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January 4, 2010

VIA EMAIL AND HAND DELIVERY

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

filed electronically in docket office on 01/04/10

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 Post-Hearing Brief for filing in Docket No. 09-00104. An electronic copy of the filing has also been transmitted via email 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
NASHVILLE, TENNESSEE

PETITION OF PIEDMONT NATURAL GAS COMPANY, INC. TO IMPLEMENT A MARGIN DECOUPLING TRACKER (MDT) RIDER AND RELATED ENERGY EFFICIENCY AND CONSERVATION PROGRAMS	)))))	DOCKET NO. 09-00104

BRIEF OF PETITIONER PIEDMONT NATURAL GAS COMPANY, INC. IN SUPPORT OF APPROVAL OF PROPOSED SERVICE SCHEDULE NO. 317 AND RELATED ENERGY EFFICIENCY PROGRAMS

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January 4, 2010

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NASHVILLE, TENNESSEE

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BRIEF OF PETITIONER PIEDMONT NATURAL GAS COMPANY, INC.
IN SUPPORT OF APPROVAL OF PROPOSED SERVICE SCHEDULE NO. 317
AND RELATED ENERGY EFFICIENCY PROGRAMS

Pursuant to the Order of Presiding Director Freeman at the hearing of this matter, Piedmont Natural Gas Company, Inc. ("Piedmont" or the "Company"), through counsel, respectfully submits the following brief in support of its proposals to implement new Service Schedule No. 317 and related energy efficiency programs in this proceeding and opposing the recommendations of the Consumer Advocate and Protection Division of the Tennessee Attorney General's Office ("CAPD"). Piedmont respectfully submits that the adoption of its Service Schedule No. 317 and proposed energy efficiency programs is consistent with the requirements of Section 65-4-126 of the Tennessee Code Annotated and is otherwise in the public interest. Piedmont further submits that the concerns and proposed modifications interposed by the CAPD relating to Piedmont's Service Schedule No. 317 and energy efficiency programs are unwarranted on the facts of this case, particularly in light of the consumer protective measures proposed by Piedmont in the rebuttal testimony of Mr. Frank Yoho. As such, and as is discussed in greater detail below, Piedmont's proposals should be adopted by the Authority in order to conform Piedmont's rate structure with the enunciated public policy of the State of Tennessee and to permit Piedmont's Tennessee customers to participate in and reap the benefits of Piedmont's proposed energy efficiency programs.

EXECUTIVE SUMMARY

The fundamental question presented by this proceeding is whether the Tennessee Regulatory Authority ("Authority" or "TRA") should approve the margin decoupling tracker ("MDT") mechanism proposed by Piedmont as its Service Schedule No. 317 and the related energy efficiency programs filed with Piedmont's Petition, including Piedmont's proposed low-income weatherization assistance program. The answer to this question, supported by four distinct factors, is an unequivocal yes. The four factors supporting this answer are as follows:

1. The Governor and the General Assembly of the State of Tennessee have both clearly articulated the public policy goals of (1) aligning utility financial incentives with helping customers use energy more efficiently, and (2) promoting cost-effective, measurable, and verifiable energy efficiency programs. Piedmont's proposals serve both of these policy objectives whereas the CAPD's proposals do not.
2. Decoupled rate design mechanisms are a clear trend for natural gas utilities in the United States as they allow a reasonable opportunity for utilities to recover their fixed costs in the face of declining per customer usage.
3. The asserted risks to customers from adoption of Piedmont's Service Schedule No. 317 are overstated and inconsistent with the fundamental operation of the MDT mechanism – which is neutral in character and serves only to preserve average per customer usage assumptions upon which rates have been set by the Authority.
4. Piedmont's modified proposal to implement its Service Schedule No. 317 and energy efficiency programs on an experimental basis with overearnings protection and fully shareholder funded energy efficiency plans eliminates all purported risks to customers arising from its proposals.

Based on these factors, and as the evidence demonstrates, the Authority should accept Piedmont's proposals and approve the implementation of Piedmont's Service Schedule No. 317 and Piedmont's proposed energy efficiency programs under the terms proposed in Piedmont witness Yoho's rebuttal testimony.

The express public policy of the State of Tennessee, as certified by Governor Bredesen and as enacted in TCA § 65-4-126, is to align Piedmont's financial incentives with helping its customers use energy more efficiently and to promote cost-effective, measurable, and verifiable energy efficiency programs. Piedmont's proposals in this docket achieve both these policy goals whereas Piedmont's current rate structure does not. Specifically, under its current rate structure Piedmont is impaired in its ability to help its customers achieve energy efficiency because the volumetric nature of that rate structure creates an affirmative economic incentive for Piedmont to maximize the amount of natural gas its customers use. More gas used by Piedmont's customers equates directly to more revenues for Piedmont. As a publicly traded and investor owned public utility, Piedmont has a strong economic incentive to maximize revenues and, therefore, to promote the maximum usage of gas by its customers. This so-called "throughput incentive" is fundamentally and irreconcilably inconsistent with Tennessee's stated policy of aligning Piedmont's financial incentives with helping its customers use less natural gas, a fact obviously recognized by the General Assembly.[1]

Piedmont's proposed Service Schedule No. 317 corrects this inconsistency and eliminates Piedmont's incentive to promote increased usage by allowing Piedmont to collect the average per customer margin approved by the Authority in Piedmont's most current rate proceeding regardless of customer usage patterns. Under the mechanism, if Piedmont collects higher than allowed margin revenues, they are simply returned to customers through the

[1] It is also recognized by multiple pieces of federal legislation including the American Recovery and Reinvestment Act of 2009 ("ARRA") and the Energy Infrastructure and Security Act of 2007 ("EISA"), both of which encourage state regulatory authorities to consider realigned or decoupled rate structures for regulated utilities.

deferred account mechanism included in Service Schedule No. 317. As such, the mechanism is neutral in character and protects both Piedmont and its customers from variations in customer usage. Most importantly, it satisfies the express State policy goals of aligning Piedmont's financial incentives with helping its customers use less natural gas whereas Piedmont's existing approved rate structure does not.

Piedmont currently has no energy efficiency programs in place in Tennessee and is inhibited from initiating such programs by the "throughput incentive" underlying its current rate structure, as explained above. In connection with the implementation of its Service Schedule No. 317, however, Piedmont has proposed the implementation of three energy efficiency programs – a residential low income energy efficiency program, a high-efficiency equipment rebate program, and a customer education program. Piedmont plans to spend $500,000 a year on these programs and initially proposed to pay roughly one-third of the costs for these programs for the first three years of operation. Piedmont has since increased its commitment by offering to pay 100% of the costs of these programs for a period of three years or until Piedmont's next rate case, whichever is shorter, in conjunction with approval of Service Schedule No. 317.

Each of Piedmont's proposed programs have been either subjected to formal cost-effectiveness testing or have been tested through actual implementation in other states in which results indicate that they are effective and desirable programs. Piedmont will also conduct appropriate post-implementation analysis of the programs to determine their effectiveness and will report the results of that testing to the Authority. Piedmont's program proposals therefore satisfy the cost-effective, measurable, and verifiable policy standards adopted by the State for energy efficiency programs. Notably, Piedmont does not seek cost-recovery or an earnings opportunity associated with these programs for the initial period offered which is a clear and substantial benefit to both program participants and Piedmont's customers in general.

Adoption of Piedmont's MDT mechanism is also a rational approach to evolving natural gas utility rate designs in the face of declining per customer usage and the predominantly fixed nature of natural gas utility costs. In an environment of sustained declines in average per customer usage of natural gas, natural gas utilities such as Piedmont do not have a reasonable opportunity to recover their fixed costs through volumetric rates, because, over time, the usage assumptions upon which volumetric rates are set become invalid. The only existing remedy for this erosion in customer usage is the filing of regular, costly, and time-consuming rate cases. The MDT mechanism provides an alternative means of correcting for this erosion in customer usage by simply preserving the per customer margin responsibility utilized to design its volumetric base rates in the first place. This allows Piedmont the reasonable opportunity to recover its approved level of fixed costs by adjusting for variations in usage but also automatically protects customers from the over-collection of these costs – an advantage that Piedmont's current volumetric rate structure does not provide. It also tends to reduce the frequency with which general rate cases must be filed. The fact that roughly 50% of states have adopted some form of decoupled rates for natural gas utilities subject to their jurisdiction is a strong indication of the reasonableness and widespread acceptance of this mechanism.

The CAPD has posed a number of speculative risks that could arise from adoption of the MDT mechanism including the prospect that it could cause Piedmont to overearn or that Piedmont's return on equity could be "too high" as a result of changes that have occurred to Piedmont's capital and cost structure since its last rate case. These concerns are fundamentally misplaced, however, as they reflect potential concerns with aspects of Piedmont's rates that have nothing to do with the MDT mechanism itself.[2] For example,

[2] Changes in Piedmont's capital structure and cost rates have occurred since Piedmont's last rate case and will continue to occur in the future. These changes have a direct impact on Piedmont's calculated return on equity, which can be fairly volatile. A good example of this is the significant impact recent high levels of short-term debt associated with unrecovered gas costs have had on Piedmont's calculated return on common equity by artificially elevating that return even when revenues and overall returns have been stable or declining. These types of

inasmuch as the MDT mechanism is a tracker that simply "trues-up" margin recovery with the levels approved in Piedmont's last rate case, it is impossible for the mechanism to cause Piedmont to overearn. Further, the MDT mechanism does not allow for the recovery of additional or changed costs and does not provide for updated rate base expense to be automatically recovered from customers. As such, it does not eliminate a utility's incentive to provide service on an efficient and cost-effective basis.[3] More to the point, the most current 303 reports provided to the Authority indicate that Piedmont's overall return is currently in the range of 7.4% to 7.70%. The testimony of Piedmont's witnesses further confirms that Piedmont's budgeted capital expenditures in Tennessee for infrastructure development in the immediate future are in the range of $70 million which will further reduce Piedmont's return. Finally, Piedmont's witnesses indicate a projected overall return after the implementation of decoupling of less than 8.0% and a return on equity in the range of 10.0% - 10.5%.[4]

In short, the proper evaluation of the Authority in this proceeding should be an analysis of the incremental risks, if any, posed to customers by the MDT mechanism. The truth is that no incremental risks are created by the MDT mechanism. In light of these facts, the speculative risks posed by the CAPD, which relate to other aspects of Piedmont's cost of service and the occurrence of which is completely unsupported by the evidence, provide no basis to reject an otherwise proper and widely accepted decoupling mechanism consistent with State rate design policies.

Finally, the consumer protective measures proposed by Piedmont witness Frank Yoho in his rebuttal testimony eliminate even the speculative risk to customers postulated by the CAPD.

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changes to Piedmont's capital structure occur wholly unrelated to the MDT mechanism, however, and will continue to occur whether or not the mechanism is adopted. It makes little sense to reject the MDT mechanism on the basis of wholly unrelated changes in other aspects of Piedmont's cost of service structure.

[3] *See* Carpenter Hrg. Test. (Tr. at pp. 154-59).

[4] These post-decoupling return projections are easily within the range of reasonableness and are well below the comparable returns for Piedmont in North Carolina and South Carolina where decoupling mechanisms are already in place.

These protective measures include (1) adoption of Service Schedule No. 317 on an experimental basis for the lesser of three years or until Piedmont's next general rate case, (2) placing a cap on Piedmont's overall return at its current approved rate of return of 8.42% for this same period, and (3) full payment by Piedmont for each of its proposed energy efficiency programs during the experimental period.[5] These measures allow the Authority and other interested parties an opportunity to observe how the MDT mechanism and proposed energy efficiency programs work during the experimental period with absolutely no risk to customers or any other party. All of the rights of the parties and the Authority would be reserved with respect to continuation of the programs and Service Schedule No. 317 beyond the experimental period. This approach should effectively mitigate all concerns with the adoption of Piedmont's proposals and remove any perceived obstacles to their approval.

Based on the foregoing, Piedmont respectfully submits that this Authority should approve Piedmont's proposed Service Schedule No. 317 and its proposed energy efficiency programs subject to the consumer protective measures contained in the rebuttal testimony of Piedmont witness Yoho and further review and reevaluation at the end of the experimental period.

STATEMENT OF THE FACTS AND CASE

On March 23, 2009, and as a condition to the receipt of federal stimulus funds under the ARRA, Governor Bredesen certified to the Secretary of the United States Department of Energy that this Authority would seek to:

> implement, in appropriate proceedings for each electric and gas utility, with respect to which the State regulatory authority has ratemaking authority, a general policy that ensures that utility financial incentives are aligned with helping their customers use energy more efficiently and that provide timely cost recovery and a timely earnings opportunity for utilities associated with cost-effective measurable and verifiable efficiency savings, in a way that sustains or enhances utility customers' incentives to use energy more efficiently.

[5] CAPD witness Dismukes indicated approval of Piedmont's offer in testimony at the hearing of this matter and also stated he was unaware of any other instance in which a utility offered to fund 100% of energy efficiency program costs. (Tr. at pp. 276, 279).

Pet. at ¶ 5. On June 25, 2009, as the result of separate legislative activity, Governor Bredesen signed into law Section 65-4-126 of the Tennessee Code Annotated which provides that:

> The general assembly declares that the policy of this state is that the Tennessee regulatory authority will seek to implement, in appropriate proceedings for each electric and gas utility, with respect to which the authority has rate making authority, a general policy that ensures that utility financial incentives are aligned with helping their customers use energy more efficiently and that provides timely cost recovery and a timely earnings opportunity for utilities associated with cost-effective measurable and verifiable efficiency savings, in a way that sustains or enhances utility customers' incentives to use energy more efficiently.

Pet. at ¶ 6. On July 16, 2009, and in an effort to comply with the enunciated public policies of the State of Tennessee as set forth above, Piedmont filed its Petition in this docket. Piedmont's Petition seeks: (1) approval of a margin decoupling mechanism that aligns Piedmont's financial interests with those of its customers around customer usage by eliminating any throughput incentive Piedmont would otherwise have to promote increased customer usage; and (2) authorization to implement several cost-effective energy efficiency programs, including a low-income weatherization plan, a high-efficiency equipment rebate program, and a customer education program. Pet. at ¶¶ 5-13 and Exhs. A & B. As a showing of good faith by Piedmont, and in an effort to provide a "jump start" to its proposed energy efficiency programs, Piedmont initially offered to commit $475,000 of its own funds – approximately one-third of the total cost of these programs -- during the first three years of their operation. Pet. at ¶ 13.

On July 31, 2009, the CAPD filed its Complaint and Petition to Intervene in this docket in which it sought to intervene in this proceeding and raised several objections to Piedmont's proposals. On August 24, 2009, the Authority convened a contested case proceeding in this docket for the consideration of Piedmont's proposals and the CAPD's objections thereto. The CAPD's motion to intervene was subsequently allowed by the Hearing Officer by Order dated October 13, 2009. In that same Order, the Hearing Officer established five issues to be addressed at the hearing of this matter. These issues are as follows:

Issue 1. 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?

Issue 2. If such mechanism or incentive is adopted, what is the appropriate customer usage level and/or margin to be used as the benchmark for Piedmont's proposed decoupling mechanism?

Issue 3. Prior to implementing a decoupling mechanism, should Piedmont's earnings be evaluated?

Issue 4. Does the implementation of a decoupling mechanism lower the business risk for Piedmont, thereby justifying an adjustment to its rate of return? If so, what method or evaluation tools should be utilized to quantify an appropriate adjustment to the rate of return?

Issue 5. Should Piedmont be required to meet specific, verifiable, measurable energy efficiency goals and/or benchmarks for any approved conservation programs?

On December 4, 2009, Piedmont and the CAPD filed direct testimony in this proceeding. Piedmont filed the testimony of Frank Yoho, Russell Feingold, David Carpenter, and Steve Lisk in support of its proposals. The CAPD filed the testimony of Terry Buckner, David Dismukes, and Christopher Klein in opposition to Piedmont's proposals. In addition to opposing Piedmont's proposals, CAPD witnesses Klein and Dismukes offered several modifications and/or alternatives to those proposals.

On December 11, 2009, Piedmont and the CAPD each filed rebuttal testimony. Piedmont filed the rebuttal testimony of Frank Yoho, Russell Feingold, David Dzuricky, David Carpenter, and Steve Lisk. The CAPD filed the rebuttal testimony of Terry Buckner. In his rebuttal testimony and in response to concerns expressed by the CAPD, Piedmont witness Yoho recommended the adoption of several consumer protective measures in association with approval of Piedmont's MDT mechanism and adoption of Piedmont's proposed energy efficiency programs. These consumer protective measures proposed by Mr. Yoho are: (1) adoption of the MDT mechanism on an experimental basis for the shorter of a period of three years or until Piedmont's next general rate case filing, (2) a cap on Piedmont's overall return for the experimental period set at Piedmont's current approved overall return of 8.42%; and (3)

Piedmont's commitment to fund 100% of the costs of its proposed energy efficiency programs for the experimental period.

On December 15, 2009, the CAPD filed the surrebuttal testimony of Christopher Klein and a motion seeking authorization to file such testimony in this proceeding. Piedmont did not object to the CAPD's motion and CAPD's witness Klein's surrebuttal testimony was accepted for filing by order of presiding Director Freeman at the hearing of this matter.

The hearing of this matter was conducted, as scheduled, on December 17th and 18th in the Authority's hearing room.

DISCUSSION

Piedmont respectfully submits the following discussion of the evidence and the positions of the parties in this proceeding arranged in accordance with the issues set for hearing by the Hearing Officer in his October 13, 2009 *Order Granting Intervention, Determining Issues, and Establishing Procedural Schedule*.

I. PIEDMONT'S PROPOSED SERVICE SCHEDULE NO. 317 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.

Piedmont filed its Service Schedule No. 317 in this proceeding in response to adoption of a new policy by the State of Tennessee in order to conform its rate structure with the express policy of state lawmakers and in alignment with the interests of its customers in using less energy. Section 65-4-126 of the Tennessee Code Annotated provides that it is the express public policy of the state of Tennessee that "the Tennessee regulatory authority will seek to implement, . . . a general policy that ensures that utility financial incentives are aligned with helping their customers use energy more efficiently." This statement of policy was adopted by the General Assembly, and signed by the Governor, in the context of longstanding volumetric rate structures for Tennessee natural gas utilities like Piedmont that do not align utility financial incentives with helping their customers use energy more efficiently. To the contrary, these

longstanding volumetric rate structures create affirmative incentives for natural gas utilities to promote greater usage of natural gas by their customers.[6] The MDT mechanism contained in Service Schedule No. 317 will do exactly what TCA § 65-4-126 intends by "decoupling" Piedmont's margin recovery from the consumption patterns of its customers, thereby making Piedmont indifferent to the amount of natural gas consumed by its customers. This type of decoupling mechanism has been endorsed by NARUC, the Natural Resources Defense Council,[7] the Edison Electric Institute, and the American Gas Association and has been adopted in almost half of the states in the nation. The CAPD has proposed a myriad of alternative and/or modified mechanisms through its witness Dismukes but none of these alternative or modified mechanisms conform to the requirements of TCA § 65-4-126 because none of them align Piedmont's financial incentives with helping its customers use energy more efficiently. Based on these factors, it is clear that Piedmont's proposed Service Schedule No. 317 is the most appropriate mechanism to ensure that Piedmont's financial incentives are aligned with State's energy conservation policy set out in TCA § 65-4-126.

A. Piedmont's Proposed Service Schedule No. 317 Satisfies All Requirements of Tennessee Policy Established by TCA § 65-4-126 and Should Be Approved.

A decoupled rate design is a natural and intended result of the adoption of the policies articulated in TCA § 65-4-126. Consistent with those policies, Piedmont's decoupling proposal aligns Piedmont's financial incentives with the interests of its customers by "trueing up" the recovery of average per customer margin from Piedmont's residential customers in a way that assures that Piedmont will recover exactly the right amount of fixed costs from its residential customers as determined by the TRA in a general rate proceeding. (Carpenter Dir. Test. p. 5; Tr. at p. 140). The mechanism is neutral in character in that both under-recoveries and over-

[6] This incentive is oftentimes referred to as the "throughput incentive" because under a volumetric rate structure higher throughput correlates directly to higher utility revenues.
[7] The Natural Resources Defense Council ("NRDC"), a longstanding environmental advocacy group, filed a letter in support of Piedmont's decoupling proposal in this docket.

recoveries of margin are trued up. (*Id.*) The mechanism is beneficial to customers in a number respects: (1) it protects against over-recovery of margin when customer usage is higher than projected; (2) it preserves customer preferences for usage based rates; (3) it sends proper price signals to customers by preserving the gas cost savings benefits associated with conservation, (4) it extends the period between rate cases by eliminating margin erosion from declining per customer usage, and (5) it permits Piedmont to actively promote and participate in energy efficiency and conservation programs that will save customers money by reducing their consumption of natural gas and lowering their overall utility bills. It is, in short, exactly the kind of mechanism anticipated by TCA § 65-4-126. As such, it is consistent with the policy of this State and it should be approved by the Authority.

In addition to compliance with TCA § 65-4-126, adoption of Piedmont's Service Schedule No. 317 makes sense purely from a rate design perspective because it allows for the recovery of Piedmont's fixed costs on a fixed basis. As Piedmont witness Feingold discusses in his direct testimony, multiple factors facing natural gas utilities like Piedmont support adoption of decoupling or Straight Fixed Variable ("SFV") rate designs in order to stabilize those factors that are beyond the utility's control and to ensure an adequate opportunity to recover fixed costs.[8] (Feingold Dir. Test. pp. 5-11; Tr. at p. 110). CAPD witness Buckner acknowledged that recovery of fixed costs on a fixed basis was the most efficient approach to fixed cost recovery. (Tr. at p. 320-21). CAPD witness Buckner also acknowledged that many utility or quasi-utility services providers – such as cable, internet, cell phone, and local telephone service providers – utilize a fixed monthly charge to recover their costs rather than usage-based charges and that there is nothing inherently unfair or unjust about this pricing model. (Tr. at p. 314-15). Mr.

[8] Decoupling mechanisms and SFV rate designs achieve the same essential goal – fixed recovery of utility fixed costs – by two different means. For purposes of a utility's fixed cost recovery, however, they are equivalent mechanisms. A third type of mechanism has been adopted in some states which has the same practical effect as decoupling. That mechanism is an annual rate update mechanism which effectively refreshes all aspects of a utility's rates – including customer usage – every year. Piedmont is subject to such a mechanism in South Carolina.

Buckner also acknowledged that the majority of Piedmont's costs are fixed in nature. (Tr. at p. 316). Moreover, as is discussed in the testimony of Piedmont witness Feingold and CAPD witness Dismukes, many States as well as the Federal Energy Regulatory Commission have adopted either decoupling mechanisms or SFV rate designs to ensure that utilities subject to their jurisdiction have an adequate opportunity to recover their fixed costs without reliance on customer usage patterns. (Feingold Dir. Test. pp. 11-14; Exh. DED-5; Tr. at pp. 264-68). Witness Feingold indicates that 19 states have approved decoupled rate structures (with 3 such proposals pending) and that another 4 states have approved SFV rate designs – which is another recognized form of decoupling. (Feingold Dir. Test. p.11 & Exh. RAF-2; Tr. at p. 90). Mr. Feingold also identified 5 additional states that have approved annual rate refresher mechanisms, which Mr. Yoho testified were essentially equivalent to decoupled rate designs. (Tr. at p. 122). Witness Feingold also testified that there is a clear trend toward the adoption of such mechanisms by states that have considered them, indicating that only three states had adopted decoupling in 2002 but as of November 2009, 23 states had adopted decoupling with proceedings pending in 3 more. (Id.; Tr. at p. 124). Even CAPD witness Dismukes can point to only 4 states where such mechanisms have been rejected.[9]

Witness Feingold also provides substantial evidence that a number of legislative enactments and policy pronouncements by various trade groups support decoupling. On the legislative side, these most notably include Federal laws like the ARRA and EISA 2007, and state laws, including TCA § 65-4-126. On the trade group side, these include statements by the American Gas Association and the NRDC presented to the National Association of Regulatory Utility Commissioners ("NARUC") in July 2004, and the NRDC and the Edison Electric Institute statement to NARUC in 2003. Further, NARUC itself has endorsed the concept of decoupling

[9] And CAPD witness Dismukes confirms that 18 states have approved decoupling but also acknowledges that such mechanisms are required by statute in 6 other states and that still more states have approved straight fixed variable rate designs or annual rate update mechanisms. (Dismukes Dir. Test. p. 27 & Exh. DED-5; Tr. at pp. 264-68).

and encouraged its member states to consider implementation of decoupled rate designs. (Feingold Dir. Test., Exh. RAF-3).

The foregoing factors demonstrate overwhelming support for the conclusion that a decoupled rate design is the natural and intended result of adoption of the policies articulated in TCA § 65-4-126 and that such a rate design mechanism is and would be fully consistent with a national trend toward elimination of throughput incentives in the rates of natural gas utilities and with the recommendations of groups as diverse as NARUC and the NRDC. The evidence demonstrates that Piedmont's proposed Service Schedule No. 317 is such a mechanism and meets all of the policy goals of TCA § 65-4-126 and, therefore, should be adopted and implemented by the Authority.

B. The CAPD's Criticisms of Piedmont's Service Schedule No. 317 are Neither Valid Nor Compelling.

In his direct testimony, CAPD witness Dismukes finds fault with Piedmont's proposed MDT mechanism on several grounds. These assertions include that Piedmont's proposal would shift a disproportionate level of risk to customers, that the Company's proposal has no consumer protective measures, and that Piedmont has not shown a likelihood of harm from its proposed energy efficiency programs. These criticisms/concerns on the part of witness Dismukes are misplaced, misconstrue the purpose and effect of Piedmont's proposed MDT mechanism as well as state law, and attempt to place a burden of proof on Piedmont that does not exist under Tennessee law.

With respect to the concern that Piedmont's proposed MDT mechanism would shift risk to customers, CAPD witness Dismukes is mistaken in his analysis. Rather than shifting risk to customers, the MDT mechanism will eliminate risk for both customers and Piedmont by ensuring that Piedmont will recover from its residential customers exactly the level of margin responsibility allocated to those customers by this Authority. (Yoho Reb. Test. p. 6; Tr. at p. 40). This fact also reduces risk for the Authority and for Piedmont's customers associated with early,

frequent, or unexpected rate cases and of possible over-earnings by Piedmont where relief can only come on a prospective basis after a prolonged administrative hearing process.

The suggestion that Piedmont's proposals offer no consumer protective measures is also unfounded. Piedmont's proposed consumer protective measures, set forth in the rebuttal testimony of Piedmont witness Yoho, effectively eliminate any prospective incremental risk to customers from adoption of the MDT mechanism and Piedmont's energy efficiency programs. These measures propose adoption of Piedmont's Service Schedule No. 317 on an experimental basis for a period of the shorter of 3 years or until Piedmont's next general rate proceeding, a cap on Piedmont's earnings during this experimental period at Piedmont's existing approved overall rate of return of 8.42%, and full payment by Piedmont (without cost-recovery or an earnings opportunity) for Piedmont's energy efficiency programs for the same period. (Yoho Reb. Test. pp. 9-10; Tr. at p. 185). Even CAPD witness Dismukes acknowledged that these were measures beneficial to ratepayers. (Tr. at p. 276). These proposals eliminate all possible incremental risks that could arise from Piedmont's proposals and constitute substantial consumer protective measures.

Finally, the suggestion that Piedmont has not shown a likelihood of harm from its proposed energy efficiency programs of sufficient magnitude to justify its MDT mechanism is simply irrelevant to the matters before the Authority because its misconstrues the meaning of TCA § 65-4-126. The premise implicit in this criticism of Piedmont's MDT proposal is that the provisions of TCA § 65-4-126 that address aligning utility financial incentives with helping customers use energy more efficiently are somehow directly contingent upon utility sponsored energy efficiency programs. That is not the case.

TCA § 65-4-126 consists of a two-part statement of policy. These are that the TRA should seek to implement a general policy that (1) "ensures that utility financial incentives are aligned with helping their customers use energy more efficiently," and (2) "provides timely cost recovery and a timely earnings opportunity for utilities associated with cost-effective measurable

and verifiable efficiency savings." While there is clearly a relationship between these two statements, the relationship is just as clearly not directly causal in nature. In other words, the statute cannot fairly be read to say only that utilities should be compensated for the loss of revenues associated with utility sponsored energy efficiency programs – which is apparently the meaning given to it by witness Dismukes – because such an interpretation would entirely ignore the requirement to align utility financial incentives with assisting customers save money. This interpretation of the purpose of TCA § 65-4-126 is confirmed by Mr. Feingold in his testimony as consistent with the manner in which decoupling has been implemented in 90% of the States where it has been approved. (Tr. at pp. 125-26). As such, the criticism that Piedmont has not shown that savings from its energy efficiency programs will be so great as to necessitate approval of its MDT as some form of compensatory mechanism is simply a *non sequitur* and provides no basis for rejection of Piedmont's proposals.

C. The CAPD's Alternative Proposals Do Not Satisfy the Requirements of TCA § 65-4-126 and Are Otherwise Inappropriate.

In addition to criticizing Piedmont's MDT mechanism, the CAPD also offered several alternative or modified proposals for consideration by the Authority. The primary affirmative proposal of the CAPD – that the Authority simply disapprove Piedmont's Service Schedule No. 317 and retain Piedmont's existing rate structure – is unworkable because it is completely inconsistent with the policy articulated in TCA § 65-4-126. (Dismukes Dir. Test. pp. 4, 31). And even though CAPD witness Dismukes testified that existing rate structures satisfied TCA § 65-4-126 (Dismukes Dir. Test. p. 31; Tr. at pp. 274-75), that testimony is simply not credible for a number of reasons.[10] First, there can be no realistic dispute that Piedmont's current volumetric rate structure provides it with the incentive to maximize throughput in order to maximize

[10] Notably, and to his credit, CAPD witness Buckner was unwilling to make this same assertion when questioned by Director Roberson. (Tr. at p. 296).

revenue.[11] Helping customers use energy more efficiently means helping them use less energy. Using less energy correlates directly to lower throughput for Piedmont and, therefore, lower revenues. Accordingly, under Piedmont's existing volumetric rate structure it has an incentive to encourage higher customer usage and a disincentive to promote lower customer usage. This incentive structure is directly and irreconcilably contrary to and in conflict with the policy articulated in TCA § 65-4-126. Thus, the suggestion that the *status quo* somehow satisfies the policy requirements of TCA § 65-4-126 does not make sense and the CAPD's recommendation that the Authority need do nothing as a result of TCA § 65-4-126 must be rejected.

Second, the enactment of TCA § 65-4-126 did not occur in a vacuum. It came on the heels of a long debate in the legislature about decoupling and other rate design structures that served to eliminate the throughput incentive provided by volumetric rates for utility services. Members of the Authority participated in that debate as did representatives of Piedmont and the CAPD. It also occurred in the context of multiple pieces of federal legislation, such as EISA 2007 and the ARRA, that promoted rate design policies identical or substantially similar to those articulated in the Tennessee statute. The enactment of TCA § 65-4-126 also followed closely on the heels of Governor Bredesen's certification that Tennessee would adopt the policy it then adopted in this statute as a condition of receipt of stimulus funds. Finally, adoption of TCA § 65-4-126 occurred in the midst of both a national discussion around volumetric rate designs and their implications for utility margin recovery and environmental health, and a national trend toward the adoption of decoupled rate structures for natural gas utilities. In this context, it is simply impossible to conclude either that the General Assembly (1) was not aware of these factors when it enacted TCA § 65-4-126, or (2) did not intend to change the *status quo* with respect to utility financial incentives inherent in volumetric rates by adopting the statute. Accordingly, the CAPD's suggestion that TCA § 65-4-126 either does not require a change in

[11] Even CAPD witness Dismukes admitted on cross-examination that (1) Piedmont is a for profit company, (2) that Piedmont makes money in Tennessee by selling gas, and (3) the more gas Piedmont sells, the more money it makes. (Tr. at p. 261).

existing utility volumetric rate designs or that existing volumetric rate designs satisfy the requirements of the statute is completely untenable.

The additional alternative and/or modified proposals offered by the CAPD are equally problematic. These proposals, all of which are included in the testimony of CAPD witness Dismukes, include: (1) implementing a Lost Revenue approach that adjusts delivery rates for changes in customer usage caused only by Piedmont's energy efficiency programs; (2) requiring a performance based compensation program tied to energy savings from Piedmont sponsored energy efficiency programs; (3) placing a hard revenue cap on recoveries under Piedmont's proposed MDT mechanism based on the total margin revenues allocated to residential customers in the most recent rate case; and (4) restricting Piedmont's recovery under the MDT mechanism to reductions in per customer usage in excess of a benchmark figure or a cap based on total revenues. (Dismukes Dir. Test. pp. 75-77, 85-86). Each of these suggestions would act, in large part, to defeat the intended operation of the MDT mechanism and would also be inconsistent with the fundamental policy established by TCA § 65-4-126, as discussed below.[12]

Witness Dismukes proposal to implement a Lost Revenue adjustment mechanism would fail to eliminate Piedmont's throughput incentive because it represents a ratemaking mechanism that is very narrow in scope and, therefore, very limited in its ability to remove Piedmont's financial disincentive to aggressively pursue energy conservation and efficiency programs. (Feingold Reb. Test. pp. 27-28)

Witness Dismukes' suggestion that the Authority adopt a performance based incentive program for energy efficiency programs is not a new concept in the world of energy efficiency programs but it has no direct relevance to the consideration of Piedmont's MDT mechanism in

[12] Witness Feingold testified that of the 18 states that have currently adopted decoupling, the vast majority have adopted "full" decoupling rather than a restricted form such as those proposed by the CAPD. (Feingold Dir. Test. p. 12). Witness Feingold also testified that, in his opinion, TCA § 65-4-126 contemplates full decoupling. (Feingold Dir. Test. p. 17).

this proceeding. Performance based incentive programs may be a means of facilitating the promotion of energy efficiency programs and they could be considered under the second policy prong articulated in TCA § 65-4-126 involving adoption of cost-effective, measurable, and verifiable energy efficiency programs; however, they do nothing to align utility financial incentives with helping customers save energy because they do not eliminate the throughput incentive associated with volumetric rate structures. As such, witness Dismuke's suggestion that a performance based plan could be adopted by the Authority does not address the primary requirement of TCA § 65-4-126 around aligning utility financial incentives with reductions in customer usage and, therefore, is not a viable alternative to Piedmont's MDT mechanism.

Similarly, witness Dismukes suggestion that the Authority place a hard revenue cap on Piedmont's ability to recover its approved margin under the MDT mechanism also fails to eliminate the throughput incentive and also will increase pressure on general rate filings. This suggestion would effectively cap margin revenues collected by the Company at the aggregate level approved in a rate proceeding. In a growing service area such as Piedmont's, where Piedmont is consistently adding new customers,[13] this suggestion would effectively render the MDT mechanism ineffective as soon as customer growth compensated for margin lost through reductions in usage. Inasmuch as 100% of new incremental revenues would be compared to very small incremental reductions in existing customer usage, the likelihood that the MDT mechanism would function appropriately in this scenario is very small. And when it ceased to function, then Piedmont would have the incentive not only to promote additional usage as the sole means available to it to capture additional revenues but it would also have the incentive to file rate cases to refresh its rates to include the costs associated with serving new customers. As such, and as is the case with all of witness Dismukes' suggestions, capping the MDT

[13] Witness Yoho testified at the hearing that Piedmont's Tennessee service area is a growth market for the company. (Tr. at p. 52).

mechanism in this way would not eliminate Piedmont's throughput incentive and, therefore, would not comply with the policy articulated in TCA § 65-4-126.

Finally, restricting Piedmont's recovery under the MDT mechanism to reductions in per customer usage in excess of a benchmark figure or a cap based on total revenues are also problematic suggestions that would simply negate the effectiveness of the MDT mechanism and require more and more frequent rate cases. They would also fail to eliminate the throughput incentive and, therefore, would not be consistent with aligning Piedmont's financial incentives with helping its customer save energy.

Based on the foregoing, it is apparent that the only proposal filed in this proceeding that would actually satisfy the "alignment" policy articulated by the General Assembly in TCA § 65-4-126 is the proposal of Piedmont to implement its Service Schedule No. 317. That proposal fully satisfies the policies of aligning utility financial utility savings with reductions in customer usage and the corollary energy savings associated with such reductions. Piedmont's proposed Service Schedule No. 317 should be approved by the Authority and the alternate and modified proposals sponsored by the CAPD should be rejected.

II. THE APPROPRIATE CUSTOMER USAGE LEVELS AND/OR MARGIN TO BE USED AS THE BENCHMARK FOR PIEDMONT'S PROPOSED DECOUPLING MECHANISM ARE THOSE APPROVED IN PIEDMONT'S LAST GENERAL RATE PROCEEDING.

Piedmont's Service Schedule No. 317 utilizes four factors to true-up monthly actual normalized average per customer usage with the assumed level of normalized average per customer usage underlying Piedmont's approved volumetric rates. These factors are the R factor, the Heat Sensitivity factor, Heating Degree Days, and the Base Load factor. (Buckner Dir. Test. p. 9). Each of these factors is normally established in the context of a general rate proceeding. (Carpenter Reb. Test. p. 2). In Piedmont's Petition, it proposes to use the only approved versions of these factors known to Piedmont – those established in its last general rate proceeding. The CAPD proposes either: (1) that the Authority convene a new general rate

proceeding to update these factors; or (2) that it update three out of the four factors so as to eliminate the effective operation of the tracker until Piedmont's next rate proceeding. Neither of the CAPD's recommendations are appropriate and they should not be adopted by the Authority.

As Mr. Yoho testified, one of the desirable attributes of Piedmont's MDT proposal is that it would effectively serve as a bridge between rate cases, thereby extending the period before Piedmont would be required to file a new general rate proceeding. (Tr. at pp. 47-48, 57). CAPD witness Buckner testified that rate cases typically cost customers $300,000 to $400,000 each. (Tr. at p. 307). Given the expensive and protracted nature of these proceedings, the costs of which are largely borne by customers, it would be to the benefit of customers to avoid an unnecessary rate case if possible. Inasmuch as a general rate proceeding would also serve to refresh all areas of Piedmont's cost of service, including operations and maintenance cost increases and new rate base investment since the last case, and the fact that the vast majority of rate cases result in rate increases, it makes little sense to adopt the CAPD's suggestion that a general rate case be convened to implement Piedmont's Service Schedule No. 317 as that suggestion would expose customers to expanded risk of higher rates. (Yoho Reb. Test. pp. 4-5). Put differently, under either a general rate case or Piedmont's MDT proposal in this docket, the per customer usage levels underlying base rates will be refreshed. Under Piedmont's proposal, however, that is all that will be refreshed and customers will be responsible for margin collections based on Piedmont's 2004 attrition period cost of service. If the Authority adopts the CAPD's general rate case recommendation, however, then customers will be responsible for margin collections based on Piedmont's 2010 or 2011 attrition period cost of service – which is certain to be higher. This makes no sense to Piedmont and would result in harm to customers.

The CAPD's alternate suggestion – that 3 out of the 4 factors underlying Piedmont's MDT mechanism should be updated – makes no more sense. Inasmuch as the purpose of the MDT mechanism is to true up variations in average per customer usage from the assumed levels of usage underlying Piedmont's base rates, it does not make sense to separate these two

factors from each other in the implementation of the MDT mechanism. That is exactly what the CAPD proposes, however, by suggesting that all of the MDT factors except the R factor be updated for purposes of implementing Service Schedule No. 317. (Tr. at pp. 305-06). The practical effect of adopting the CAPD's suggestion would be to compare revenues resulting from a base rate margin factor set in 2003 against levels of average per customer usage from 2009 that would support a much higher R factor – in effect mixing apples (the base rate calculation from Piedmont's last rate case) and oranges (current average per customer usage levels that do not correspond to base rates). CAPD witness Buckner acknowledged this fact at hearing by admitting that the R factor established in Piedmont's 2003 rate case was based on higher levels of customer usage than currently exist on Piedmont's system. (Tr. at p. 318). The obvious and intended effect of this alternative recommendation by the CAPD is to nullify the operation of the MDT mechanism until Piedmont's next general rate case, where all factors would be updated simultaneously. While this would achieve, as a practical matter, the CAPD's apparent goal of defeating Piedmont's proposed decoupling mechanism – at least until all four MDT factors are updated in a coordinated fashion in Piedmont's next general rate proceeding – it simply makes no sense from a rate design or methodological basis.

In analyzing the CAPD's "staleness" arguments with respect to the MDT factors, it is also appropriate to keep in mind that while individual components of Piedmont's cost of service have changed since its last rate case, Piedmont's recovery of that overall cost of service has not changed dramatically as measured by the consistency of its overall returns reported to the Authority in its 303 reports. (Carpenter Reb. Test. pp. 4-5). Given that base rates are set on the total revenue requirement established by Piedmont's total cost of service – rather than on individual components of that cost of service – changes to individual components are effectively meaningless if the total costs and revenue relationship remain stable as they have here. In other words, if the asserted changes to Piedmont's cost structure since its last rate case were a threat to consumers that threat would reveal itself in growing overall returns reported by the

Company in its 303 reports. That threat has obviously not materialized given Piedmont's most recent reported overall returns in the range of 7.4% to 7.7%. (Carpenter Reb. Test. p. 9; Hearing Exh. 9). It is therefore reasonable to conclude that any changes in the components of Piedmont's overall cost of service since its last rate case have been largely offsetting but in the aggregate have favored customers. This undeniable fact, in and of itself, refutes the CAPD's concerns over the purported "staleness" of the MDT factors established in Piedmont's last rate proceeding.

Based on these matters, the Authority should reject the CAPD's suggestions to either convene a general rate case to refresh all MDT factors or to perform a selective update of less than all factors. Instead, the Authority should adopt the factors currently underlying Piedmont's approved base rates and utilize those in the implementation of Service Schedule No. 317 until Piedmont's next rate case at which time they would be refreshed as part of the rate case process.

III. PIEDMONT'S EARNINGS DO NOT REQUIRE ANY SEPARATE EVALUATION PRIOR TO IMPLEMENTING A DECOUPLING MECHANISM.

CAPD witnesses Buckner, Klein, and Dismukes contend that Piedmont's earnings should be evaluated prior to implementation of Service Schedule No. 317. These witnesses cite to purported over-earnings by Piedmont during the period since its last rate case and projected over-earnings after adoption of Service Schedule No. 317 as the basis for their recommendation. They also recommend a general rate case as the vehicle through which this evaluation should occur. Piedmont strongly disagrees with each of the CAPD's conclusions that: (1) an earnings evaluation is necessary prior to implementing Service Schedule No. 317; (2) Piedmont is or has been over-earning; or (3) the convening of a general rate proceeding is necessary or appropriate in these circumstances. Each of these conclusions by the CAPD is refuted by the testimony and evidence of Piedmont witnesses, including evidence of the economic performance of Piedmont over the relevant time period as previously reported to the

Authority. In short, Piedmont's evidence demonstrates that Piedmont's current earnings are well below its allowed overall rate of return and that adoption of the MDT mechanism will not cause it to earn more than its allowed return. It is clear that no benefit to customers would result from invoking a general rate case proceeding and that such a proceeding could actually cause substantial harm to customers.

According to CAPD witness Buckner, Piedmont's adjusted overall rate of return over the past five years has been 8.62% and its adjusted overall rate of return for the most recent twelve months was 8.54%. (Buckner Dir. Test. p. 17). Witness Buckner argues that these levels of return require an evaluation of Piedmont's earnings in a general rate case proceeding and further require that the R factor established in Piedmont's last general rate case and applicable to Piedmont's MDT and WNA mechanisms must be reduced in order to reflect the return on equity recommendations of CAPD witness Klein (discussed below under Issue 4) and the updated HDD, Heat Sensitivity, and Base Load factor recommendations of CAPD witness Dismukes (discussed above under Issue 2). Stated more directly, the CAPD asserts that an examination of Piedmont's earnings in the context of a general rate case is required in order to adjust Piedmont's allowed return on common equity downward (as urged by CAPD witness Klein) and to reduce Piedmont's R factor (as urged by CAPD witness Dismukes).[14] There are several problems with this argument. The first is that it is based on inaccurate overall rate of return calculations – both historical and current. The second is that it misperceives the operation of the MDT mechanism and how that mechanism impacts rates of return.

The evidence presented at the hearing of this matter convincingly demonstrates that Piedmont has not been over-earning since its last rate case and is not over-earning now. In Mr. Carpenter's rebuttal testimony, he indicates that the rates of return reported by the Company for the years 2004 through 2008 have been 9.68%, 8.56%, 7.53%, 7.46%, and 8.79% respectively.

[14] Notably, despite the CAPD's contention that Piedmont has been over-earning for several years, CAPD witness Buckner acknowledged that the CAPD had not taken this position prior to this proceeding or asked the TRA to invoke its show cause powers. (Tr. at pp. 313-14).

(Carpenter Reb. Test. pp. 4-5). These rates of return average 8.40%. (Id.). These rates of return were reported to the Authority on Piedmont's 303 reports in the ordinary conduct of Piedmont's operations and were calculated using its standard methodology. In its calculations, the CAPD adopted an "adjusted" methodology for calculating Piedmont's returns by factoring out the effect of prior period accounting adjustments. Perhaps unsurprisingly, the CAPD "adjustments" to Piedmont's reported returns caused them to increase. Mr. Carpenter then identified a flaw in the CAPD's methodology, however, and when he recalculated the returns using the corrected CAPD "adjusted" methodology, Piedmont's average annual return for the period 2004-2008 was 8.43% -- well below the return asserted by the CAPD and virtually identical to Piedmont's approved rate of return of 8.42%. (Carpenter Reb. Test. pp. 4-5). Accordingly, it is clear that under either Piedmont's 303 reports or the adjusted methodology utilized by the CAPD, when properly applied, Piedmont was not over-earning during the period 2004-2008.

The same is true of the most recent 12 month period reported by Piedmont in September 2009, where Piedmont's overall return reported was 7.47%. (Carpenter Reb. Test. p. 9; Hearing Exh. 9). This level of return is 95 basis points below Piedmont's current allowed return. Further, when asked about Piedmont's projected return after implementation of the MDT mechanism, Piedmont witness Dzuricky indicated that the Company's projections were that the overall return would be less than 8% and the corresponding return on equity would be in the range of 10.0% to 10.5%. (Carpenter Reb. Test. P. 13; Tr. at pp. 223, 225). These assurances are bolstered by the testimony of Piedmont witnesses that the Company is budgeted to invest more than $70 million in new rate base in Tennessee, with more than $45 million of that investment coming in the next year. (Tr. at p. 74). Obviously, Piedmont's current and projected returns are substantially more meaningful for purposes of the Authority's deliberations in this proceeding than historic returns and the current and projected returns for Piedmont provide no basis for concern that Piedmont will over-earn as a result of adoption of the MDT mechanism.

To the contrary, those rates of return provide reassurance that Piedmont's overall rate of return will remain in a range that is reasonable and that compares favorably with returns Piedmont is allowed to earn in other jurisdictions where Piedmont has decoupling or comparable rate design mechanisms in place.[15]

A further flaw in the CAPD's arguments in favor of an earnings analysis for Piedmont in conjunction with the implementation of Service Schedule No. 317, is the failure to recognize that the MDT mechanism itself is neutral in character and literally cannot cause over-earnings. (Tr. at pp. 53, 140). The mechanism operates to true-up margin recovery from residential customers on an average per customer basis to the levels approved in Piedmont's last general rate case. (Carpenter Dir. Test. p. 5). If per customer margin recovery for a period is below that approved by the Authority in Piedmont's last rate proceeding, then an entry is made to the MDT deferred account that permits Piedmont to recover the shortfall. (Id.). If Piedmont over-recovers its allowed margin per customer an entry is made to the same deferred account to return the over-recovery amount to residential customers. (Id.). Accordingly, the mechanism is simply not capable of resulting in over-earnings by Piedmont. It makes little sense to argue in this proceeding that an earnings evaluation is necessary to protect against over-earnings when Piedmont's MDT mechanism cannot cause such over-earnings to occur.[16]

Finally, the argument that a rate case proceeding is necessary or appropriate to protect consumers or adjust Piedmont's rates will serve only to put customers at risk for higher rates. This is because the MDT mechanism will serve to update only a single aspect of Piedmont's

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[15] Piedmont's overall allowed return in North Carolina, where it has full decoupling approved on a permanent basis, is 8.55% and its allowed rate of return on common equity is 10.6%. (Tr. at pp. 157, 223). Piedmont's overall allowed return in South Carolina, where Piedmont is subject to an annual cost-of-service update mechanism, is 9.26% and its allowed return on equity is 11.2%. (Tr. at p. 223).

[16] One of the ironies of the CAPD's earnings arguments is that they really have nothing to do with the potential incremental effects of the operation of Piedmont's proposed MDT mechanism but instead relate to other aspects of Piedmont's overall cost structures that will not be impacted by (and do not impact upon) the usage per customer factors adjusted by Service Schedule No. 317.

rates – per customer margin recovery. The sole effect of the mechanism will be to correct for sustained erosion in customer usage that has occurred since Piedmont's last rate case. The net result will be identical to what would have occurred if the per customer usage assumptions used to calculate Piedmont's current base rates had turned out to be correct. In other words, the effect of the MDT mechanism will be to charge residential customers for gas service on a going forward basis exactly the amount that the settlement stipulation and Authority Order in Piedmont's last rate case anticipated they would be charged. This is neither unfair nor inappropriate and the effect on customers will be small. Convening a general rate case will have a much different impact. In that proceeding, every single element of Piedmont's cost structure will be updated and Piedmont's significant investment in new rate base will be included in its revenue requirement. (Yoho Reb. Test. p. 5). All of these costs will be in addition to the correction for declining per customer usage addressed by the MDT. Accordingly, it is reasonable to expect that the results of a general rate proceeding will be higher rates for customers than they will experience with just the MDT in place. (Yoho Reb. Test. pp. 5-6). In fact, Piedmont witness Yoho indicates that one of the most beneficial aspects of approving the MDT mechanism would be the "bridging" effect it would have on Piedmont's need to file a new rate proceeding. (Tr. at pp. 47-48, 57). On the basis of these facts, it seems obvious that a general rate case proceeding is not only unnecessary, it is highly undesirable from the perspective of consumers.

IV. THE IMPLEMENTATION OF PIEDMONT'S PROPOSED MARGIN DECOUPLING TRACKER MECHANISM DOES NOT LOWER THE BUSINESS RISK FOR PIEDMONT, OR JUSTIFY AN ADJUSTMENT TO ITS ALLOWED RATE OF RETURN ON COMMON EQUITY.

CAPD witnesses Klein and Dismukes assert that adoption of Piedmont's MDT mechanism will lower its business risk thereby justifying a reduction in Piedmont's allowed return on equity. CAPD witness Klein specifically recommends a 50 basis point reduction in Piedmont's allowed return on equity in connection with adoption of the MDT mechanism. (Klein

Dir. Test. p. 15). These assertions by the CAPD's witnesses are not supported by the facts, however, or even practically capable of implementation.

First, Piedmont has no approved return on equity established by this Authority. The settlement stipulation in its last rate case, which was approved by the Authority, did not set forth a return on common equity because the parties could not agree on either a common capital structure or agreed costs of debt or equity. Accordingly, there is no approved ROE for Piedmont.[17] This fact begs the question that even if the Authority accepted witness Klein's proposal that Piedmont's allowed ROE should be reduced by 50 basis points as a result of adoption of Service Schedule No. 317, what would be the starting point for that calculation? Without an approved allowed return on common equity established by the Authority it is literally impossible to make the calculation urged by CAPD witnesses.

Second, the evidence presented by witnesses for both parties reveals that ROE calculations can be highly volatile in a situation where all other aspects of a capital structure are established. For example, CAPD witness Klein clearly indicated on cross-examination that all other factors remaining equal, a temporary increase in short-term debt, such as might be encountered to support uncollected wholesale gas costs from customers, would increase the calculated return on equity for Piedmont even though neither Piedmont's revenues nor overall return were changed at all. (Tr. at pp. 293-95). This phenomenon illustrates the danger inherent in an *ad hoc* reduction in ROE undertaken outside the context of a rate case and is supported by the rebuttal testimony of Piedmont witness Carpenter who directly challenged the CAPD's return on equity evidence stating that Piedmont's ROE for the period ending July, 2009 corrected for anomalous levels of short-term debt was less than 10%. (Carpenter Reb. pp. 8-9). This danger is further affirmed by the fact that the Authority itself does not monitor the returns on equity achieved by natural gas utilities under its 303 report mechanism relying instead on a

[17] *Order Approving Rate Increase and Rate Design and Approving Rates Filed by Nashville Gas Company*, TRA Docket No. 03-00313 (July 14, 2004).

calculated overall rate of return.[18] This makes perfect sense inasmuch as overall rates of return are more indicative over time of the relative earnings status of a utility than returns on equity, which can vary substantially over short periods of time for a variety of reasons that have nothing to do with over-earnings.

Third, the evidence presented by Piedmont witnesses strongly suggests that a reduction in allowed ROE undertaken in conjunction with the implementation of the MDT mechanism would likely be viewed as a negative by industry analysts thereby putting potential downward pressure on Piedmont's share price and ultimately increasing costs to customers. (Dzuricky Reb. Test. pp. 4-5; Feingold Reb. Test. pp. 37-38; Tr. at pp. 213-14). And while Piedmont witness Dzuricky agreed that industry analysts take note of decoupling mechanisms as part of their overall analyses of natural gas utilities, just as they take note of many factors involving the operations of companies they evaluate, he strongly disagreed that the presence or absence of a decoupling mechanism alone was material enough to impact the assessment of a natural gas utility's business risk in the capital markets.[19] (Dzuricky Reb. Test. p. 3; Tr. at p. 209). This testimony by a witness with more than 30 years of direct experience in the capital markets and with the ultimate responsibility for obtaining the capital necessary for Piedmont to meets its operational needs was uncontroverted.

Fourth, the undisputed evidence demonstrates that Piedmont is currently under-earning its overall return by a significant margin. (Carpenter Reb. Test. p. 9; Tr. at pp. 308-12; Hearing Exh. 9). Piedmont's witnesses also testified that based on their projections of the impact of the MDT mechanism, Piedmont will still be under-earning its allowed overall rate of return upon implementation of that mechanism at a rate below 8.0% and that Piedmont's projected return on

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[18] Piedmont's current overall rate of return of 7.47% as reported to the Authority in its most recent 303 report is more than 100 basis points lower than its allowed overall rate of return of 8.42% and even after implementation of the MDT mechanism Piedmont projects its overall rate of return to be below 8.00%.

[19] Given that Tennessee represents only approximately one-third of Piedmont's total throughput, this observation makes complete sense.

equity following implementation of the MDT mechanism will be in the range of 10.0% to 10.5%. (Carpenter Reb. Test. p. 13; Tr. at pp. 223-25). These returns are eminently reasonable in the context of Piedmont's Tennessee operations and fall far short of being fairly characterized as over-earning.

Based on these factors, it is not reasonably possible to conclude that Piedmont's overall business risk will be materially impacted by adoption of the MDT mechanism or that its allowed return on equity should be adjusted as a result. More to the point, it is not even practically possible to implement such a reduction in allowed ROE in this proceeding because Piedmont has no allowed ROE. Finally, the evidence indicates that Piedmont's overall return is well below its approved level currently and will remain below that level even after adoption of its Service Schedule No. 317. In this context it is clear that no arbitrary reduction in Piedmont's return as a condition to implementation of its Service Schedule No. 317 is necessary or appropriate.

V. PIEDMONT'S PROPOSED ENERGY EFFICIENCY PROGRAMS ARE COST-EFFECTIVE, MEASURABLE, AND VERIFIABLE.

The second articulated policy adopted in TCA § 65-4-126 is to promote timely cost recovery and timely earnings opportunities associated with cost-effective, measurable, and verifiable efficiency savings that sustain or enhance the ability of utility customers to use energy efficiently. In Piedmont's Petition and as supported by the direct and rebuttal testimony of Piedmont witness Steve Lisk, Piedmont has proposed three programs that satisfy these goals. These programs are a Residential Low-Income Energy Efficiency Program focusing on weatherization of low income residential structures, a High Efficiency Equipment Rebate Program providing affirmative economic incentives for the purchase and utilization of high-efficiency natural gas equipment, and a Customer Education Program focusing on communications designed to prompt customers to undertake energy savings measures on their own without direct subsidization by Piedmont or other customers. Each of these programs is designed and intended to help customers utilize energy more efficiently. Each of these

programs is cost-effective as measured either by one or more of the California Standard Practice Manual cost-effectiveness tests or by Piedmont's practical experience in implementing the programs in other states. (Lisk Reb. Test. pp. 3-8). Two out of the three programs have verification and measurement protocols built into them. (Lisk Reb. Test. p. 8). The third – Customer Education – is not verifiable or directly measurable but does have the countervailing advantage of potentially being much more cost-effective than the other two. This is because it involves a minimum investment on Piedmont's part with a substantial potential payoff if Tennessee consumers react to Piedmont's conservation messages in the same fashion as Piedmont's North Carolina customers have reacted.

It is also noteworthy that under its proposed consumer protective measures, as set forth in the rebuttal testimony of Frank Yoho, Piedmont is not seeking either cost recovery or an earnings opportunity for these programs. Instead, Piedmont has proposed that for the initial experimental period and in conjunction with the implementation of its Service Schedule No. 317, it would absorb all of the costs of these programs. (Yoho Reb. Test. p. 10). This approach to the initial implementation of energy efficiency programs is highly beneficial to all of Piedmont's customers and, as even CAPD witness Dismukes acknowledged, contrary to the normal pattern of utility recovery of energy efficiency program costs from customers. (Tr. at p. 279). Piedmont's payment of these costs benefits those customers participating in these programs by allowing them to receive the energy and cost-savings benefits of those programs and it benefits all of Piedmont's customers by reducing the costs they would otherwise incur if Piedmont were seeking timely cost recovery or timely earnings opportunities on these programs.

In response to Piedmont's proposals, CAPD witness Dismukes raises a number of criticisms ranging from the fact that Piedmont didn't perform every one of the five cost-effectiveness tests identified by the California Standard Practice Manual on each of its programs

to perceived inadequacy in various aspects of Piedmont's programs.[20] While CAPD witness Dismukes has numerous recommendations relating to increasing the level of granularity in Piedmont's description, analysis, and evaluation of its programs, he does not support his recommendations by reference to "best practices" in other jurisdictions or provide any convincing analysis that Piedmont's programs will not achieve their stated objectives. In other words, while he asserts that Piedmont should have performed more tests, should explain in greater detail the underlying analysis of and benchmarks of effectiveness for its programs, and should have more defined monitoring and verification measures, his testimony provides no basis to believe or prediction that Piedmont's proposed programs will not operate as intended and consistent with their stated objectives. In short, while CAPD witness Dismukes is entitled to his opinions about how Piedmont's energy efficiency programs could be improved -- and he has many such opinions – he has not provided an evidentiary basis sufficient to establish either that Piedmont's programs will not work or that they do not comply with the policy articulated in TCA § 65-4-126.

Further, witness Dismukes' criticisms also fail to acknowledge that Piedmont utilized a third-party consultant – the Cadmus Group – to analyze its programs or that the results of that analysis were positive. (Lisk Reb. Test. pp. 3-5). Witness Dismukes also failed to give credit for the fact that Piedmont's low-income energy efficiency program was modeled on a successfully federal program with the most significant difference being a slightly expanded eligibility pool to capture customers who fall just beyond eligibility for federal assistance but who are still struggling. (Tr. at p. 171). Nor does witness Dismukes acknowledge the significance of Piedmont's actual experiences in implementing similar programs in North Carolina and the approval and ongoing monitoring of those programs by the North Carolina Utilities Commission.

[20] Ironically, this criticism by witness Dismukes is undercut by a report of utility energy efficiency programs cited in his own testimony which indicates that many successful utility energy efficiency programs have been tested under less than all of the tests of the California Standard Practice Manual, including those used by Piedmont in its programs. (Tr. at pp. 172-73 & 270-72; Hearing Exh. 6).

All of these factors provide substantial reassurance that Piedmont's proposed programs are reasonable, cost-effective, and efficient.

Clearly, for every low-income residence weatherized by Piedmont the participating customer will receive a significant economic and energy savings benefit. No rational person could contend otherwise. Piedmont's experience in North Carolina with a virtually identical program bears this out. That program resulted in average per customer energy savings in excess of $250 per year. (Lisk Reb. Test. p. 8). Similarly, every piece of high-efficiency natural gas equipment that is purchased and installed in lieu of a lower efficiency unit will also result in energy and cost savings to the customer installing that unit. This conclusion does not require separate or additional testing or verification – it is obvious and irrefutable. Finally, given that Piedmont proposes to fully fund all of its programs during the initial implementation period without seeking cost-recovery or an opportunity to earn on the programs, CAPD witness Dismukes criticisms should carry no weight as 100% of the risk of those programs is on Piedmont and its shareholders. Allowing these programs to proceed also will allow Piedmont, the CAPD, and the Authority to gain experience actually implementing energy efficiency programs in Tennessee, at no cost to consumers, which is obviously of more benefit to the citizens of Tennessee than rejecting Piedmont's proposals because they are – in the CAPD's opinion – imperfect in some respects.

Based on the foregoing, Piedmont submits that its proposed energy efficiency programs should be approved for implementation by the Authority, in conjunction with approval of Piedmont's MDT mechanism, as soon as reasonably practical so that would-be participants in those programs can begin to reap the cost and energy savings benefits of those programs as soon as reasonably possible.

CONCLUSION

Piedmont submits that its proposed Service Schedule No. 317 and proposed energy efficiency programs are in the public interest and consistent with the policies expressed in TCA § 65-4-126. Piedmont further submits that the CAPD has not shown otherwise and that its predictions of potential customer harm are overstated. Nonetheless, Piedmont has proposed consumer protective measures that will completely mitigate any potential or perceived harm to customers. Accordingly, the Authority should promptly approve Piedmont's proposed Service Schedule No. 317 and energy efficiency programs in order to allow the residents of Tennessee served by Piedmont to begin participation in Piedmont's proposed energy efficiency programs and to enjoy the protections afforded by both Piedmont's proposed MDT mechanism and the cap on overall returns earned by the Company as expeditiously as possible.

Respectfully submitted this 4th day of January, 2010.

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CERTIFICATE OF SERVICE

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

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This 4th day of January, 2010.

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