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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

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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 Russell A. Feingold 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

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.

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 and Exhibits
of
Russell A. Feingold

On Behalf Of
Piedmont Natural Gas Company, Inc.

December 11, 2009

Introduction

Q. Mr. Feingold, please state your name and business address.

A. My name is Russell A. Feingold. My business address is 2525 Lindenwood Drive, Wexford, Pennsylvania 15090-7914.

Q. Are you the same Russell A. Feingold who submitted direct testimony in this proceeding?

A. Yes, I am.

Q. On whose behalf are you appearing in this proceeding?

A. I am appearing on behalf of Piedmont Natural Gas Company ("Piedmont" or the "Company") in this proceeding.

Purpose of Testimony

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

A. The purpose of my rebuttal testimony is to respond to certain aspects of the direct testimony of Dr. David E. Dismukes submitted on behalf of the Tennessee Attorney General, Consumer Advocate and Protection Division ("Consumer Advocate"). His direct testimony addresses revenue decoupling and related utility regulatory policy as it pertains to the Margin Decoupling Tracker ("MDT") mechanism proposed by the Company in this proceeding. Other Company witnesses also will respond to specific aspects of Dr. Dismukes' direct testimony.

Q. Can you briefly summarize your findings and conclusions related to Dr. Dismukes' direct testimony?

A. Yes. Based on my review of the points and the underlying support presented by Dr. Dismukes concerning the Company's MDT proposal, I have reached the following conclusions:

1. The criticisms presented by the Consumer Advocate of the Company's revenue decoupling proposal are without merit and either overly biased or misleading when viewed against the real factors driving the need for this proposed ratemaking mechanism.
2. The numerous recommendations offered by Dr. Dismukes in his direct testimony are inappropriate and should be rejected by the Authority since they will undermine the purpose and intent of the Tennessee legislation that prompted the filing of the Company's revenue decoupling proposal, and will severely limit its desired outcomes.
3. There is a demonstrated and important need for the Tennessee Regulatory Authority (the "Authority") to approve the operation of Piedmont's MDT proposal when viewed against the stated public policy of the State of Tennessee and the factors otherwise establishing an incentive for Piedmont to promote increased natural gas usage by its customers;
4. The Company's MDT proposal is appropriate for, consistent with, and supportive of, the goals of Tennessee Code Annotated 65-4-

126 and the regulatory trends and principles in today's business environment that are associated with the establishment of a utility's revenue requirement and the rates that are designed to recover its approved level of margin revenues;

5. The Company's MDT proposal is conceptually sound and based upon widely accepted utility ratemaking approaches; and
6. The Company's MDT proposal is balanced and designed to provide significant benefits to the Company and its customers.

I will demonstrate below that the Company's revenue decoupling proposal is fully supported by the evidence in this proceeding, is consistent with sound regulatory principles, and is in the public interest. Dr. Dismukes' claims are without merit and simply misleading.

Addressing the Consumer Advocate's Claims Regarding What is the Most Appropriate Ratemaking Mechanism for the Company

Q. In the Order Granting Intervention, Determining Issues, and Establishing Procedural Schedule issued on October 13, 2009, the Hearing Officer identified five issues as being relevant to the resolution of the Company's petition. What is the nature of the first issue identified by the Hearing Officer?

A. The Hearing Officer's Issue 1 addresses the question – what is the most appropriate mechanism, or financial incentive, to insure that Piedmont's financial incentives are aligned with the state's energy conservation policy as set out in 2009 Public Act 531, Section 53.

Q. What are the Consumer Advocate's recommendations regarding Issue 1 as presented in Dr. Dismukes' direct testimony?

A. At page 31 of his direct testimony, Dr. Dismukes recommends that the Authority reject the Company's MDT proposal "since current regulation in Tennessee provides adequate financial incentives for the promotion of cost-effective energy efficiency." He further states that the Company's ratemaking proposal should also be rejected since the Company "has not shown that its proposed energy efficiency proposals would create any form of financial harm or disincentives."

Q. Do you agree with the recommendations made by the Consumer Advocate regarding Issue 1?

A. No. Dr. Dismukes' recommendations have no support as they relate to the Company's specific situation and are contrary to the growing ratemaking trends observed in the gas distribution utility industry with regard to revenue decoupling and other innovative ratemaking approaches.

Q. How do you respond to Dr. Dismukes' claim that "current regulation in Tennessee provides adequate financial incentives for the promotion of cost-effective energy efficiency?"

A. Under current regulation in Tennessee, a gas utility such as Piedmont will be financially harmed by declining use per customer whether it is caused by customers responding to the energy efficiency programs offered by the Company or by any other independent actions taken by customers to reduce their natural gas consumption. The traditional utility regulatory

processes of the past are no longer sufficient to accommodate the business conditions faced today by gas distribution utilities such as Piedmont. These business conditions have introduced elements of considerable and recurring variability, unpredictability, and uncontrollability that did not exist in the past related to a natural gas utility's costs of delivery service and the gas usage factors used to set its base rates to recover such costs. As a result, these business conditions have created the need for a much more dynamic and responsive process to produce base rates that will actually recover the regulatory commission-approved cost of service and rate of return for the utility. The widespread and growing regulatory acceptance of revenue decoupling mechanisms, Straight Fixed-Variable ("SFV") rate structures, Weather Normalization Adjustment ("WNA") mechanisms, infrastructure cost recovery mechanisms, and revenue (return) stabilization mechanisms are indicative of the need for effective ratemaking solutions to address these business challenges.

Finally, I would note that Dr. Dismukes' conclusion that the Company's existing ratemaking approach is sufficient and appropriate and that no change in the Company's approach is warranted appears to fly in the face of the obvious conclusion reached by the Tennessee legislature when enacting 2009 Public Act 531, Section 53, that the utilities' existing ratemaking approaches are not sufficient. Stated differently, if a utility's existing ratemaking approach is adequate and sufficient (as Dr. Dismukes

contends), then there was no need for the legislation that prompted Piedmont's filing in this proceeding.

Q. How was weather accommodated by the traditional utility ratemaking process of the past and why can't it be accommodated now?

A. Weather was accommodated by the traditional utility ratemaking process of the past by designing rates in a utility's rate case on the basis of normal weather. Since the early 1980s, many utilities have received regulatory approval of WNA mechanisms (including Piedmont) to accommodate the increased weather variability and warming temperatures experienced relative to the normal weather assumptions used within the rate case process to design rates. Rates continue to be based on normal weather, but those rates are adjusted periodically to reflect the unpredictable deviations from normal weather that occur over time.

Q. How was customer use accommodated by the traditional utility ratemaking process of the past and why can't it be accommodated now?

A. Customer use was accommodated by the traditional utility ratemaking process of the past by designing rates that would enable the recovery of the utility's total cost of service using the historical, weather normalized customer usage levels reflected in the test year of the utility's rate case. It was assumed that such billing determinants were stable which provided the utility with rates that would enable the recovery of its total cost of service. With the more recent weather trends described above and the

increased emphasis being placed on energy conservation and efficiency by utility customers, the customer usage assumptions made in a rate case no longer fairly represent the actual gas usage levels experienced by the utility in future periods. The substantial declines in use per customer experienced by the natural gas distribution utility industry in more recent times, coupled with the widespread use of volumetric delivery service rates, have caused utilities throughout the U.S. to experience an ongoing under recovery of fixed costs.

Q. How were wholesale natural gas prices accommodated by the traditional utility ratemaking process of the past and why can't it be accommodated now?

A. Wholesale natural gas prices were accommodated by the traditional utility ratemaking process of the past through the use of Purchased Gas Adjustment ("PGA") mechanisms which enabled the utility to recover on a timely basis the gas costs it incurred to serve its sales customers. While today wholesale natural gas prices continue to be accommodated by utilities through their PGA mechanisms, the increased volatility and level of wholesale natural gas prices over the last decade has had a major impact upon the level of gas used by utility customers. As wholesale natural gas prices increase, customers' gas bills increase as well. As a result, some customers undertake short-term actions to conserve natural gas (e.g., "dialing-down" of home thermostats) causing a decline in use per customer. These actions contribute to the situation described above.

Q. Can't a utility such as Piedmont attempt to manage these business challenges and associated risks as implied by Dr. Dismukes in his direct testimony?

A. While it is easy for Dr. Dismukes to simply suggest these risks should be managed by the Company, the reality is that such an objective is not feasible. No utility is in a position to "manage" the variability in weather, the customer actions that impact use per customer, or the market dynamics that influence wholesale natural gas prices.

Q. How do you respond to Dr. Dismukes' claim that "the Company has not shown that its proposed energy efficiency proposals would create any form of financial harm or disincentives?"

A. I believe that Dr. Dismukes' claim is simply not relevant in determining the appropriateness of implementing revenue decoupling for a gas utility such as Piedmont. The degree to which a utility chooses to offer energy conservation and efficiency programs to its customers should not influence the decision to eliminate its throughput incentive. There are multiple actions that the Company's customers can take to conserve natural gas that are independent of any Company-sponsored energy efficiency programs, and these actions will create financial harm for Piedmont unless the resulting decline in use per customer is addressed through a ratemaking solution such as revenue decoupling.

Furthermore, as I noted in my direct testimony, there are other equally important reasons why a natural gas utility and its regulatory commission

should be interested in "breaking the link" (i.e., eliminating the utility's "throughout incentive") between a utility's revenues and sales through revenue decoupling.

First, revenue decoupling compensates for the inherent deficiency in traditional utility ratemaking and rate structures created by the attempt to recover fixed distribution costs in the variable portion of rates (i.e., the volumetric rate component). Second, revenue decoupling addresses the uncertainties in establishing a natural gas utility's sales volume level in its rate case that will be representative of its future sales volume level, especially in the period after the first year that the new rates are in effect. In both cases, "breaking the link" is critical to eliminating the importance of sales volumes in enabling the natural gas utility to achieve its approved level of revenues and ensuring that customers are charged only for the level of utility service they require. Revenue decoupling recognizes that a natural gas utility is entitled to a reasonable opportunity to recover fully its previously approved level of fixed costs between rate case filings, even when the various factors I discussed in my direct testimony adversely affects the utility's revenues over this period.

Q. Do you agree with Dr. Dismukes' claim at page 14 of his direct testimony that under traditional utility ratemaking and regulation, the utility and its shareholders typically bear the risk of revenue and sales differences from the test year?

A. No. Under the Company's volumetric-based delivery service rates, the

Company and its customers bear the risk of revenue and sales differences. When sales are higher than expected, the customer bears the risk of overpaying for delivery service through the higher revenues collected from volumetric-based delivery rates because the fixed costs of delivery service do not change with changes in sales. When sales are lower than expected, the Company bears the risk of under-recovering its revenue requirement through the lower revenues collected from volumetric-based delivery rates. The risk is symmetrical so long as the baseline revenues and sales are set at appropriate levels.

Q. At pages 21-22 of his direct testimony, Dr. Dismukes contends that "regulatory lag can be an important policy tool in controlling utility costs which ultimately can lead to lower rates." How do you respond to Dr. Dismukes' contention?

A. I fundamentally disagree with Dr. Dismukes' contention. Regulatory lag does not give utilities an incentive to reduce costs and become more efficient. In the case of a natural gas utility such as Piedmont with declining use and a growing rate base, all that regulatory lag accomplishes is: (1) to keep the utility from having the full opportunity to earn the allowed return, and (2) to foster continued rate cases.

Dr. Dismukes is really saying his view of regulation is that a reasonable opportunity to earn the allowed return should require the utility to overcome tremendous obstacles to earn the return authorized. This is contrary to the accepted concept of a "reasonable opportunity." In fact,

based on this view, it is my belief that Dr. Dismukes would have regulators impose asymmetric earnings risk on the utility since, without a reasonable chance to recover the allowed revenues and in the face of required new capital investment that produces no additional revenues, lower returns are a certainty.

The basic principle of regulatory lag relates to the overall earnings of the utility. As Bonbright states in his well known treatise on utility ratemaking, it is "the quite usual delay between the time when reported rates of profit are above or below standard and the time when an offsetting rate decrease or increase may be put into effect by commission orders or otherwise."[1]

Earnings attrition is the deterioration of a utility's actual rate of return on equity below its allowed rate of return on equity that occurs when the relationship between revenues, costs, and rate base used to establish rates (i.e., using a historical test year) have changed by the time rates go into effect. For example, if external factors are driving costs to increase more than revenues, then the rate of return will fall short of the allowed return, even if the utility is operating efficiently. Similarly, when growth in the utility's investment outstrips the rate base used in its test year, the earned rate of return will fall below the allowed return through no fault of the utility's management.

[1] Bonbright, Danielson, Kamerchen, Principles of Public Utility Rates, Public Utility Reports, Inc., Second Edition 1988.

In my opinion, utilities and regulatory commissions have worked hard to address the revenue and cost components of a utility's total revenue requirement and to manage regulatory lag and minimize earnings attrition through a variety of innovative ratemaking approaches, including:

1. Approval of ratemaking trackers that address particular cost elements (e.g., infrastructure costs, bad debt expense, pension expense) that cannot adequately be recognized and reflected in rates through the traditional rate case process.
2. Approval of inflation or attrition rate adjustments for certain utility operating expenses.
3. Approval of step adjustments to capture the known changes to a utility's infrastructure investments that do not warrant the separate filing of a rate case to be able to include these investments in rates.
4. Approval of rate of return stabilization mechanisms that enable the utility's revenue requirement to be adjusted on a periodic basis, outside of a general rate case, to reflect more current revenue and cost relationships that cannot adequately be captured in a traditional rate case environment.
5. Adoption of future test years and more balanced rate base and expense adjustments in rate cases in an attempt to reflect more realistic revenue requirements, rate, and cost levels.

6. The streamlining of the regulatory and ratemaking processes through the fostering of rate case settlements and other Alternate Dispute Resolution processes.

Adoption of the asymmetric rate risk apparently advocated by Dr. Dismukes will serve primarily to prompt additional and more frequent rate proceedings by natural gas distribution companies like Piedmont facing simultaneous declines in customer usage and increasing infrastructure investments. This is true because Piedmont will be in the position of constantly "chasing" its allowed return under conditions where it has no realistic chance to achieve that return.

Q. At page 24 of his direct testimony, Dr. Dismukes argues that if utilities are given the ability to change, and generally increase their rates (through revenue decoupling), without any annual justification, then the discipline typically imposed by regulatory lag is completely removed as well. Do you agree with Dr. Dismukes' argument?

A. No. Dr. Dismukes' argument is fundamentally flawed. Very simply, the periodic rate adjustments resulting from a utility's revenue decoupling mechanism do not affect the cost side of the utility's revenue requirement equation. The utility's costs are subject to the same economic forces, and the same level of managerial oversight, as exists under traditional regulation.

Q. At page 20 of his direct testimony, Dr. Dismukes contends that revenue decoupling is clearly a policy that has been utilized in the past and abandoned almost as quickly as it was implemented. Do you share Dr. Dismukes' characterization of revenue decoupling plans of the past?

A. No, I do not. The real reasons why revenue decoupling for electric utilities in the early 1990s disappeared by 2000 were associated with unique utility operating circumstances during that era rather than deficiencies in the ratemaking concept of revenue decoupling. I will discuss later in my rebuttal testimony the circumstances surrounding the revenue decoupling mechanism of Central Maine Power ("CMP") in Maine (that was raised by Dr. Dismukes in his direct testimony), and how the effects of the economic recession on the utility's customer were inappropriately blamed on the revenue decoupling mechanism. In California, revenue decoupling which was adopted in the early 1990s was functioning properly. But by 1996, the state's move to retail competition brought the utility's revenue decoupling plans to an end. With the energy crisis of 2000-2001, California recognized the importance of energy efficiency and reinstated in 2002 the revenue decoupling mechanisms for all electric and natural gas utilities. In Washington State, the impact of higher power costs on utility customers' electric bills during the early 1990s and their treatment in the utility's revenue decoupling mechanism caused controversy over the approved revenue decoupling plan – despite

the fact that the true-up and weather normalization process in the mechanism worked well.

Contrary to Dr. Dismukes' claim that, "by 2000, no states had an active revenue decoupling mechanism in place, including California," Maryland had already approved revenue decoupling in 1998 for Baltimore Gas & Electric Company's gas operations. That ratemaking mechanism is still in operation today. In addition, Dr. Dismukes ignores the fact that many WNA mechanisms (a form of partial revenue decoupling) had been approved for natural gas utilities during the 1980s and 1990s, with many still in operation today (to the extent they were not more recently replaced with full revenue decoupling mechanisms). Piedmont's current WNA mechanism has been in operation since it was approved by the Authority in 1991.

Q. Dr. Dismukes suggests at page 25 of his direct testimony that consumer groups are particularly concerned about the adoption of revenue decoupling mechanisms and the implications they have for customer bills. Do you share Dr. Dismukes' industry-wide perspective on this topic?

A. No. I believe Dr. Dismukes' industry-wide viewpoint on this topic is biased. In states such as Arkansas, Indiana, and Colorado, State Attorney Generals and other consumer groups have signed onto utility rate case settlements that proposed revenue decoupling mechanisms. In addition, the former New York Governor and Attorney General was supportive of

revenue decoupling in its comments in the New York Public Service Commission generic proceeding on the subject that led to the ordering of all natural gas and electric utilities in the state to file revenue decoupling proposals. Furthermore, the utility consumer advocates in the states of Colorado, Indiana, Ohio, and Wyoming, with the states of California and Massachusetts abstaining, voted against the National Association of State Consumer Advocates ("NASUCA") Resolution urging utility regulators not to adopt revenue decoupling concepts. Finally, the Connecticut Office of Consumer Counsel and the Office of the Ohio Consumers' Counsel endorsed the recommendations[2] of the National Action Plan for Energy Efficiency ("Action Plan") – which included as one of its recommendations to encourage state utility regulators to consider revenue decoupling mechanisms.[3]

It is not surprising that so-called consumer advocates, such as the Tennessee Consumer Advocate, would be less enamored with ratemaking mechanisms that allow utilities a more stable revenue stream and a better opportunity to recover their total cost of service and a fair and reasonable rate of return. However, Dr. Dismukes' direct testimony ignores the

[2] National Action Plan for Energy Efficiency, Public Statements & Commitments in Support of the Action Plan, pp. 8 and 31.

[3] Issued in July 2005, the "Action Plan" was facilitated by the U.S. Department of Energy and U.S. Environmental Protection Agency with the participation of over 50 utilities, public utility commissions, energy consumers, and non-governmental groups to set a broad course for encouraging greater energy efficiency investment in the United States, p. 2-17.

substantial differences of opinion that exist even within the ranks of consumer advocacy groups.

Q. At pages 25-26 of his direct testimony, Dr. Dismukes summarizes the position of the Electric Consumers Resource Council ("ELCON") on revenue decoupling. Have any industry groups taken issue with the cited ELCON position paper?

A. Yes. In May 2008, the American Gas Association ("AGA") published a response to the ELCON 2007 Revenue Decoupling Policy Brief to show how the ELCON positions were incorrect, biased, or focused on electric utility issues. Rebuttal Exhibit ___ (RAF-1) presents the formal AGA response to the ELCON policy paper. Pages 10-18 of this Exhibit respond to each of the positions taken and recommendations made by ELCON that were cited by Dr. Dismukes in his direct testimony.

Q. Does the AGA response to the ELCON policy brief specifically address the group's recommendations that were cited by Dr. Dismukes at page 26 of his direct testimony?

A. Yes. The AGA responded to each of ELCON's recommendations concerning revenue decoupling with extensive comments that are provided in Exhibit ___ (RAF-1). I have summarized the AGA's key points below for each of ELCON's recommendations concerning revenue decoupling:

- *ELCON Recommendation - Decoupling Promotes Mediocrity in the Management of a Utility*

  AGA Comment: "This contention is wholly unsupported. There is

no regulatory or court finding and no academic literature that has shown a cause-and-effect relationship between revenue decoupling and utility management mediocrity. Quite the contrary, the outside evaluation of NW Natural's 2002 decoupling mechanism, conducted as part of the Oregon PUC's 2005 review of the program, found that decoupling changed the company focus from marketing to promoting energy efficiency, and that this changed focus caused no deterioration of customer service and no shifting of risk to customers."

- *ELCON Recommendation - Decoupling Shifts Significant Business Risk From Shareholders To Consumers With Only Dubious Opportunities For Net Increases In Consumer Benefits*

  AGA Comment: "There is no shifting of risks from shareholders to consumers for RD [revenue decoupling] because customers bear no risk at all from their choice to consume delivery service from the utility. The economic definition of risk is exposure to the consequences of uncertainty. Consuming less (or more) of a product and paying less (or more) money for the product is not an uncertainty, it is a choice. Natural gas customers receive a fixed amount of delivery service annually. It is not possible to receive more or less delivery service unless the customer hooks up a second home or business. This service has a fixed cost that does not increase or decrease when the customer consumes more or less

natural gas commodity. RD is simply a rate design that recovers the fixed costs of a fixed cost business on a non-volumetric basis from customers. Since there is no ability to consume more (or less service) there is no risk that the cost to the customer will change. Rather than shifting risk from the utility to the customer, RD smoothes out the artificial variability in delivery service charges paid by the customer that is the natural consequence of volumetric rate designs."

- *ELCON Recommendation - Decoupling Eliminates A Utility's Financial Incentive To Support Economic Development Within Its Franchise Area.*

  AGA Comment: "On the contrary, with RD, utility growth comes from the addition of new customers, not from sales of increased volumes of natural gas, so the utility remains financially committed to economic development within its franchise area because that means new customers. Also the utility's investment in pipelines and property is not transferable out of the franchise area, so the well being of local manufacturing and the local workforce is equally good for the utility."

- *ELCON Recommendation - Revenue Decoupling Mechanisms Tend To Address 'Lost Revenues' And Not The Real Issue, Which Is Lost Profits.*

  AGA Comment: "[R]evenue decoupling addresses the utility's

ability to recover its revenues, and because it ignores expenses, does not directly address the utilities ability to recover its profits. Of course, an enhanced ability to recover revenues will lead to an enhanced ability to earn profits, but the RD mechanism simply does not work by adjusting the utility's profits."

- *ELCON Recommendation - The First And Most Important Step Regulators Can Take To Promote Energy Efficiency Is To Send The Proper Price Signals To Each Customer Class.*

  AGA Comment: "Accurate price signals lead customers to make more informed energy efficiency decisions. With respect to investment and consumption behavior, the most important price signal natural gas consumers receive is the natural gas commodity cost. That price signal to customers is the same whether rates are decoupled or not. Moreover, residential consumption is relatively price inelastic, i.e., consumers use enough natural gas to meet their needs no matter how high or low the price."

- *ELCON Recommendation – Third Party, Independent Delivery of Energy Efficiency Services is a More Effective Means of Addressing Incentives*

  AGA Comment: "AGA members have experience and success in delivering energy efficiency programs to residential and commercial customers. The average American home uses one third less natural gas than it did a quarter century ago. Utility energy

efficiency programs have been an important driver in this reduction in per-capita natural gas use."

Q. Do you agree with the AGA's rebuttal arguments discussed above?

A. Yes. They are conceptually appropriate and refute the positions taken in the ELCON document.

Q. At page 27 of his direct testimony, Dr. Dismukes describes Exhibit DED-5 which is an analysis of the "current progress" of revenue decoupling in the U.S. Do you have any comments on Dr. Dismukes' portrayal of revenue decoupling for natural gas utilities in the U.S.?

A. Yes, I do. I believe Dr. Dismukes' portrayal of revenue decoupling presented in Exhibit DED-5 is incomplete and needs to be updated for recent industry developments. First, Dr. Dismukes has excluded from Exhibit DED-5 the states that have approved SFV rate design – which is a ratemaking approach widely recognized as an equivalent form of full revenue decoupling. SFV rate design has been approved for natural gas distribution utilities by regulatory commissions in Georgia, Missouri, Ohio, Oklahoma, and North Dakota. Next, Minnesota has recently approved a revenue decoupling mechanism for CenterPoint Energy Minnesota Gas.[4] As a result, Exhibit DED-5 should reflect approval of revenue decoupling in twenty-three (23) states, and revenue decoupling

[4] Minnesota Public Utilities Commission, Docket No. G-008/GR-08-1075, authorized on December 1, 2009.

proposals pending in an additional three (3) states,[5] for a total of twenty-six (26) states.

Q. At pages 29-30 of his direct testimony, Dr. Dismukes notes that some states have changed their positions on revenue decoupling. Do you have any comments on Dr. Dismukes' observations on this topic?

A. Yes, I do. I believe Dr. Dismukes' observations on this topic actually support the growing trend for the adoption of revenue decoupling concepts precipitated by changed regulatory positions on the concept and enabling legislation supporting the approval of revenue decoupling by regulatory commissions.

Q. Please explain.

A. There has been a steady, discernible, and growing trend toward the adoption and approval of revenue decoupling mechanisms by regulatory commissions, particularly for natural gas distribution companies, in the recent past. For example, as I pointed out in my direct testimony, in 2002 there were only three (3) states that had adopted revenue decoupling mechanisms, whereas the number now is twenty-three (23) states.

Q. Do you agree with the need for "ratepayer protection" provisions in the Company's proposed MDT mechanism as recommended by Dr. Dismukes at pages 38-41 of his direct testimony?

A. No. The inclusion of limits on the resulting rate adjustments reduces the ability of the utility's revenue decoupling mechanism to completely

[5] Pending in the states of Michigan, Nebraska, and Tennessee.

"break the link" between its non-gas revenues and sales volumes – which is a fundamental objective of this type of ratemaking mechanism. In addition, the use of rate/revenue limits or caps with revenue decoupling mechanisms skews the price signal to customers.

Furthermore, Dr. Dismukes' claim at page 38 of his direct testimony, as supported by Exhibit DED-9, is simply incorrect that "Caps on Accruals" is an approach that is "common among approved decoupling mechanisms" to cap the amount of overall accrual to some pre-defined level. As depicted in Rebuttal Exhibit ___ (RAF-2), most (approximately three-quarters) of the natural gas utilities with revenue decoupling mechanisms approved in the U.S. do not include any rate/revenue limits or caps.

Q. At pages 52-53 of his direct testimony, Dr. Dismukes argues that under the Company's revenue decoupling proposal, customers would be required to make the utility whole for revenue shortfalls caused by a contraction in the economy. Is this a valid criticism of the Company's revenue decoupling proposal?

A. No. The outcome is no different than under traditional regulation – the utility would always have the ability to file a rate case to address the revenue shortfalls caused by an economic downturn. In fact, I have observed over the last year or so with the economic downturn we are experiencing in the U.S. that there have been more utility rate cases filed than during other recent time periods.

Q. At pages 53-54 of his direct testimony, Dr. Dismukes provides what he characterizes as a "real-world example" of how revenue decoupling can lead to serious economic problems during an economic contraction. Do you agree with his conclusion on this issue?

A. No. Contrary to Dr. Dismukes' claim, the Maine experience with revenue decoupling in the 1990s that he cites does not serve as an example of how a revenue decoupling mechanism failed. While the Maine Electric Revenue Adjustment Mechanism ("ERAM") of CMP was not deemed a success, this had little to do with the concept of revenue decoupling and more to do with the construct of the recovery mechanism that was established.

In the U.S. Environmental Protection Agency's ("EPA's") National Action Plan for Energy Efficiency, it identified the deferred recovery process as a source of the problem with this experience – and not the revenue decoupling mechanism itself. In mid-1991, the Maine Public Utilities Commission ("MePUC") approved the ERAM for CMP on a three-year trial basis. This revenue decoupling mechanism adjusted CMP's rates annually based on its previously approved revenue level and the actual sales levels of its customers. Due to the ensuing economic downturn in New England, sales levels declined early in the ERAM trial period causing revenue deferrals that CMP was ultimately entitled to recover. CMP filed a rate case in late 1991 that would have increased rates at the time, but likely would have caused lower revenue deferrals

under the ERAM. However, that rate case was withdrawn by agreement of the parties to avoid immediate rate increases during bad economic times. At the same time, the MePUC decided not to implement the true-up aspect of the ERAM and instead to further defer the unrecovered electric revenues to a future time period with the hope of stronger economic conditions. When economic conditions did not improve, customers faced even larger rate increases. In its review of the Maine ERAM case, the EPA concluded that "responsibility for large rate increases was inappropriately attributed to the revenue decoupling plan, when general economic conditions were primarily responsible."[6] The EPA further concluded that a lesson from this experience was not to allow extended periods of time between rate true-ups.

Q. Please comment on Dr. Dismukes' observation at page 49 of his direct testimony that other states have preferred to adopt revenue decoupling in rate case proceedings rather than in rate design only proceedings like the one in Tennessee.

A. While that may be Dr. Dismukes' view on the subject, over the last five years, I am aware of at least twelve (12) revenue decoupling mechanisms (besides the Company's current MDT proposal) that were considered and approved by utility regulators in stand-alone, rate design only proceedings rather than in general rate cases. Obviously, there are some regulatory

[6]Environmental Protection Agency, National Action Plan for Energy Efficiency (July 2006), p. 2-5.

commissions that believe a rate design only proceeding is an appropriate venue in which to consider the adoption of a utility's revenue decoupling proposal.

Q. What is your opinion concerning the relative level of review and evaluation of revenue decoupling plans that occurs in rate design only proceedings compared to general rate cases?

A. In my opinion, a rate design only proceeding can provide for a greater level of scrutiny of a utility's revenue decoupling plan compared to what can occur in a general rate case. In a rate design only proceeding, by its very name, the parties are singularly focused on the ratemaking proposal of the utility. In a general rate case, the parties also must address the appropriate determination of the utility's total revenue requirement, which includes the review and evaluation of a multitude of expense and rate base components that comprise the utility's total revenue requirement. By contrast, in a rate design only proceeding, the parties are able to spend a greater amount of time considering the ratemaking alternatives, the appropriate design elements, and the degree to which these alternatives can satisfy the desired ratemaking objectives. With the increased industry-wide importance being placed on the development of energy efficiency and conservation programs for utility customers, I believe this type of focused regulatory proceeding is conducive to addressing the fundamental ratemaking changes that are consistent with, and supportive of, such initiatives.

Q. Do you have any perspectives on Dr. Dismukes' concept of a "Lost Base Revenue Approach" that he presents at pages 75-77 of his direct testimony as an alternative to the Company's revenue decoupling proposal?

A. Yes. In its most extreme, limited form, a revenue decoupling mechanism becomes conceptually equivalent to a "Lost Revenue Adjustment ("LRA") or "lost margin recovery mechanism." An LRA is a ratemaking approach that was used in the past primarily by electric utilities to compensate the utility for the sales margin lost when consumers take advantage of utility energy conservation programs. It is my observation that consumer advocates sometimes favor this limited ratemaking approach. However, I believe an LRA has certain serious shortcomings, including:

- Lost margin recovery does not affect the throughput incentive: if the utility's short-run marginal cost is lower than its retail rate, it still profits when sales increase. The incentive, therefore, is to fund programs which produce theoretical savings (generating lost margin recovery) but not actual savings.
- The utility may have a powerful incentive to discourage energy efficiency that does not involve utility programs. For example, the utility might receive lost margin recovery when builders accept utility incentive payments to build more efficient homes, but would resist improved energy codes, since these would also produce lower margins per customer, but would not fall into the "utility

program" limitation of the lost margin mechanism. The result would be to encourage high-cost conservation while discouraging low-cost energy code improvements.

- Lost margin mechanisms are very tedious, requiring an estimate of the energy savings from each utility conservation program, and, in some cases, a separate calculation of how many customers would have utilized similar conservation measures in the absence of a utility program (isolation of free riders). While conservation evaluation has become an advanced science, this is a very time-consuming element of lost margin mechanisms.

Q. In your opinion, is Dr. Dismukes' recommendation that the Authority should adopt an LRA mechanism a reasonable alternative for it to consider?

A. No. Dr. Dismukes' LRA concept would produce a ratemaking mechanism that is very narrow in its scope and, as a result, very limited in its ability to remove the Company's financial disincentive to aggressively pursue energy conservation and efficiency programs. Adoption of such a ratemaking approach would simply defeat the purpose of T.C.A. 65-4-126 and undermine the energy conservation goals envisioned under the ARRA and other federal energy initiatives and guidelines.

Addressing the Consumer Advocate's Claims Regarding the Effect of Revenue Decoupling on the Company's Business Risk

Q. Did the Hearing Officer identify in his list of issues the need to examine the effect of revenue decoupling on the Company's business risk?

A. Yes. The Hearing Officer's Issue 4 addresses the question – does the implementation of a decoupling mechanism lower the business risk for Piedmont, thereby justifying an adjustment to its rate of return.

Q. What is the Consumer Advocate's recommendation regarding Issue 4 as presented in Dr. Dismukes' direct testimony?

A. Dr. Dismukes recommends that a reduction to the Company's return on equity allowance should be made by the Authority if it approves Piedmont's MDT proposal. He supports this recommendation based on his claim made at page 60 of his direct testimony that "the Company's decoupling proposal shifts a significant amount of risk to ratepayers."

Q. Do you agree with the recommendation made by Dr. Dismukes on behalf of the Consumer Advocate regarding Issue 4?

A. Absolutely not. I fundamentally disagree with Dr. Dismukes' contention that risk is shifted to ratepayers through a revenue decoupling mechanism. First, Dr. Dismukes has painted the expected operation of the Company's revenue decoupling proposal as extremely one-sided because he highlights only the resulting higher rates that he alleges customers would experience under this ratemaking mechanism. The reality is that the symmetry

considered in the design of the Company's proposed revenue decoupling mechanism preserves the relative risk relationship between the Company and its customers and provides a much more balanced ratemaking result than what is alleged by Dr. Dismukes. The Company's revenue decoupling proposal will not shift business risk to customers because of the symmetrical treatment of the variation in volumes and associated non-gas revenue caused by factors (other than weather) that impact use per customer. For example, under a utility's traditional volumetric-based rates, it over-recovers non-gas revenues due to colder-than-normal weather, and its customers overpay for delivery service. The Company's approved WNA mechanism already remedies that situation equally for both the Company and its customers by adjusting the non-gas revenues recoverable by the Company and the level of rates charged to its customers for delivery service. Therefore, Piedmont's customers no longer have the risk of overpaying for delivery service caused by weather under the Company's current WNA mechanism.

In addition, the approval and implementation of the Company's proposed MDT mechanism does not guarantee it will achieve the financial performance established by the Authority in its last rate case. As such, any suggestion that customers somehow will absorb risks related to the Company's ability to achieve enhanced financial performance under this ratemaking mechanism is simply unfounded. As always, the Company

will have ongoing pressures on earnings in the form of, among other things:

- Disparities between actual costs and representative costs used to set rates and the associated regulatory lag involved with setting rates based on a historical test year.
- Changing costs over time as a result of any number of factors, including legislative, judicial, or regulatory requirements not occurring in the utility's historical test year.
- General cost increases due to inflationary impacts.
- Increases in capital costs for plant investments.

With the Company's proposed revenue decoupling mechanism and its current WNA mechanism, its upside opportunities are limited at the same time as its downside risk.

Q. Do you agree with Dr. Dismukes' contention at pages 54-55 of his direct testimony that "commodity risk" is shifted to the Company's customers under its proposed MDT mechanism?

A. No. "Commodity risk" is not shifted to the Company's customers under its proposed MDT mechanism because customers will continue to respond to the market risk associated with natural gas commodity prices, as embodied in measures of price elasticity. This price response will not change by the existence of the Company's revenue decoupling mechanism. To the extent customers reduce their gas usage, under the Company's MDT mechanism; they will continue to experience reductions

in the gas commodity portions of their gas bills. Moreover, the Company is committed to promoting energy efficiency and conservation programs which will have the effect of reducing commodity price risk to the customer.

Q. Do you have an opinion on the recommendation made by the Consumer Advocate that the Company's return on equity allowance should be adjusted downward because of the change in its risk profile that allegedly would occur under the Company's revenue decoupling proposal?

A. Yes. I do have certain comments from a ratemaking perspective in response to the assertion of the Consumer Advocate. The Company's witness David J. Dzuricky will respond to this topic in his rebuttal testimony as it relates to its implications for determining the Company's return on common equity. First, a revenue decoupling mechanism such as the Company's proposal does not eliminate a utility's business risks. As always, the utility will have ongoing pressures on earnings in the form of the cost increases I described earlier. Second, since revenue decoupling mechanisms are designed on a symmetrical basis, the utility's upside opportunities are limited at the same time as its downside risk. Finally, I question the fundamental appropriateness of making a reduction to a utility's return on equity allowance to account for the relative risk associated with any enhanced revenue collection capabilities of a particular rate design. I have never seen in any prior utility rate case an

explicit risk premium added to a utility's return on equity level in recognition of any reduced revenue collection capabilities inherent in the utility's then prevailing rate design or rate structure. The process of determining an appropriate return on equity level for a utility is not so granular that the ratemaking methods can have a material influence on the ultimate return level. Since regulatory commissions have not considered this type of upward adjustment in conjunction with the setting of a utility's return on equity allowance, I do not see why now regulatory commissions should be pressured by certain parties to make such a downward adjustment to single out ratemaking as a relevant consideration in the return on equity determination process.

Q. Have others in the utilities industry recently addressed this issue?

A. Yes. In December 2008, the American Gas Foundation ("AGF") issued a report that addressed this issue within the broader context of return on equity considerations in the natural gas utility sector.[7] As part of the report, perceptions of the industry, and their implications for the utility sector, were compiled based on extensive interviews with equity analysts, bond rating agencies, and senior utility industry executives. One of the thematic issues discussed in the report is particularly relevant to the discussion of the impact of utility ratemaking on a utility's allowed return on equity: How does return on equity interact with other regulatory

[7] Regulatory Policy of Return on Equity – Review and Analysis of the Natural Gas Utility Sector, American Gas Foundation, December 9, 2008.

issues, such as decoupling, pass-through trackers, etc.?

With regard to this issue, the report addressed how the process of setting a utility's return on equity can be affected by the existence of innovative ratemaking approaches for other utilities.

> "*...where RoE is set by reference to a proxy group of other LDCs [local distribution companies], it is important to ask whether the observed results from those LDCs already reflect the impact of the same mechanisms. That is, if a population of proxy LDCs demonstrates an investor-required RoE of, say 11 percent, and if all of those proxy LDCs already have a decoupling mechanism in place, it is inappropriate to apply an additional decrement to the indicated return to reflect the introduction of a decoupling mechanism in the LDC whose rates are being set.*"[8]

The report also summarized the comments of natural gas utility executives on this issue. While they acknowledge that properly designed revenue decoupling, WNA mechanisms, and SFV rate design do stabilize revenues and consumer costs, they also point out that rate stability is a "two-sided coin" – "protection against the down-side of load loss is offset by the loss of the upside of load gain. Thus, it is not as if the LDC has been unilaterally relieved of a risk, rather it has given up an upside gain opportunity for some protection against a downside risk."[9]

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[8] Ibid, p. 21.

[9] Ibid, p. 22.

Q. Does the AGF report address the evolving and increasing business risks associated with natural gas distribution utilities that you mentioned in your direct testimony?

A. Yes. The AGF report notes that despite the positive attributes of the above-described ratemaking mechanisms, natural gas distribution utilities are exposed to a variety of risks that have been steadily increasing. The report details the nature of these increasing risks as follows:

> *"These risks include unfunded government mandates, precipitous run-up in the cost of critical materials such as steel and in the cost of contract labor, the regulatory risk of cost disallowances, especially in periods of rapid gas-cost increase, and asymmetric regulation of uncollected gas cost (e.g., paying interest on overcollections but collecting no interest on undercollections). Additionally, in the competitive, unbundled world of today's interstate pipelines, the risk of bypass for LDCs' highest volume customers – industrial and power generation – is pervasive.*
>
> *It is important to contrast the impact of these evolving risks with the impact of the revenue volatility that is addressed by rate-design changes such as decoupling. As noted above, revenue stabilization is a two-sided coin. Before it took place, volatility caused by factors such as weather could and did result in increased earnings from time to time, in addition to the periods when it led to deficient earnings. Conversely, the evolving areas of increased risk are*

'one-way.' They work only to the detriment of the LDC without the potential for a compensating upside."[10]

Q. At pages 58-59 of his direct testimony, Dr. Dismukes claims that the financial community "recognizes the risk shifting nature of revenue neutrality mechanisms." Do you agree that the two examples he cites supports his claim of risk shifting?

A. No. It is my opinion that Dr. Dismukes has misrepresented the conclusions reached in the two Moody's Investor Service reports that he cites at page 59-60 of his direct testimony. First, the 2005 Moody's report (that I cited in my direct testimony) states that these types of revenue neutrality mechanisms serve to "stabilize," not "improve" a utility's credit metrics and credit ratings.[11] Next, the 2006 Moody's report states that utilities that have revenue decoupling mechanisms "stand a better chance to maintain their credit ratings or stabilize their credit ratings."[12]

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[10] Ibid, p. 23.

[11] "Impact of Conservation on Gas Margins and Financial Stability in the Gas LDC Sector," Special Comment Report, Moody's Investor Service, June 2005. p. 8.

[12] "Local Gas Distribution Companies: Update on Revenue Decoupling and Implications for Credit Ratings," Special Comment Report, Moody's Investor Services, June 2006, p. 1.

Q. Is there evidence to suggest that utilities without ratemaking mechanisms such as revenue decoupling may, in fact, receive negative treatment from financial rating agencies?

A. Yes. The 2006 Moody's report indicates that a regulatory commission's denial of a utility's proposal for a revenue decoupling mechanism may increase risk and result in a credit downgrade.

> "Southwest Gas Corporation did not fare as well in its Arizona RD application where it generates 54% of its gross margin. The company's credit metrics were already weaker than its Baa utility peers and it badly needed an effective RD mechanism across all its jurisdictions to protect its gross margins. While the Arizona Corporation Commission finally granted it a partial rate increase after over one-year in the application process and brought current recent cost and customer usage factors in Arizona, it denied the company its request for RD through "balancing accounts" as it has in California. The company also lacks RD in its Nevada jurisdiction (37% of gross margins) and the company lost gross margins in 2005 when it experienced one of the 10 warmest years on record, which followed a warm 2003, one of the warmest years in over 100 years. The cumulative effects of this warmer than normal weather continued into the company's quarter ending March 31, 2006 which was mostly responsible for the company's loss of $9 million in operating margin. Moody's took action in May

2006 to downgrade the company's senior unsecured debt to Baa3 from Baa2 where it is currently under stable outlook." (Emphasis added.).[13]

Q. How would a ratings downgrade like this impact a gas utility and its customers?

A. It would increase the cost of debt and equity which would ultimately be paid by the utilities' customers.

Q. Does this conclude your rebuttal testimony?

A. Yes it does.

[13] Ibid, p. 6.

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	)	Docket No. 09-00104

AFFIDAVIT

STATE OF COLORADO)
)
COUNTY OF JEFFERSON)

Russell A. Feingold, being duly sworn, deposes and says that he is the Russell A. Feingold 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.

Russell A. Feingold

Jefferson County, Colorado
Signed and sworn to before me this day by Russell A. Feingold

Date: December 10, 2009 Elaine D. Hegler
(Elaine D. Hegler, Notary Public)

(Official Seal) ELAINE D HEGLER NOTARY PUBLIC STATE OF COLORADO

My commission expires: 11-17-10

REBUTTAL
EXHIBIT__(RAF-1)

AGA RESPONSE TO ELCON 2007 REVENUE DECOUPLING POLICY BRIEF

The Electricity Consumers Resource Council (ELCON) published a position paper in January 2007 expressing concerns about mechanisms proposed and implemented in many states to remove financial obstacles to utility investments in energy efficiency and distributed resources. The ELCON critique faults decoupling as a failed rate design that promotes mediocrity of management, shifts business risk to customers, eliminates utility support of economic development, and focuses on profits, not efficiency. Each of these assertions is untrue and unproven in the ELCON paper. AGA seeks in this response to correct the record by responding to the primary assertions set out in the ELCON paper.

America is facing a dual challenge – meeting ever-increasing demands for energy, while at the same time dramatically reducing greenhouse gas emissions. In this new era, traditional rate designs have become a roadblock that discourages natural gas utilities from promoting energy efficiency and conservation. While utilities' costs for delivering natural gas are relatively fixed regardless of how much natural gas customers use, regulations that have been used to set delivery service rates for the past 100 years are based on the amount of natural gas that flows through the pipes. What was once a regulatory paradigm meant to maximize energy sales is now a regulatory impediment to energy efficiency.

Recognizing this problem, many states during the past 20 years have moved to "decouple" natural gas utility delivery rates from the volume of natural gas delivered to customers. Decoupling frees natural gas utilities – which are best placed to reach their customers with the message – to promote efficiency and conservation measures without placing themselves in financial jeopardy. Customers who practice energy conservation in their homes and businesses benefit by not paying for gas they do not use. And because decoupling removes a rate design imperfection but does not change the risks faced by the utility, decoupling also does not change the level of profits to which the utility has the opportunity to earn.

TEXT OF ELCON JANUARY 2007 PAPER FOLLOWS
With inserted AGA comments in blue

Revenue Decoupling

A Policy Brief of the Electricity Consumers Resource Council

Introduction

For over two decades advocates of ratepayer-funded energy efficiency and load reduction programs have recommended that the 'link' between utility's revenues and its sales be "decoupled" to eliminate a utility's disincentive to sponsor such programs. The argument is that the combination of the utility management's fiduciary duty to shareholders and the use of rates based on a revenue requirement, that includes sales in its calculation, discourages utilities from being competent vendors of energy efficiency and load reduction services.

COMMENT: AGA agrees that utilities incur financial losses from load reduction programs and that significantly expanded efforts to improve efficiency would increase such losses. AGA also believes that society will benefit from energy efficiency and conservation programs, but that using rates based, in part, on sales forecasts prevents utility management from aggressively pursuing socially beneficial conservation and energy efficiency. Decoupling the utility's approved revenues from the utility's volumes of gas delivered to customers removes the financial disincentive imposed on the utility by energy efficiency programs.

Revenue decoupling (RD) is generally defined as a ratemaking mechanism designed to eliminate or reduce the dependence of a utility's revenues on sales …

COMMENT: Revenue decoupling (RD) is designed to eliminate the dependence of the utility's revenues on sales *volumes,* not sales per se. It is an artifact of current rate designs and regulatory policy that a utility's authorized revenues are recovered volumetrically rather than per customer, even though the primary utility cost driver is a fixed cost - the miles of installed pipelines through which natural gas utilities provide service to customers. The other main cost driver, natural gas supplies procured on behalf of customers, is a volumetric cost that is passed directly through to customers with no mark-up or profit to the utility. Utilities serve as a broker of natural gas supplies for their customers, but unlike stock brokers, insurance brokers, or real estate brokers, natural gas utilities receive no percentage of sales or other mark-up on the cost of natural gas supplies they procure and deliver on behalf of their customers. RD breaks the artificially created link between sales volumes and recovery of the utilities' authorized revenues.

… It is adopted with the intent of removing the disincentive a utility has to administer and promote customer efforts to reduce energy consumption and demand, or to install distributed generation to displace electricity delivered by the utility's T&D system …

COMMENT: Many of the examples and illustrations in this paper describe the electric industry and are not applicable to the natural gas industry. There is nothing analogous to distributed generation in the natural gas industry.

... In regulatory parlance, RD takes the form of a tracker or attrition allowance in which authorized per customer margins are subject to a true-up mechanism to maintain or cap a given level of revenues or revenues per customer. Variations from the targeted sales or revenues are subsequently recaptured from ratepayers through a surcharge or credit.

In a significant departure from traditional cost-of-service principles, which historically provides utilities with only the opportunity to earn a fair return, ...

COMMENT: There exists more than one rate design that employs cost-of-service principles and practices, and allows the opportunity to earn a fair return, so it is false to say that RD is a departure from traditional ratemaking principles. Traditional ratemaking makes ample provision for trackers and true-ups associated with, for example, commodities of natural gas purchased on behalf of customers and passed through to customers with no additional mark-up or margin; changes in utility revenues caused by weather fluctuations; and infrastructure investments made to replace old and worn utility system pipes.

... RD guarantees actual earnings at the level of authorized earnings. Under RD, a utility is indifferent to the impact of sales levels or when the sales occur because of changing economic conditions, weather, or new technologies.

COMMENT: RD provides no "guarantee" of earnings. Earnings do not equate with revenues, and will vary with changes in utility costs, inflation, and unexpected operating events. Earnings are what remain after costs are subtracted from revenues, and when costs fluctuate there is no adjustment made to the utilities earnings with RD. RD allows the utility to track the level of revenues authorized by regulators and to use an adjustment mechanism when revenues deviate from the authorized levels. Therefore, RD is no guarantor of utility earnings.

ELCON members are strong supporters of energy efficiency and are world-class practitioners of innovative technologies that reduce their energy costs to improve their competitiveness. But ELCON strongly opposes decoupling because it disrupts and distorts the utility core business functions and is not a particularly effective way of promoting energy efficiency or anything of benefit to customers ...

COMMENT: The essential business functions of a natural gas utility are to broker natural gas supplies for its customers and to deliver natural gas to customers safely, reliably and economically. There are no other essential business "functions," although ELCON stipulates later that "sales," "building communities," and "market transformation" are core functions of the utility.

... Time and time again decoupling has been tried in several states, only to be suspended because it unduly interferes with the overall regulatory process ...

COMMENT: AGA knows of only two decoupling programs that have been discontinued, and those were flawed electric programs in Maine and New York. Natural gas decoupling has been used in California since 1978 and electric decoupling has been in place in California since 1982. As of March 2008, 26 utilities in 13 states serving 20 million natural gas residential customers use revenue decoupling.

... ELCON believes that there are other ways to promote energy efficiency and load reduction services that have proven to be more effective ...

COMMENT: AGA agrees that there "are other ways to promote energy efficiency (EE) and load reduction services," and specifically agrees with ELCON's description of "flat monthly fee" and "demand based" rate designs as being models that will address the same problems that RD addresses. However, these alternative rate designs are not the only rate designs that will successfully promote energy efficiency and load reduction. RD is a time-tested and successful approach that removes the financial disincentive imposed as an artifact of rate design that prevents utilities from promoting energy efficiency and conservation.

... This paper describes the simple mechanics of decoupling, why decoupling has historically failed and is not likely to be any more effective in future applications...

COMMENT: Natural gas RD has not failed in a single instance and electric and gas decoupling has been successful in California for more than two decades. Since 1974, California has held its per-capita consumption essentially constant, while energy use per person for the United States overall has jumped 50 percent. Revenue decoupling made possible the successful energy efficiency programs in California. As of March 2008, electric decoupling is being used by utilities in California, Idaho, Maryland, and Delaware, and is pending in several additional states.

... and proposes alternative regulatory policies that more effectively focus on market transformation and the effective delivery of demand-side services.

COMMENT: As previously stated, market transformation is not a core utility business function and has never been a reason to use RD. ELCON's policy goals and regulatory bias are apparent with this statement.

The Mechanics of Revenue Decoupling
An Illustrated Example of An Annualized RD Mechanism[1]

Base Year Assumptions

COMMENT: AGA finds two exceptions (in red) to the example below: Base Year Two should not assume a $45 million RD balance – since, by definition, this is a base year not an actual year to which a RD balance would apply; and there is no associated adjustment to the Effective Rate per KWh in Year Two.

	Year One	**Year Two**
Utility's Operating Costs (A)	$4 billion	$4 billion
Utility's Rate Base (B)	$5 billion	$5 billion
Authorized Return to Equity Owners (ROE)	10%	10%
Authorized Earnings to Equity Owners (C) (10% of $5 billion)	$500 million	$500 million
Utility's Authorized Revenue (A + C)	$4.5 billion	$4.5 billion
RD Balance Account (D)	0	$45 million
Baseline Sales (E)	45,000 GWh	45,000 GWh
Base Rate per KWh (A + C)/E	$0.10	$0.10
Effective Rate per KWh (F) (A + C + D)/E	$0.10	$0.101
Actual Sales Year		
Actual Sales (G) (1% deviation from baseline forecast)	44,550 GWh 1% Below Baseline	45,450 GWh 1% Above Baseline
Actual Revenues Collected (H) (F □G)	$4,455 million	$4,590 million
Unadjusted Earnings to Equity Owners (I) (H minus A)	$455 million	$590 million
Reported ('Authorized') Earnings (C)	$500 million	$500 million
Actual ROE (I/B)	9.1% Reduction of 90 basis points	11.8% Increase of 180 basis points
Reported ('Authorized') ROE	10%	10%
End-of-Year Balance Account (D) (A + C) minus H	$45 million	$90 million

1 This is a simplified example of revenue decoupling that assumes no variable T&D costs or change in the number of customers. Also, tax implications and accounting for price elasticity are ignored.

How Decoupling Works

RD mechanisms can take several forms but all accomplish the same thing: customer rates are automatically adjusted to immunize utility earnings from sales fluctuations.

COMMENT: This statement incorrectly states and misconstrues the operation of revenue decoupling mechanisms. Even with the use of a RD mechanism to adjust *revenues* from the impact of sales fluctuations, the utility's *earnings* will still fluctuate due to the impact of variations in costs, inflation, and unexpected events. Because costs are not included in the true-up mechanism, there is no "guarantee" or "immunization" of *earnings* from the use of a RD mechanism.

The first example is illustrated on the spreadsheet on page 5. It provides a simplified form of mechanism in which true-ups are done on an annual or multi-year basis. The process usually starts with a baseline determination of a utility's revenues that may include the anticipated consequences of a DSM program. This is the 'base case' in the illustration.

The illustration holds this baseline constant over a two-year period. In the first year, actual sales are 1% below the baseline amount; in the second year actual sales are 1% above the baseline. The result is a revenue shortfall in the first year of $45 million. Absent any other offsetting revenue recovery mechanism, this shortfall reduces earnings to equity owners and the expected return on equity (ROE). This illustrates a main argument of proponents of RD that any small reduction in sales can produce a significant reduction in the utility's allowed earnings. In the example, the actual ROE is 9.1%, a reduction of 90 basis points from the allowed ROE of 10%.

Applying the RD mechanism in the second year, revenues are adjusted by increasing the customer rate upwards to ensure that sufficient revenues are collected to achieve the allowed ROE. However, actual sales are 1% above the baseline amount and the utility over collects $90 million. The actual ROE is 11.8% or 180 basis points above the allowed ROE. This simple example highlights the potential year-to-year volatility of the RD mechanism.

COMMENT: This illustration is somewhat incomplete in that it does not describe what happens in years three, four and later. This analysis would yield different results if a third year and fourth year were included, and if different assumptions, such as decreasing sales in the forward years were assumed. While increasing sales may be the norm in the electricity industry, they are NOT the norm in the natural gas utility industry. However, natural gas sales do vary from year to year, and it is entirely possible that actual natural gas sales may increase from the authorized and forecasted level of sale upon which the company's rates were established by the regulators.

AGA agrees that there is revenue and associated utility return on equity volatility associated with the use of RD mechanisms. What ELCON fails to acknowledge is that there is utility revenue, utility ROE and customer bill volatility associated with traditional volumetric rate mechanisms, and that without in any way transferring risk among the parties, RD smoothes the revenue stream for the utility, smoothes the bill payments for the customer, and removes the artifact of utility rate design and regulatory policy that prevents

the utility from having a "fair opportunity," not a "guarantee," of earning its authorized return.

With compounding economic events (e.g., recessions), the accrual account can grow quite large unless more frequent rate cases or true-ups are ordered. RD mechanisms tried in the past tended to generate substantial accruals that quickly became a dilemma for regulators and a burden for ratepayers.

COMMENT: The past RD mechanisms referenced were flawed electric decoupling models that did not allow or require frequent true-ups. The California electric decoupling program and all natural gas decoupling programs allow the recovery of accruals in the next period, usually the next year, and this prevents the very large accrual of past fixed-cost revenues that caused past problems.

The second example (on page 9) illustrates decoupling on a revenue-per-customer (RPC) basis. The base year revenue collected per customer (RPC) on an average customer class basis is fixed, and the annual charge is then typically allocated on a monthly, normalized basis over a reference year. Each month the actual revenues collected per ratepayer are compared to the allowed monthly RPC and the difference is either credited or debited to a balancing account. Customers would still be billed on a per-unit consumption basis, but the rate would be trued-up based on actual revenues collected per customer. This prevents the utility from earning additional profit from unexpected sales but also ensures that the utility recovers its costs resulting from unexpected customer growth. For unexpected declines in sales per customer and/or declines in the number of customers, the mechanism works the same way. Under- or over-recoveries in any month are automatically trued-up the following month or at the end of the year.

COMMENT: RD is as fair to customers as it is to utilities exactly because it prevents the utility from over-recovering when unexpected growth in sales per customer would otherwise allow the utility to profit from increased sales. It is this fairness, along with RD's ability to jumpstart EE programs, that has led regulators in 13 states to approve RD for natural gas utilities.

The RPC mechanism highlights the 'blunt instrument' nature of decoupling. The utility is made whole for earnings losses that go beyond the limited losses caused solely by energy efficiency and load reduction programs...

COMMENT: Rather than being a blunt instrument, decoupling is a traditional rate adjustment mechanism that usefully simplifies the otherwise complex factors affecting natural gas sales volumes. Revenue decoupling does not attempt to separate all of the causes of sales fluctuations but ensures that recovery of authorized revenues is not affected by consumption changes that regulators did not anticipate when they set the utility's rates.

... The net effect of the true-up mechanism is to put the utility's revenue stream on autopilot. This isolates utility management and equity owners from the normal business risk inherent to the utility industry ...

COMMENT: Utility management runs the operational and the cost side of the business and no degree of revenue decoupling will ever put a natural gas utility on "autopilot." Utility management exercises control over many aspects of the natural gas distribution business and equity owners reap the reward of a well-managed business or suffer the consequences of a poorly run one. Rate design is an artifact of regulation and in no way implies or confers excellence of management. Revenue decoupled rate designs give management a fairer opportunity to achieve the company's authorized revenues (*not earnings*) but it in no way isolates management and owners from normal business risks of increased costs, inflation, unexpected events, and all the consequences of a poorly run and managed corporation.

... notwithstanding that the existence of a ROE is to reward equity owners with a return on their investment that includes a sizeable risk premium commensurate with the business risk.

COMMENT: The existence of an ROE is to compensate (not reward) equity owners for the use of their capital. ROE is a required cost of providing utility service to customers, and without it there would be no service. By long settled law, the amount of "compensation" that equity owners require must acknowledge the risks faced by the utility, and the risk premium must be commensurate with the risks faced by similarly situated business entities. In regulated utility ratemaking, return on equity is a cost of doing business. As with all other utility costs, the regulator determines the proper level of ROE and few regulators give "sizable" treatment to a utility's costs.

In short, an RD mechanism makes retail electric distribution service virtually risk free for utilities.

COMMENT: Revenue decoupling does not eliminate utility risks, including business risk, market risk, regulatory risk, legislative risk, and supplier risk.

The Mechanics of Revenue Decoupling
An Illustrated Example of Revenue-Per-Customer (RPC) Mechanism With Monthly True-Ups [2]

Base Year Allowed RPC
For a Base Year Month

Base Year Rate per kWh (A)	$0.10
Base Year (Month) Sales in kWh (B)	1 billion
Base Year (Month) Revenue (A x B)	$100 million
Base Year Number of Customers (C)	1,000,000
Allowed RPC (A x B)/C	$100

Calculation of Revenue Adjustment For A Single Month

Base Year Rate per kWh (A)	$0.10
Actual Sales for the Month (D) 5% Reduction from Baseline (B)	0.95 billion
Actual Revenues for the Month (E) (A x D)	$95 million
Actual Number of Customers (F)	1,010,000
Allowed RPC	$100
Allowed Revenues (G) (F x E)	$101 million
Revenue Adjustment (H) (G – E)	$6 million
Forecasted Next Month Sales (I)	1.0 billion
Rate Adjustment (True-Up) (H/I)	$0.006

This adjustment is added to rates for sales the following month, or at the end the year.

2 This example assumes that sales per customer decline but the number of customers grows.

ELCON Position & Recommendations

A . Decoupling Promotes Mediocrity In The Management Of A Utility.

The primary function of a regulated electric utility is and will always be to efficiently sell and deliver electric energy to customers. For investor-owned utilities, the profit-motive is a legitimate and practical means to incent utility managers to operate their business in a competent and efficient manner.

COMMENT: Selling is a function of all for profit businesses and is not a "core business function" of regulated utilities. More accurately, natural gas utilities broker natural gas supplies on behalf of their customers. For this service, natural gas utilities recover their costs but do not earn a profit.

... There also need not be any conflict with 'unselling' the business' primary product by offering energy efficiency and load reduction services.

COMMENT: There IS a major conflict with selling the utility's primary service, natural gas delivery service, and "unselling" the product that is delivered by the utility, commodity natural gas, when the revenues from the utility's delivery service are tied to the volumes of commodity gas that are delivered.

Firms in many industries meet the competition by selling a range of products competing for different segments of the market share...

COMMENT: The analogy to firms in UNREGULATED industries competing by offering a range of products is shaky when used to describe the situation of natural gas utilities offering energy efficiency services to customers. Unregulated industries offer competing services in different market segments when such services are likely to bring in greater revenues than if the company did not offer the competing product. As of September 2007, natural gas utilities in 37 states offer energy efficiency and conservation services to their customers. Only 9 states allow the utility to earn a reward or a profit from these services. However, in no case does the profit earned on the EE service make up for the profits foregone on the delivery of the natural gas.

... But in regulated industries, such as electric utilities, rate structures and regulatory policies may have to be aligned to make this work. The attractiveness of revenue decoupling to many utility executives is that it will immunize the company's earnings or revenues from sales fluctuations...

COMMENT: As stated previously, RD does not immunize or guarantee the utility's earnings.

... This can only promote mediocrity and indifference to the utility's core business, a situation that should not be in the best interests of either advocates of selling or unselling the energy product.

COMMENT: This contention is wholly unsupported. There is no regulatory or court finding and no academic literature that has shown a cause-and-effect relationship between revenue decoupling and utility management mediocrity. Quite the contrary, the outside evaluation of NW Natural's 2002 decoupling mechanism, conducted as part of the Oregon PUC's 2005 review of the program, found that decoupling changed the company focus from marketing to promoting energy efficiency, and that this changed focus caused no deterioration of customer service and no shifting of risk to customers.

B. Decoupling Shifts Significant Business Risk From Shareholders To Consumers With Only Dubious Opportunities For Net Increases In Consumer Benefits.

COMMENT: There is no shifting of risks from shareholders to consumers for RD because customers bear no risk at all from their choice to consume delivery service from the utility. The economic definition of risk is exposure to the consequences of uncertainty. Consuming less (or more) of a product and paying less (or more) money for the product is not an uncertainty, it is a choice. Natural gas customers receive a fixed amount of delivery service annually. It is not possible to receive more or less delivery service unless the customer hooks up a second home or business. This service has a fixed cost that does not increase or decrease when the customer consumes more or less natural gas commodity. RD is simply a rate design that recovers the fixed costs of a fixed cost business on a non-volumetric basis from customers. Since there is no ability to consume more (or less service) there is no risk that the cost to the customer will change. Rather than shifting risk from the utility to the customer, RD smoothes out the artificial variability in delivery service charges paid by the customer that is the natural consequence of volumetric rate designs.

Decoupling does not create an economic incentive promoting greater energy efficiency or load reduction. It establishes, at best, utility indifference to these objectives.

COMMENT: Decoupling removes an economic DISINCENTIVE; it does not provide an incentive. Decoupling is a legitimate and preferred regulatory mechanism to outdated volumetric rate designs that place incentives on utilities to promote and market increased natural gas usage by their customers. Natural gas consumers and society in general benefit from progressive utility regulation that aligns the interests of utilities and their customers in the wise use of natural gas through decoupled tariffs and ratemaking treatment for more comprehensive and expanded EE programs.

... At the same time, it undermines customer efficiency efforts and muddles price signals to consumers. For example, conservation efforts are rewarded with higher future rates, while excessive consumption paradoxically produces bill credits. This is a cynical way to induce energy conservation that is not likely to be effective...

With natural gas RD, conservation efforts are rewarded with lower bills because customers do not pay for gas they did not use. The fact that distribution rates will be higher in the future in no way negates the fact that customers saved by not paying for the commodity

that they did not consume. With natural gas RD, excessive consumption produces higher bills from increased commodity consumption and it is in no way paradoxical that this also produces a bill credit for the delivery service. Natural gas customers know the difference between bill impacts and rate mechanisms, and customers care about what is on their bill. RD mechanisms that allow the utility a fair opportunity to recover its authorized revenues in no way undermine a customer's efficiency efforts or savings from conserving natural gas commodity.

... Decoupling only removes an alleged disincentive while at the same time creating real disincentives for competent management of the business. The Maine Public Utilities Commission stated in 2004:

> Revenue decoupling does not ... provide any positive incentive for utilities to promote or support energy efficiency or conservation programs; it only makes them financially neutral to such activities.
>
> **COMMENT: Maine stated it incompletely. Decoupling removed the disincentive and raised the company's position from negative to neutral. This is an important point. Neutral is better than opposed. Maine implicitly acknowledges that there was a real – not alleged – disincentive.**

There is growing national concern that utilities are under-investing in infrastructure and not adequately planning for the future needs of their customers. Why this situation has been allowed to happen is troublesome given that for many utilities their allowed return is already above their actual cost of capital.

COMMENT: The statement that many utilities allowed return is already above their actual cost of capital demonstrates an unawareness of natural gas capital costs. Capital includes debt and equity in a weighted average of the two. Equity costs are higher than debt costs; thus capital costs, which is the average of the debt costs and the equity costs, is lower than the equity costs. This is simple regulatory financing and in no way implies that the situation is "troublesome."

... Regulatory policies need to refocus utility management on its core responsibilities to efficiently sell and deliver electric energy and to make prudent long-term investments...

COMMENT: There has been no demonstration that utility management is not focused on its core responsibilities.

... Regulators must not bargain with their utilities from a weak position that assumes that financial incentives in excess of a reasonable return is necessary for ordinary business behavior ...

COMMENT: There are no financial incentives with RD; there is only the removal of a financial disincentive.

... For all practical purposes RD mechanisms put utility management on autopilot and this will only further encourage them to ignore their core business, the value of economic development in their franchise area, and the broader needs of the utility's customers. These objectives are at least as important as any attempt to only eliminate a disincentive to energy efficiency.

COMMENT: This statement that utility managements will ignore their businesses is wholly unsubstantiated. ELCON then follows with a proposal that utility management spend more time on non-core business functions of economic development and customers' broader needs, even though on page 3, ELCON strongly disapproved of utilities engaging in non-core business functions.

An important feature of the financial structure of investor-owned utilities is that the utility's shareholders assume normal business risk. This is the risk-reward model that pervades private businesses in the US and global economies. Shareholders are best able to diversify business risk and market-based economies strive on this basis. Utility ratepayers are least able to do so; yet it is the expressed intent of RD mechanisms to shift risk from shareholders to consumers ...

COMMENT: AGA is aware of no expressed intent of RD mechanisms to shift risk to customers. As previously stated, customers do not bear risk from being served by utilities using RD rate designs.

... a radical departure from standard regulatory policy intended to balance the interests of equity owners and ratepayers.

Proponents of RD mechanisms almost always support preserving the utility's allowed return on equity at a level that assumes the shareholders retain such risk. Getting utility management to buy into the scheme would be difficult otherwise ...

COMMENT: It is wrong to link decoupling in any way to utilities' ROE. Decoupling creates both upside and downside exposure for company shareholders (they will no longer under-recover authorized fixed costs if retail sales drop below expectations, but they also will lose their longstanding opportunity for gains from sales increases). ROE is an important cost component that should be calculated after a thorough examination of the utility's risk profile. Whether the net result is a material change in the company's risk profile cannot be determined without company-specific and capital market experience.

... Hence RD mechanisms are an attempt to force energy efficiency and load reduction programs at any cost, and with no regard for the economic welfare of the impacted ratepayers.

COMMENT: This is another unsupported statement. Energy efficiency programs are nearly always required to be "cost efficient," and the programs, most of which are required of utilities by their state regulators, usually must pass some type of ratepayer impact test. Increasingly, energy efficiency programs are meant to improve the welfare of the environment and the welfare of society, as well as the welfare of impacted ratepayers.

Using RD mechanisms in conjunction with general rate cases also can have a ratchet effect on revenues and rates to the extent the RD adjustments in between rate cases are memorialized in the next rate case. For these and other reasons there is ample justification for dismissing the alleged value of RD mechanisms in ratemaking.

COMMENT: Properly designed RD programs have modest true-up adjustments, not ratchet effects on revenues and rates.

C. Decoupling Eliminates A Utility's Financial Incentive To Support Economic Development Within Its Franchise Area. This Includes The Incentive To Support The Well Being of Manufacturers And Their Workforce.

Promoting growth in sales through the addition and expansion of business enterprises is a key area where utility financial incentives and local public interests are precisely aligned. Revenue decoupling breaks that alignment. While its sole purpose is the elimination of the alleged disincentive to a utility's active support for energy efficiency and load reduction programs ...

COMMENT: The disincentive is real, not alleged.

... it also eliminates the financial incentive to actively promote the economic development of the utility's franchise area...

COMMENT: On the contrary, with RD, utility growth comes from the addition of new customers, not from sales of increased volumes of natural gas, so the utility remains financially committed to economic development within its franchise area because that means new customers. Also the utility's investment in pipelines and property is not transferable out of the franchise area, so the well being of local manufacturing and the local workforce is equally good for the utility.

... More specifically, it neutralizes the financial incentive to attract new commercial and industrial businesses—and new job opportunities—to the utility's franchise area, and to support the well being of its existing commercial and industrial customers, unless those customer classes are specifically exempt from the RD mechanism.

COMMENT: California is the only state that applies RD to natural gas industrial customers. The other 12 states with natural gas RD apply the mechanism to residential and commercial customers only.

ELCON believes that regulatory policies should promote greater customer focus, not less.

COMMENT: There is no showing that RD promotes or interferes with the customer focus of utilities.

D. Revenue Decoupling Mechanisms Tend To Address 'Lost Revenues' And Not The Real Issue, Which Is Lost Profits.

To the extent that rates based on sales create a disincentive for utility efforts to promote energy efficiency and load reduction, the problem is in the rate design and the failure to abide by longstanding cost-of-service ratemaking principles...

COMMENT: As stated on page 2, revenue decoupling addresses the utility's ability to recover its revenues, and because it ignores expenses, does not directly address the utilities ability to recover its profits. Of course, an enhanced ability to recover revenues will lead to an enhanced ability to earn profits, but the RD mechanism simply does not work by adjusting the utility's profits.

... RD mechanisms have the effect of shifting the recovery of the utility's fixed costs into the customer (or demand) charge of base rates where they belonged in the first place...

COMMENT: In the area of alternative rate designs, AGA finds itself in agreement with ELCON. There are several additional non-volumetric rate designs, such as straight-fixed variable, and a flat monthly fee, that will remove the financial disincentive to the support of energy efficiency measures that is caused by the use of volumetric rate designs.

... Thus, from one perspective, RD can be viewed as a stopgap ratemaking mechanism to overcome rate designs that have been used and abused for other misguided policy objectives such as the imposition of cross-class subsidies and stranded cost recovery...

COMMENT: Cross-class subsidies are policy designs, not rate designs.

... The complexity of RD mechanisms also makes them very expensive to administer and regulate. This greatly reduces the transparency of the ratemaking process and, even more so in the public mind, reduces the logic of cost causation.

The ability of a utility to have the opportunity to earn a fair return on assets that are prudently incurred and that remain used and useful is a grand compromise of regulation that has withstood the test of over 100 years of practice. Any increased opportunity for a utility to earn its authorized rate of return must be commensurate with an increase in business risk, not the reverse!

COMMENT: Unfortunately, instead of an increased opportunity for the utility to earn its authorized rate of return, energy efficiency programs create a decreased opportunity to earn, which demands that utilities be granted an increased ROE. ELCON cannot have it both ways – acknowledging that increased opportunities demand returns commensurate with the change in risk, but refusing to acknowledge that decreased earning opportunities with increased risks should be met by higher rates of return.

There is no inherent inconsistency that a utility would both sell and 'unsell' electric energy if rates are appropriately designed for the different services. Selling competing products and

services is a common business choice and need not be a moral dilemma only for utility executives. There are examples of state ratemaking practices such as shareholder performance incentives that create more explicit economic inducements for promoting energy efficiency and load reduction. These practices avoid the collateral damage created by the 'blunt instrument' nature of RD mechanisms.

COMMENT: As shown earlier, with regulated utilities there is an inconsistency with the idea of increasing total profits by selling a service at the same time as selling its competitor. AGA has studied the current use of shareholder performance incentives that create more explicit inducements for promoting energy efficiency and AGA supports the expanded use of such mechanisms. However, the level of incentives in use today in no way compensates the utility for the loss of revenues from conservation and EE programs, thus highlighting the importance of decoupling to allow the utility to recover revenues required to operate the delivery system safely and reliably.

E. The First And Most Important Step Regulators Can Take To Promote Energy Efficiency Is To Send The Proper Price Signals To Each Customer Class.

In the short term, seasonal weather variations are the predominant cause of variations from sales forecasts. For example, unseasonably mild winters can lead to below forecast sales. In the longer term, economic growth in the form of increased customer accounts and usage drive electric sales and revenue growth. Ratepayer investments in energy efficiency gradually moderate energy sales growth. Load shifting efforts from peak to off-peak periods may not reduce overall kWh sales, but should lower the cost of supplying that energy.

Thus the first and most important step regulators can take to ensure that ratepayers themselves are induced to make energy efficient investments and behavioral changes is to implement retail rates that send the proper price signals to each customer class...

COMMENT: Accurate price signals lead customers to make more informed energy efficiency decisions. With respect to investment and consumption behavior, the most important price signal natural gas consumers receive is the natural gas commodity cost. That price signal to customers is the same whether rates are decoupled or not. Moreover, residential consumption is relatively price inelastic, i.e., consumers use enough natural gas to meet their needs no matter how high or low the price. A recent study conducted by two George Washington University professors on behalf of AGA indicated that in the short run, for every 10 percent increase in the price of natural gas, residential customers reduced their consumption by only 2 percent.[1]

... This includes allocation of fixed costs to customer (or 'demand') charges and time-variant energy charges...

[1] Joutz, Frederick, and Robert Trost, "An Economic Analysis of Consumer Response to Natural Gas Prices", American Gas Association, March 2007.

COMMENT: AGA agrees that allocating costs to the customer charge and the use of demand charges are appropriate rate designs that will also break the inefficient link between volumes of gas and recovery of revenues.

The Energy Policy Act of 2005 directs the states to consider expanded deployment of time-based pricing and advanced metering, and ELCON strongly encourages states to pursue this path to more efficient pricing rather than the futile pursuit of decoupling mechanisms.

COMMENT: The Energy Policy Act of 2005 also directs the states to consider implementing rates such as decoupling that separate fixed-cost revenue recovery from the volume of transportation or sales service provide to the customer.

Large industrial customers are almost always on some form of time-of-use rate, with a demand charge, and this rate structure is extremely valuable to the customer for evaluating the cost effectiveness of energy efficiency improvements in their manufacturing facilities. Large industrial customers do not look for guidance from utilities ...

COMMENT: Natural gas RD focuses on residential rather than large industrial customers, and these customers very much DO look for guidance from their utilities on how to evaluate and implement energy efficiency improvements.

... on how to co-optimize their energy consumption and manufacturing activities, and 'decoupling' does not make utilities experts in these matters. By further blunting price signals to ratepayers, RD mechanisms actually undermine incentives for customers to invest in more efficient appliances and equipment because the reward for reducing consumption is higher rates in the future...

COMMENT: RD trues-up the customer's delivery service rate but causes very little change in the customer's bill. It is this stability of the bill that makes the price signal to the customer stronger, not weaker. With decoupling, the price for the service will more closely match the price set by the regulator. Making the delivery service component of the bill more stable allows the volume of gas usage and the volatility of natural gas commodity prices to be more apparent to the customer, which leads to enhanced, not undermined incentives for customers to invest in more efficient appliances and equipment. The Oregon PUC review of Northwest Natural's decoupling program found that Oregon now has the highest share of high-efficiency furnaces in the nation (as a percentage of new furnace sales).

... ELCON members believe that a utility's fundamental responsibility is to efficiently sell and deliver energy at the lowest possible cost, and appropriate price signals are an essential component of that objective.

F. Several States Have Successfully Used Alternative Entities—Including Government Agencies—For Unselling Energy. This Creates An Entity Whose Sole Mission Is To Promote Energy Efficiency, And Retains A Separate Entity Whose Responsibility Is To Efficiently Sell And Deliver Energy.

Some states believe that simultaneously selling and unselling electric energy is a real conflict of interest and have assigned the administration of the unselling function to an independent entity or agency whose mission is dedicated to promoting energy efficiency and load reduction. This policy recognizes that another entity—the utility—must be responsible for efficiently selling and delivering electric energy. States that have taken this path are Wisconsin, Maine, New Jersey, Ohio, Vermont, Oregon, New York, and Connecticut.

In New York, for example, the New York State Energy and Research Development Authority (NYSERDA) is charged with the responsibility for demand-side programs, and is funded by a systems benefit charge that is collected by the utilities. Wisconsin established *Focus On Energy* as a public-private partnership offering energy information and services to residential, business, and industrial customers throughout the state. There services are delivered by a group of firms contracted by the Wisconsin Department of Administration's Division of Energy.

COMMENT: AGA members have experience and success in delivering energy efficiency programs to residential and commercial customers. The average American home uses one third less natural gas than it did a quarter century ago. Utility energy efficiency programs have been an important driver in this reduction in per-capita natural gas use. In 2006, AGA members serving 32 million residential customers (50 percent of U.S. total) administered 53 natural gas energy efficiency programs in 27 states. These companies spent in excess of $280M on natural gas energy efficiency programs. As a result, residential customers saved 9.5 TBtu of gas -- averaging 8 percent of usage, and avoided 0.5 Million metric tons of carbon dioxide emissions.

REBUTTAL
EXHIBIT__(RAF-2)

Approved Revenue Decoupling Mechanisms [1] – Gas Utilities

Utility	State	Year Approved	Type	Revenue/Rate Caps
CenterPoint Energy	AR	2007	Full w/WNA	No
Arkansas Western Gas	AR	2007	Full w/WNA	No
Arkansas Oklahoma Gas	AR	2007	Full w/WNA	No
Pacific Gas and Electric	CA	2002	Full	No
San Diego Gas and Electric	CA	2002	Full	No
Southern California Gas	CA	2002	Full	No
Southwest Gas	CA	2002	Full	No
Public Service Company of Colorado	CO	2007	Limited	Yes
Peoples Gas Light and Coke Company	IL	2008	Full	No
North Shore Gas Company	IL	2008	Full	No
Vectren Indiana Gas	IN	2006	Full w/WNA	No
Vectren Southern Indiana G&E	IN	2006	Full w/WNA	No
Citizens Energy Group	IN	2007	Full w/WNA	No

[1] Excludes gas utilities with SFV rate design

Approved Revenue Decoupling Mechanisms [1] – Gas Utilities

Utility	State	Year Approved	Type	Revenue/Rate Caps
Baltimore Gas and Electric	MD	1998	Full	No
Washington Gas	MD	2005	Full	Yes
Bay State Gas	MA	2009	Full	Yes
CenterPoint Energy	MN	2009	Limited	Yes
Southwest Gas	NV	2009	Full	No
New Jersey Natural Gas	NJ	2006	Full	Yes
South Jersey Gas	NJ	2006	Full	Yes
Consolidated Edison of New York	NY	2007	Full w/WNA	No
National Fuel Gas Distribution	NY	2007	Full w/WNA	No
Central Hudson Gas & Electric	NY	2009	Full w/WNA	No
Piedmont Natural Gas	NC	2005	Full	No
Public Service Co. of North Carolina	NC	2008	Full	No
Vectren Energy Ohio	OH	2006	Full	No

[1] Excludes gas utilities with SFV rate design

Approved Revenue Decoupling Mechanisms [1] – Gas Utilities

Utility	State	Year Approved	Type	Revenue/Rate Caps
Cascade Natural Gas	OR	2006	Full	No
NW Natural Gas	OR	2002	Full w/WNA	No
Questar Gas Company	UT	2006	Full w/WNA	Yes
Virginia Natural Gas	VA	2006	Full w/WNA	No
Avista Corp.	WA	2006	Limited	Yes
Cascade Natural Gas	WA	2006	Limited	No
Wisconsin Public Service	WI	2008	Full	Yes
Questar Gas Company	WY	2009	Full w/WNA	No

[1] Excludes gas utilities with SFV rate design

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:

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This 11th day of December, 2009.

Erin M. Everett

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