and focus upon one single issue.

Other state commissions have tested the "disincentive" argument with varying degrees of depth. The Utilities Board of the State of Iowa ("Board") has conducted a thorough review of the effects of reduced usage per customer on rate regulated natural gas utilities within its

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<sup>13</sup> *Id.*

<sup>14</sup> The fixed service charge paid by consumers has been increased in recent years for each member of the Industry, thus greatly reducing the risk of the recovery of their fixed costs. The fixed service charge recovers the majority of the Industry's fixed costs, thus the reliance upon and the risk of the volumetric charge is far less than it once was.

jurisdiction.<sup>15</sup> Despite the fact that the legislature in Iowa has required energy efficiency and conservation programs since 1990 and that the usage per customer had decreased, the Board concluded that Iowa's natural gas utilities have been able to engage in meaningful energy efficiency programs without concern for earnings. In the course of their review, the Board examined the net operating income of the LDCs in the state recorded between 1995-2005, the impact of generally warmer weather during that period and how the results of state and company sponsored conservation efforts affected the industry. The Board concluded that there was no direct correlation between net operating income and the declining usage per customer attributable to industry participation in energy efficiency and conservation programs.

Actual company sponsored conservation appears to have no measurable impact on the financial status of the Industry. While there is doubt as to the "disincentive" theory, the opposite conclusion may well be true. There is a fundamental relationship between price volatility and the reaction of consumers in their utilization practices. The higher the price of natural gas climbs, the greater the reaction of consumers in using less.<sup>16</sup> While the Industry may insist it has a disincentive to promote conservation efforts, it is apparent that conservation and price stability may well be in the Industry's long term financial health in terms of customer growth and retention. The Industry must at some point in the near future grapple with the issue of how long residential natural gas service can remain competitive with electricity in a region dominated by the Tennessee Valley Authority. Increasing the burden on consumers during times of potential

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<sup>15</sup> *Inquiry into the Effect of Reduced Usage on Rate-Regulated Natural Gas Utilities*, Docket No. NIOI-06-1, *Order Addressing Issues and Closing Docket*, (December 18, 2006).

<sup>16</sup> *Annual Energy Outlook 2007: Energy Information Administration*, p.89. An additional influence is economic growth.



price volatility does not bode well for customer growth or retention of existing customers.

## **B. Consumers Will Reap No Benefit From Decoupling**

Decoupling has been described as a “win-win” situation for the Industry and consumers in that a utility is guaranteed its margins on a per customer basis and consumers will reap the benefit of cheaper natural gas prices via the effect of conservation on market prices.<sup>17</sup> While the pilot conservation program may assist some low-income households, the suggestion that a decoupling mechanism in tandem with a conservation program in this state will result in cheaper gas prices is a fiction. A conservation program focused on low-income households would have no impact on the price of natural gas.<sup>18</sup> Demand for natural gas is growing and will continue to grow.<sup>19</sup> The market for natural gas does not exist in a vacuum. As such, even when residential consumers use less, demand from other sources may still provide upward pressure on gas prices. Demand has increased in some degree due to natural gas powered electric generation which some in the Industry expect will continue to put upward pressure on the natural gas market.<sup>20</sup>

In fact, decoupling mechanisms that have been proposed and some that have been approved erode the incentive of the individual consumer to conserve. Under the traditional fixed

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<sup>17</sup> *Comments of Atmos*, p. 5 (August 8, 2007).

<sup>18</sup> Transcript of Workshop, p. 145-146, line 25, lines 1-5 respectively (January 31, 2007).

<sup>19</sup> *Comments of Nashville Gas*, p. 2 (August 8, 2007).

<sup>20</sup> *Id.*; However, the Energy Information Administration (“EIA”) has noted that the portion of the electric power sector that employs natural gas in production is sensitive to the price of natural gas. The EIA forecast predicts that should prices remain high, electric power generators will use less natural gas. This is illustrated by the Tennessee Valley Authority (“TVA”) which uses natural gas to make less than 1% of its power load. The costs of using natural gas is nearly five times more expensive than coal and ten times more expensive than nuclear production. According to TVA officials, use of natural gas during price spikes is avoided when possible due to the costs.

service charge/volumetric rate design, a consuming household is rewarded by both the savings of using less gas and the resulting savings of avoiding a small percentage of the volumetric charge. The household's individual efforts are rewarded in full. However, a decoupling mechanism would change that. A typical decoupling mechanism functions with the setting of a benchmark based on a current average level of consumption per consumer and the implementation of a true-up mechanism. For residential consumers, the mechanism functions as a form of cruise control rate regulation. As time passes, the true-up process will result in a deferred revenue requirement that will be passed onto residential rate-payers as a whole. The net result is a rather unfair state and unavoidable quandary in that a household that conserves and a household that does not will collectively be subject to automatic rate increases attributable to "conservation".

### **C. Decoupling Mechanisms Ignore Offsetting Revenue from Customer Growth and Other Factors**

The fundamental problem with a decoupling mechanism is the rigid focus on margins per customer that does not recognize the offsetting revenue generated from customer growth and savings generated through efficiency in operations.<sup>21</sup> In addition, the state of the economy and capital markets impact rates. A decoupling mechanism or tracker is simply a matter of single-issue ratemaking that would circumvent the regulatory review of setting just and reasonable rates based on all attendant circumstances. When setting rates, it is traditional ratemaking policy to look at all factors rather than to isolate upon one. This is known generally as the matching principle. In essence, the matching principle embraces the importance of recognizing all revenues

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<sup>21</sup> Efficiency for a public utility is achieved by multiple means ranging from consolidation of maintenance, employee duties, and operations. There are other less complicated measures such as the use of laptops by service personnel in the field which streamlines communication and saves time. The net effect is that the industry is able to streamline operations, thus to save money and reward stockholders.

and costs during a period of time to determine any needed changes in pricing. This is one of the fundamentals of rate of return regulation. It would be improper to recognize rate adjustments for changes in known and measurable costs and revenues in one specific area without reflecting countering savings and revenue from other facets of operations. Thus any loss in “margin” per customer should be considered in light of offsetting factors such as, but not limited to, the revenue gained from customer growth.

Because offsetting revenue and savings from other aspects of operations are ignored, a decoupling mechanism will, as time passes, result in a windfall to stockholders.<sup>22</sup> A decoupling mechanism does not merely provide the opportunity to earn a just and reasonable return, it guarantees revenues garnered from residential classes.<sup>23</sup> Furthermore, by ignoring offsetting revenues such as revenue from customer growth and savings produced from efficiency, decoupling guarantees that residential revenues will not only be stable, but that they will grow to the benefit of the stockholders and to the detriment of consumers.

### **III. VOLUNTARY FUNDING**

In the course of participating as a member of the Tennessee Home Energy Conservation Task Force, the Consumer Advocate has expressed concerns regarding the statutory authority to

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<sup>22</sup> The Hearing Officer of the New Mexico Public Regulation Commission came to the conclusion that a proposed decoupling mechanism would result in a financial “windfall” to stockholders precisely because the mechanism ignores offsetting revenue. It is not a revenue neutral mechanism. *Recommended Decision of The Hearing Examiner*, Case No. 06-00210-UT (May 23, 2007).

<sup>23</sup> Some decoupling proposals also require small commercial customers to be subject to a decoupling mechanism. The irony of most decoupling proposals is that they are not applied to the industrial and large commercial classes where usage of natural gas may be more volatile in the face of economic downturns than the residential classes.

require mandatory funding contributed by or cost recovery from consumers.<sup>24</sup> Our concerns at present on this issue remain the same although we remain open to discussion and possibly resolving such concerns with the Authority Staff and interested parties. The Industry has suggested sharing the costs of a conservation program through asset management schemes. While we are continuing to study such proposals, the Consumer Advocate would like to clarify a salient point in response to the sharing mechanisms proposed by the Industry in their *Comments*. The Chairman's *Motion* requests voluntary contributions from the Industry to fund a pilot program. It does not compel a party to act involuntarily.<sup>25</sup> At this stage it appears premature for the Industry to propose or speculate upon mechanisms designed to recover the costs of a pilot program or a portion thereof from consumers when they incur such costs voluntarily.

#### **IV. FUNDING FOR RESEARCH AND DEVELOPMENT**

The Consumer Advocate has no opposition on the issue of the Industry's voluntary contributions to a particular research and development ("R&D") entity. Chairman Roberson's *Motion* does not include a provision requiring consumers to contribute to Gas Technology Institute ("GTI"). However, if such funding were to be recovered from or directly contributed by rate-payers, the Consumer Advocate would object. The basis of the objection would be grounded in the fact that an R&D surcharge or the allowance for the recovery of R&D contributions has not been approved by the Authority at the conclusion of a contested case.<sup>26</sup>

The Consumer Advocate would respectfully submit that the proper forum for the

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<sup>24</sup> Transcript of Workshop, p. 133-139 (January 31, 2007).

<sup>25</sup> Transcript of Authority Conference, p. 10-11 (July 9, 2007).

<sup>26</sup> Tenn.Code Ann. §§ 65-5-101(a), 65-5-103(a), 65-4-117(3).

Authority to consider consumer funded R&D is within a contested case setting that would collectively include the Industry, GTI, the Consumer Advocate and any other interested party in one proceeding.<sup>27</sup> Only in this manner could the prudence of Tennessee consumers funding research and development be examined and if approved, applied equally and fairly to Tennessee natural gas consumers. A consumer funded R&D requirement would be a new policy for the Authority and would affect the rates paid by consumers. A new policy affecting rates should be closely scrutinized by interested parties and the Authority with a decision on the merits after a hearing. Otherwise, the Consumer Advocate has no objection to the stockholders of the Industry voluntarily contributing to R&D.

RESPECTFULLY SUBMITTED,



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<sup>27</sup> The Hearing Officer in Docket 04-00034 (a CGC rate case) came to essentially the same conclusion regarding a GTI funding proposal within the rate case of one company. *Order Granting Motion to Sever*, p.4-5 (August 24, 2004).