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December 11, 2009

VIA EMAIL AND HAND DELIVERY

Chairman Sara Kyle
c/o Ms. Sharla Dillon
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

**Re: Petition of Piedmont Natural Gas, Inc. for Approval of Service Schedule
No. 317 and Related Energy Efficiency Programs**
Docket No. 09-00104

Dear Chairman Kyle:

Enclosed please find an original and five (5) copies of Piedmont Natural Gas, Inc.'s Pre-Filed Rebuttal Testimony of David R. Carpenter for filing in Docket No. 09-00104. A copy of the filing has also been transmitted electronically to the Tennessee Regulatory Authority Docket Manager, Sharla Dillon. Please stamp one copy as "filed" and return to me by way of our courier.

Should you have any questions concerning any of the enclosed, please do not hesitate to contact me.

Sincerely,



Erin M. Everitt

Enclosures

cc: Hon. Mary Freeman (*w/o enclosure*)
Hon. Eddie Roberson, Ph.D. (*w/o enclosure*)
Hon. Kenneth C. Hill (*w/o enclosure*)
Ryan McGehee, Esq.
James H. Jeffries, Esq.

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**Before the
Tennessee Regulatory Authority**

Docket No. 09-00104

**Petition of Piedmont Natural Gas Company, Inc.
to Implement a Margin Decoupling Tracker (MDT) Rider
and Related Energy Efficiency and Conservation Programs**

**Rebuttal Testimony
of
David R. Carpenter**

**On Behalf Of
Piedmont Natural Gas Company, Inc.**



December 11, 2009

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

2 A. My name is David R. Carpenter. My business address is 4720 Piedmont
3 Row Drive, Charlotte, North Carolina.

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

5 A. I am employed by Piedmont Natural Gas Company, Inc. ("Piedmont" or the
6 "Company") as Managing Director Regulatory Affairs.

7 **Q. Are you the same David Carpenter who submitted direct testimony in**
8 **this proceeding?**

9 A. Yes, I am.

10 **Q. What is the purpose of your rebuttal testimony in this proceeding?**

11 A. The purpose of my rebuttal testimony in this proceeding is to address certain
12 issues raised by the Consumer Advocate and Protection Division (CAPD) in
13 their direct testimony. These include Issues 2 and 3 as previously defined
14 by the Hearing Officer in this proceeding. Issue 2 addresses the question of
15 the appropriate customer usage level to be used as a benchmark in the
16 decoupling mechanism. Issue 3 addresses the question of whether an
17 evaluation of earnings is necessary. Within the broader scope of these
18 issues, I will also address decoupling pertaining to customer growth, the
19 projected Rate of Return impact of decoupling and the review of usage
20 factors utilized in the WNA calculations.

1 **Q. In his direct testimony, Consumer Advocate Witness Buckner indicates**
2 **that if the MDT mechanism is approved it would be appropriate to**
3 **utilize usage factors developed from customer data for the 12 month**
4 **period ended September 2009. You have testified that the Commission**
5 **approved usage factors from the most recent rate case are the**
6 **appropriate factors for use in the decoupling mechanism. Why are**
7 **these factors appropriate?**

8 A. The 2003 rate case factors are appropriate in order to recover costs at a
9 level approved by this Commission. As I indicated in my direct testimony,
10 during the rate case the Company was subjected to an extensive Cost of
11 Service examination involving the Company, the TRA staff, the Consumer
12 Advocate, the Authority, and various intervenors. The result of that process
13 was a Stipulation between the Company and the CAPD which was
14 subsequently approved by the TRA. In this Stipulation, the parties agreed
15 to an annual cost of service that produced an overall return of 8.42%. That
16 cost of service was then allocated amongst Piedmont's various rate classes
17 and then further allocated amongst customers in each of those classes based
18 on assumed levels of usage. This process resulted in rates that were
19 designed to recover an appropriate level of fixed costs per customer in each
20 customer class. These approved levels of fixed cost recovery were
21 developed based on usage patterns established during the test period in that
22 case. Cost recovery mechanisms such as decoupling utilize usage factors
23 from the base case in order to work in conjunction with the base rates

1 established in that case. Modification of the usage factors alone distorts the
2 basic rate design objectives and will result in recovery of costs at a level that
3 is either higher or lower than that approved by the Commission. Piedmont
4 does not believe that such an approach to establishing usage factors for
5 decoupling is sound.

6 **Q. The CAPD has also indicated that the factors used to calculate the**
7 **WNA need to be updated to current factors. Is this appropriate in the**
8 **current docket?**

9 A. No. As stated in the previous response, changes to certain rate components
10 without changes to all costs factors utilized in the development of base rates,
11 distorts the rate design objectives and results in cost recovery at a level
12 significantly different than that approved by the Commission. In addition,
13 WNA is not included in the issues defined by Hearing Officer in the current
14 docket and therefore should not be addressed at this time.

15 **Q. Issue 3 of this docket raises the question of the need for an evaluation of**
16 **Company earnings prior to implementation of a decoupling mechanism.**
17 **Do you agree with the positions taken by the CAPD regarding this**
18 **issue?**

19 A. No. As an initial matter, it is important to understand that Piedmont's last
20 rate case was settled pursuant to a stipulation between the Company and the
21 CAPD. That settlement was presented to the Authority and ultimately
22 approved. That settlement reflected an overall rate of return of 8.42% and
23 an agreement between the CAPD and Piedmont that an overall level of
24 return between 8% and 9% was reasonable. Significantly, that settlement
25 was "black box" in nature and did not specify either a capital structure or a

1 specific allowed rate of return on common equity. The reason for this is that
2 Piedmont and the CAPD could not reach agreement on these two issues but
3 were able to reach agreement on an overall cost of service and overall rate
4 of return. As a result of these facts, the Authority did not specify a capital
5 structure or allowed rate of return on common equity in its order approving
6 the settlement.

7 **Q. What comments do you have regarding Consumer Advocate witness**
8 **Buckner's earnings analysis?**

9 A. In his direct testimony, CAPD witness Buckner indicates that the Company
10 has reported earnings over the past 5 years that on the average exceeded the
11 allowed overall rate of return. This conclusion is not correct. The Company
12 has reported returns for 2004 through 2008 of 9.68%, 8.56%, 7.53%, 7.46%
13 and 8.79%. This results in a 5 year average overall rate of return of 8.40%,
14 which is below the allowed rate of return reflected in the 2003 rate case
15 order and in the bottom half of the range that the CAPD agreed was
16 reasonable in the rate case settlement.

17 **Q. The CAPD also references the exclusion by the Company of prior**
18 **period adjustments in calculating return. Do you agree with the**
19 **recalculations of return presented by Witness Dismukes that includes**
20 **the prior period adjustments?**

21 A. I partially agree with the recalculations. The monthly rate of return report as
22 filed with the TRA is intended to reflect the current 12 month Net Operating
23 Income in comparison to the most recent 12 month average investment by
24 the Company in rate base items. In reporting this information it is
25 appropriate to exclude significant non-recurring items that pertain to activity
26 outside of the reported 12 months. The Company has followed this

1 approach in filing the referenced reports. It is also appropriate that the
2 CAPD would assume that these adjustments need to be included when
3 attempting to calculate an "adjusted" 5 year average return. However,
4 slightly more than half of the prior period adjustments referenced in this
5 docket relate to issues from before 2004. The CAPD did not have this
6 information available when they calculated the "adjusted" reported return.
7 When this is taken into account, Piedmont's adjusted average overall rate of
8 return for the period since Piedmont's last rate case is 8.43% which is
9 reasonable when compared to the approved level of 8.42% and well within
10 the return range of 8.00% to 9.00% that the CAPD agreed to in the 2003 rate
11 case settlement.

12 **Q. During the 5 year period in question has the reported return exceeded**
13 **the approved 8.42%?**

14 A. Yes. It has exceeded the 8.42% on several instances and has even
15 occasionally been above the 8.00% to 9.00% range agreed to in the 2003
16 rate case settlement. During this period, it has also been below 8.42% and
17 below the bottom of the stipulated range of reasonableness of 8.00%.

18 **Q. Is this unusual?**

19 A. Not at all. Typically our overall level of return will vary over time
20 (sometimes significantly) due to a variety of factors including the impact of
21 weather in non-WNA months, significant cost cutting measures, increased
22 levels of costs, non-weather related changes in consumption, significant
23 investments in critical non-incremental revenue producing capital projects
24 (such as system strengthening) or in expansion projects that do not produce
25 a return equal to the approved level of return. Looking forward, Piedmont is
26 currently in a two year period where capital spending will exceed normal

1 budgeted capital investment by \$31 million (for a total capital investment of
2 \$71 million during this period). These additional amounts of capital will be
3 expended to address a major system strengthening project (\$16 million), a
4 new operations center (\$16 million), and upgrades to our LNG facility (\$12
5 million). None of these projects will produce appreciable incremental
6 revenues but are important for our continued delivery of reliable service.

7 **Q. How will these investments impact Piedmont's overall return during**
8 **this period?**

9 A. Because these investments will not produce appreciable incremental
10 revenues for the Company, though they are necessary for Piedmont to
11 continue to provide safe, responsive, and reliable service to its customers,
12 these investments will have a serious downward impact on Piedmont's
13 overall return until Piedmont's next rate case. My calculations indicate that
14 the order of magnitude impact of these investments is in the range of a 40
15 basis point reduction in Piedmont's overall return.

16 **Q. Do you believe that Piedmont will overearn if its MDT proposal is**
17 **approved?**

18 A. No. I think there is very little danger of that for several reasons. First, the
19 MDT mechanism itself will only allow Piedmont to recover up to its
20 approved level of margin per customer so it is not possible for the
21 mechanism itself to cause an overearnings problem. It is possible that
22 Piedmont's return could be elevated as a result of significantly decreased
23 costs but Piedmont has just completed several years worth of cost-cutting
24 measures that, along with incremental customer growth, were largely
25 responsible for the relative stability of its overall return during the last five
26 years. Based on the fact that no substantial additional savings are

1 anticipated from these efforts, Piedmont reasonably expects its overall level
2 of return to erode and has already seen that begin to occur. Finally, the
3 significant new capital investments by the Company described above will
4 place additional downward pressure on Piedmont's return.

5 **Q. Will the adoption of the MDT mechanism reduce Piedmont's incentive**
6 **to effectively manage its costs?**

7 A. No. Piedmont and its customers will continue to receive the benefit of any
8 cost saving measures Piedmont is able to implement and the MDT
9 mechanism will have no effect on that dynamic. In North Carolina, we have
10 had a decoupling mechanism in place for a number of years and during that
11 period Piedmont has continued to aggressively undertake cost savings
12 measures.

13 **Q. If Piedmont were to consistently overearn after implementation of the**
14 **MDT, does the Authority have any mechanism to deal with that**
15 **phenomenon?**

16 A. Yes. It has been our experience that all of the state public service
17 commissions that regulate us are concerned with sustained earnings levels.
18 If Piedmont were to consistently earn in excess of its approved level in any
19 of the states in which we operate, we would anticipate regulatory action to
20 address the issue. Over the past 5 years Piedmont has consistently earned at
21 or below the level approved in its last rate case in Tennessee. If we were to
22 exceed that level after implementation of our MDT mechanism on a
23 sustained basis, this Authority would have ample ability to address the
24 situation through either a show cause proceeding or other regulatory
25 mechanism. This issue is effectively mooted, however, by Piedmont's
26 proposed solution to earnings concerns. As is discussed in Mr. Yoho's

1 rebuttal testimony, Piedmont is proposing a mechanism that would provide
2 an annual cap on Piedmont's return of 8.42% with any excess credited back
3 to the customers. This mechanism provides absolute assurance that
4 overearning will not be an issue after adoption of the MDT.

5 **Q. CAPD Witness Klein Exhibits 1 and 2 reference data request responses**
6 **provided by the Company for Return On Equity (ROE) calculations for**
7 **the period of November 2008 through July 2009. Were these**
8 **calculations prepared under your supervision?**

9 A. Yes. The Company prepared this data using parameters defined by the data
10 request of the CAPD.

11 **Q. Do you agree that the calculations specified by the CAPD in their Data**
12 **Requests represent accurate rate of return on common equity**
13 **calculations for Piedmont for the specified period?**

14 A. No, I do not. The calculation is problematic. Using monthly capital
15 structure figures and corresponding cost rates for debt and equity can
16 produce volatile results that do not properly reflect the earnings experience
17 of the Company. For example, during the past 12 months the Company has
18 experienced significant changes in the level of short-term debt resulting
19 from large variations in the wholesale cost of natural gas. Given the
20 extreme circumstances of last year, the Company's capital structure during
21 this period contained an anomalous level of short-term debt which skewed
22 the capital structure in a manner that is unlikely to be repeated. If these
23 anomalous levels of short-term debt are corrected for, Piedmont's ROE for
24 this period was less than 10%.

1 **Q. Do you have any other concerns with the use of the ROE data in this**
2 **proceeding?**

3 A. Yes, there is a significant error in Klein Direct Exhibit 2, in his first ROE
4 example, which purports to use a Mid-Year Capital Structure in both
5 examples. The first example does not use the same Mid-Year Capital
6 Structure as shown in the second example on Exhibit 2. If the same Mid-
7 Year Capital Structure is used the resulting ROE would be 67 basis points
8 lower.

9 **Q. Is it your contention that during the 5 year period the Company did not**
10 **experience ROE's that approached those calculated in response to the**
11 **CAPD's data request?**

12 A. No. Due to changes in the Capital Structure and cost rates that occur in the
13 normal course of business, a utility may experience varying levels of return
14 at different points in time. Piedmont is particularly aware of this due to
15 regulatory mechanisms in other jurisdictions which result in revenue
16 reductions or increases driven by actual ROE's being over or under
17 approved ROE's. Higher rates of return are only problematic when they are
18 sustained at unreasonable levels.

19 **Q. Has that occurred in this case?**

20 A. No. On average Piedmont did not exceed its overall allowed return during
21 this period. More to the point, that level of return has dropped significantly
22 in the past few months.

23 **Q. What overall return is the Company currently earning?**

24 A. Using the data from the most recent return report filed with this Authority,
25 Piedmont is earning at an overall return level of 7.47%, well below the
26 approved level of 8.42%.

1 **Q. Is it more appropriate to monitor the Company's performance with the**
2 **Overall Rate of Return or the Return on Equity?**

3 A. Either Return percentage, when reviewed consistently, serves as a good
4 measure of the Company's financial performance. It has been our
5 experience that the ROE is more volatile due to the significant impact of
6 relatively minor shifts in capital structure which have a double impact on
7 ROE due to the fact that any reduction in the equity component
8 automatically increases the debt component and vice versa. More to the
9 point, the evaluation measure used by this Commission to review the
10 financial performance of Piedmont in the Company's 3.03 report is the
11 Overall Rate of Return and that rate has remained relatively stable over the
12 past few years but is now in decline. The validity of this overall rate of
13 return approach is buttressed by the fact that Piedmont has no approved
14 level of return on common equity under its existing rates and, therefore,
15 there is nothing with which to compare any current ROE calculation. As is
16 explained above, however, the Company has consistently earned at or below
17 the overall rate of return approved in its most recent rate case, is currently
18 earning at a level well below its allowed return, and we project that we will
19 earn well below the allowed level of return going forward even with
20 decoupling.

21 **Q. What do you conclude from these facts?**

22 A. That whatever meaning there may be in the ROE calculations presented by
23 the CAPD, they refer to a past period and have no relevance to what might
24 happen with respect to Piedmont's levels of return (overall and common
25 equity) going forward.

1 **Q. Do you agree with CAPD witness Klein's assertion that Piedmont's**
2 **ROE will continue to increase if the MDT is adopted as a result of**
3 **further reductions in consumption by residential customers?**

4 A. No. The MDT only serves to recover margin lost through the invalidity of
5 usage assumptions underlying base rates. The margin that is recovered
6 through the MDT was included in the Company's overall revenue
7 requirement approved in the last rate proceeding which formed the basis for
8 calculation of the Company's base rates. As such, it makes no sense to
9 argue that the MDT will increase Piedmont's ROE because the mechanism
10 simply allows the recovery of revenues that were part of the revenue
11 requirement calculation supporting the approved level of return in the last
12 rate case.

13 **Q. What is your response to the CAPD's other objections to the MDT**
14 **mechanism?**

15 A. The CAPD's objections to decoupling can be placed in 3 closely related
16 categories. These categories and my response to them are as follows:

17 1) Single issue ratemaking. The CAPD contends that approval of the
18 MDT mechanism constitutes single issue ratemaking. I disagree.
19 Decoupling is not single issue ratemaking. In fact, it is not ratemaking at
20 all. It is simply the adoption of a tracker mechanism that facilitates the
21 recovery of exactly the amount of fixed costs per customer approved by
22 the Authority. The base rates and per customer revenues adopted and
23 approved by the Authority in Piedmont's last rate case will not be changed
24 as a result of the MDT mechanism.

25 2) Creates revenue outside of a rate case. The MDT mechanism does
26 not create additional revenue entitlement. Instead, it simply permits the

1 Company to recover the amount of margin per customer approved by the
2 Authority that the Company has otherwise lost the ability to recover due to
3 the invalidity of the usage assumptions upon which base rates were set. In
4 short, it returns revenue collections per customer to the level previously
5 approved, and operates much the same as the WNA mechanism that has
6 been in effect for many years.

7 3) Guarantee of earnings. Decoupling alone cannot guarantee earnings
8 as revenue collection is a single component of a very complex cost of
9 service. The other components include Operating and Maintenance
10 Expense, General Taxes, Depreciation, Rate Base Investment, Capital
11 Structure and Capital Rates. Decoupling simply ensures that the Company
12 does not over collect or under collect fixed costs.

13 **Q. The CAPD has suggested in testimony that a rate case is necessary in**
14 **order to implement decoupling. Is the Company opposed to filing a**
15 **rate case?**

16 A. No. The Company continuously reviews financial performance to
17 determine if we are achieving a reasonable return in each of our
18 jurisdictions. During the past 5 years we have been able to provide quality
19 service, grow our customer base, increase our investment in Tennessee and
20 achieve a fair return despite basically flat revenues resulting from significant
21 per customer usage declines. We have achieved this through a variety of
22 efficiency efforts including cost cutting through consolidation of functions
23 and continuing business process initiatives. Current analysis indicates that
24 we have a growing deficiency of earnings that will be accelerated by the
25 substantially increased investment in infrastructure discussed earlier in my

1 testimony. Based on these trends the Company will examine the potential
2 need to file a rate case even more closely in the upcoming months.

3 **Q. If that is the case, why does the Company object to initiating a rate case**
4 **in this proceeding?**

5 A. Because it is unnecessary to the consideration of the MDT mechanism and
6 will result in substantial expenditures of time and money by the Company
7 and the Authority, and ultimately by customers.

8 **Q. What is the projected impact of decoupling on the financial**
9 **performance of the Company if it is approved in the current docket?**

10 A. Based on the customer usage patterns of the most recent 2 years, the
11 Company would expect to more correctly recover its fixed costs. This
12 correction, along with continuous efficiency efforts to properly manage
13 other variables, is expected to allow the Company to achieve an overall rate
14 of return that is projected to be below the bottom of the stipulated range of
15 8.00%. The September 2009 3.03 report filed with this Commission
16 showed an overall return of 7.47%. As indicated by CAPD Witness Klein, a
17 decoupling mechanism used during the most recent 12 months would have
18 increased the overall return by 50 basis points to approximately 7.97%, a
19 level of return that is very consistent with the allowed overall returns of
20 other Tennessee gas utilities and well below the allowed levels of return in
21 other jurisdictions.

22 **Q. How would a decoupling mechanism impact the timing of rate cases?**

23 A. With a decoupling mechanism in place to correct for variations in customer
24 usage, we would expect a greater length of time between rate cases,
25 including a reduced need to file a rate case in the near future. This would

1 reduce the volatility of rates and reduce the significant burden placed on the
2 customers for the recovery of rate case expense.

3 **Q. Does this conclude your rebuttal testimony?**

4 A. Yes it does.

**BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

IN RE:

PETITION OF PIEDMONT NATURAL GAS
COMPANY, INC. TO IMPLEMENT A
MARGIN DECOUPLING TRACKER (MDT)
AND RELATED ENERGY EFFICIENCY AND
CONSERVATION PROGRAMS

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Docket No. 09-00104

AFFIDAVIT

STATE OF NORTH CAROLINA

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COUNTY OF MECKLENBURG

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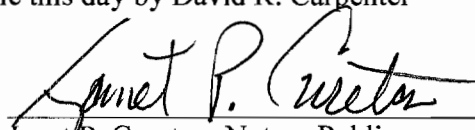
David R. Carpenter, being duly sworn, deposes and says that he is the David R. Carpenter whose Rebuttal Testimony accompanies this affidavit; that such rebuttal testimony was prepared by him; that he is familiar with the contents thereof; that the facts set forth therein are true and correct to the best of his knowledge, information and belief; and that he does adopt the same as his sworn rebuttal testimony in this proceeding.


David R. Carpenter

Mecklenburg County, North Carolina

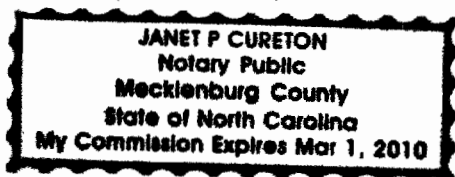
Signed and sworn to before me this day by David R. Carpenter

Date: 12-9-2009


Janet P. Cureton, Notary Public

(Official Seal)

My commission expires: March 1, 2010



CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Pre-Filed Rebuttal Testimony was served via U.S. Mail or electronic mail upon:

C. Scott Jackson
Ryan L. McGehee
Office of the Attorney General
Consumer Advocate and Protection Division
PO Box 20207
Nashville, Tennessee 37202-0207

This 11th day of December, 2009.