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IN THE TENNESSEE REGULATORY AUTHORITY
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
Petition of Piedmont Natural Gas Company, Inc. for Approval of Service Schedule No. 317 and Related Energy Efficiency Programs	))))	**DOCKET NO. 09-00104**

POST-HEARING BRIEF OF THE CONSUMER ADVOCATE

Respectfully Submitted,

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Pursuant to the directive of the Hearing Panel in this matter, Robert E. Cooper, Jr., Attorney General and Reporter for the State of Tennessee, by and through the Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate"), respectfully submits this post-hearing brief for the consideration of the Tennessee Regulatory Authority ("TRA", "Authority").

INTRODUCTION

On July 16, 2009, Piedmont Natural Gas, Inc. ("Piedmont", "Company") proposed a decoupling mechanism in tandem with three proposed energy conservation programs. In utility rate-making parlance, "decoupling", is said to break the link between profits and sales. In essence, the proposed decoupling mechanism, the Margin Decoupling Tracker ("MDT"), will transform Piedmont into a business in which revenues and profits are no longer affected by the amount of the commodity the Company sells to the public. Thus, under the banner of promoting energy conservation, Piedmont, a regulated monopoly, is proposing a mechanism that will provide an increased stream of revenue and profits for the Company.

In this proceeding, Piedmont proposed to implement decoupling for residential customers without the scrutiny of a review of its earnings and operations. The proposed decoupling mechanism is a measure which in theory will increase or decrease the charges paid by consumers to Piedmont for the delivery of natural gas which allows the Company to encourage conservation without risking revenue loss. While the theory sounds laudable, the application of the mechanism produces greater financial benefits for utilities in exchange for conservation programs which have little impact on reducing overall consumption of energy. In fact, as discussed herein, Piedmont's MDT is structured to increase rates immediately prior to the implementation of any conservation program.

The Consumer Advocate is supportive of energy conservation measures in general and supportive of the intent of the Company's proposed conservation programs. However, the Consumer Advocate cannot support Piedmont's proposed MDT as it does not comply with Tennessee policy, has no factual or evidentiary basis underlying its need and, if approved, would arbitrarily place greater burdens on Tennessee consumers out of proportion with any benefits generated from the Company's modest conservation programs. Instead, the Consumer Advocate proposes a lost base revenue mechanism which will make Piedmont financially whole from revenue loss attributable to energy conservation programs while providing financial incentives for the Company if such programs are successful and cost-effective.

Furthermore, the Consumer Advocate respectfully submits that if decoupling is adopted by the Authority, Piedmont's earnings and expenses should be reviewed and that an appropriate decoupling benchmark should be established in a rate case prior to implementation and that any mechanism approved contain a series of safeguards described herein. Finally, if any decoupling mechanism is approved, the Authority must take into account the shifting of business risk from the Company to consumers and adjust the return on equity accordingly.

The Consumer Advocate frames its position in the context of the State of Tennessee's new conservation policy enumerated in Section 53 of Public Chapter 531 enacted in 2009 ("new conservation policy"). The State's new conservation policy is as follows:

> 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.

Tenn. Code Ann.§ 65-4-126. This proceeding was initiated as a means to encourage energy conservation, a policy the Consumer Advocate supports. The Company submits the MDT is consistent with Tennessee's new conservation policy. However, Piedmont's proposal addresses only one element of the policy, the requirement to "align" the utility's financial interests with helping consumers use less natural gas. The Consumer Advocate submits Piedmont's proposal represents an over-correction of the perceived disincentive to promote energy conservation which will, in fact, over compensate Piedmont. The facts in this matter establish that the *guaranteed* financial benefits Piedmont would receive under the Company's proposal grossly outweigh any alleged benefits Tennessee consumers *may* reap under decoupling.

If the consequences of Piedmont's proposal were merely to make the Company whole from revenue loss attributable to energy conservation programs, the Consumer Advocate would not oppose Piedmont's proposal. However, Piedmont's proposed decoupling goes well beyond making the company neutral in terms of encouraging energy conservation.[1] In fact, Piedmont's

[1] Transcript of Hearing, Vol. I, p. 96 (December 17, 2009).

proposal creates an arbitrary mechanism which will raise the rates of consumers, generating a financial windfall for Piedmont greatly out of proportion with the insignificant revenue loss generated from conservation programs.

How consumers will actually benefit from decoupling is speculative.[2] Some low-income households will benefit from weatherization, as will those households that can afford a substantial investment in energy efficiency equipment while taking advantage of the Company's rebate program. While these programs may be well intentioned, they are modest in scope and impact.[3] Moreover, the programs are estimated to cause roughly $20,000 annually in financial harm to Piedmont, a sum that does not constitute a noticeable injury or financial harm to the Company's millions in revenues.[4]

On the other hand, the benefits the MDT provides to Piedmont are known and substantial. It is undisputed that had the Company's proposal been in effect since its last rate case in 2003, Piedmont's revenues would have grown by an additional $19 million and led to earnings well above the authorized return.[5] This financial windfall would have been incurred at the expense of consumers during a period when the Company had stable returns and was in fact over-earning during certain times *without* a decoupling mechanism.[6] Furthermore, if the Company's proposal is approved, rates will increase by $1.9 million in the next twelve months while the proposed conservation programs will produce $20,000 in revenue loss to the company, a result that hardly balances the interests of consumers and utilities.

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[2] Decision and Order of the Rhode Island and Providence Public Utilities Commission, Docket No. 3943, p. 70, (January 29, 2009).
[3] Direct Testimony of Dr. Dismukes, p. 18 (December 4, 2009).
[4] *Id.*, p. 19; Transcript of Hearing, Vol. I, p. 96 (December 17, 2009).
[5] To put this amount in greater perspective, Piedmont's only rate case in the last decade increased rates by $10 million in 2003 while a decoupling mechanism would have produced an additional increase in revenues by $19 million between 2003-2009.
[6] Rebuttal Testimony of Buckner, p. 4 (December 11, 2009).

Practical experience shows that decoupling mechanisms can produce extremely large rate increases and insulate a utility from economic and business risk while utility conservation programs have little, if any, measurable impact on utility revenues. Based on the Company's most recent 10-K filings, Piedmont's decoupling mechanism in North Carolina has increased the Company's overall margin by $6 million in 2009, $25.6 million in 2008 and $32.7 million in 2007.[7] In a 2008 report from the North Carolina Legislature, the North Carolina Public Utilities Commission ("North Carolina Commission") calculated Piedmont's Customer Utilization Tracker ("CUT") produced $99.1 million in additional revenue from 2005, when the mechanism was implemented, up to mid-2008.[8] Given the CUT also accounted for weather adjustments, roughly $50 million of the CUT adjustments to consumer's bills were the result of reduced usage on per customer basis due to all other factors beyond weather.[9] The North Carolina Commission attributed the CUT's significant financial results to high natural gas prices and the effects of hurricanes impacting the Gulf region.[10] Piedmont's energy conservation programs had no significant impact in reducing consumer usage or in reducing the Company's revenues.[11]

These are facts the Authority must consider in weighing whether Piedmont's proposal is designed primarily to provide the Company with more profits on a long term basis while shifting business risk to consumers and less, a policy to encourage energy conservation. Herein, the

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[7] 2009 Form 10-K of Piedmont Natural Gas Company, Inc., p. 32 (filed with the Securities and Exchange Commission on December 23, 2009).

[8] *Report of the North Carolina Utilities Commission to the Joint Legislative Utility Review Committee*, p. 6 (October 2, 2008). The Consumer Advocate would note that Piedmont's service area and customer base in North Carolina is much larger than the Company's service area and customer base in Tennessee which skews the financial results of the CUT in North Carolina when compared with Piedmont's Tennessee operations.

[9] *Id.*

[10] *Id.*

[11] *Id.*

positions, recommendations and issues the Consumer Advocate discusses are organized under the issues list outlined by the Hearing Officer.[12]

ISSUE I. The Appropriate Financial Incentive to Align the Interests of Piedmont and Consumers Under the State's New Conservation Policy

Under this issue, the Consumer Advocate proposes a lost base revenue mechanism which will align the financial interests of Piedmont to help consumers use energy more efficiently. The Consumer Advocate opposes the Company's proposed MDT for the reasons fully discussed in pre-filed testimony, at the hearing and herein. Furthermore, if the Authority concludes decoupling is appropriate, the Consumer Advocate recommends the implementation of the "Colorado Model" of decoupling and additional safeguards to protect consumers.

A. A Lost Base Revenue Mechanism With Financial Incentives for Successful Conservation Programs is the Appropriate Mechanism to Carry out the State's New Policy

The Consumer Advocate submits that a performance based mechanism that allows Piedmont the ability to recover its costs for energy conservation programs, recover non-gas revenues lost due to such programs, and allows the award of financial incentives for successful energy conservation programs aligns the financial interests of the Company with promoting energy conservation and fully complies with all elements of Tennessee's new conservation policy. The symmetry of this proposal is that it aligns the financial interests of Piedmont with those of consumers by making the utility whole for lost revenue attributable to the utility's energy conservation efforts and provides an incentive for such efforts if they are successful in producing cost-effective and measurable results.[13] In short, the higher the level of energy

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[12] *Order Granting Intervention, Determining Issues, and Establishing Procedural Schedule*, p. 2 (October 13, 2009).
[13] Direct Testimony of Dr. Dismukes, p. 4-5 (December 4, 2009).

savings achieved, the greater the financial award for the utility. Tying an explicit incentive to the promotion of energy efficiency goals gives a regulated utility a financial stake in maximizing efficiency opportunities for its customers.[14] Likewise, if consumer funded conservation programs are inefficient and wasteful, the stiffer the penalties for poor performance.

By requiring a lost base revenue mechanism with performance based incentives and penalties for conservation program efforts, the Authority would create a clear-cut financial incentive for the utility to aggressively encourage and engage in cost-effective and measurable conservation efforts. Under this framework, the Company is insulated from both the costs of conservation programs and lost revenue attributable from its conservation efforts, thereby making Piedmont effectively revenue neutral in the context of promoting energy efficiency. The financial interests are further aligned in that the Company receives a financial incentive for successful conservation programs and penalties for wasteful efforts as required. Finally, the mechanism sustains and enhances the ability of consumers to continue to reap the benefit of their own conservation efforts as required by the state's new policy.

This relatively straight-forward approach has the benefit of maintaining the incentive of Piedmont to control and manage costs. Moreover, such a proposal does not eliminate or shift to consumers a significant amount of business risk which would require an adjustment to the utility's return on equity. Arbitrary levels of fixed revenue are not guaranteed and the positive effects of regulatory lag remain in place. Furthermore, unlike Piedmont's proposed MDT, such a performance based mechanism does not create circumstances that allow utility revenues and reported returns to grow beyond that which the TRA has authorized nor require a rate case prior to implementation. A sensible avenue for the Authority in this proceeding is to reject Piedmont's proposed MDT and approve Piedmont's conservation programs in concert with a lost base

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[14] *Id.*, 24.

revenue mechanism with performance based incentives for effective results and penalties for poor performance. [15]

B. The Company's Proposed Decoupling Mechanism Is Not Just and Reasonable

Piedmont's MDT proposal is a decoupling mechanism which the Company submits is consistent with Tennessee's new conservation policy. Piedmont's proposal addresses only one element of Tennessee's new conservation policy, the requirement to "align" the utility's financial interests with helping consumers use less natural gas. If the consequences of Piedmont's proposal were merely to make the Company whole from revenue loss attributable to energy conservation programs, the Consumer Advocate would not oppose Piedmont's proposal. However, Piedmont's proposed decoupling goes well beyond making the company neutral in terms of encouraging energy conservation.[16] In fact, Piedmont's proposal creates an arbitrary mechanism which will raise the rates of consumers, generating a financial windfall for Piedmont greatly out of proportion with the insignificant revenue loss generated from conservation programs.

How consumers will actually benefit from decoupling is unknown. A small number of low-income households will benefit from weatherization, as will those households that can afford a substantial investment in energy efficiency equipment while taking advantage of the Company's rebate program. While these programs may be well intentioned, they are modest in scope and impact.[17] Moreover, the programs are estimated to cause roughly $20,000 annually in

[15] *Id.*, 32.
[16] Transcript of Hearing, Vol. I, p. 96 (December 17, 2009).
[17] Direct Testimony of Dr. Dismukes, p. 18 (December 4, 2009).

financial harm to Piedmont, a sum that does not constitute a noticeable injury to the Company's millions in revenues.[18]

On the other hand, the benefits the MDT provides to Piedmont are known and substantial. It is undisputed that had the Company's proposal been in effect since its last rate case in 2003, Piedmont's revenues would have grown by $19 million. This financial windfall would have been incurred at the expense of consumers during a period when the Company had stable returns and was in fact over-earning during certain times *without* a decoupling mechanism.[19] Furthermore, if the Company's proposal is approved, rates will increase by $1.9 million in the next twelve months while the proposed conservation programs will produce $20,000 in revenue loss to the company, a result that hardly balances the interests of consumers and utilities. These are facts the Authority must consider in weighing whether Piedmont's proposal is designed primarily to provide the Company with more profits on a long term basis and less a policy to encourage conservation.

The primary notion of decoupling presented by Piedmont is the theme that if a utility's profits are no longer dependent upon sales volume, a utility no longer has a disincentive to encourage conservation. The theory sounds laudable, however, the reality of the application of decoupling mechanisms produce financial benefits for utility stockholders substantially out of proportion with the perceived benefits of utility sponsored conservation programs. There is no economic or academic treatise endorsing decoupling as a means or as the sole solution to encourage energy conservation. On the contrary, decoupling has been characterized as a "scholarly abomination" by Professor Harry Trebing, a former director of the Institute of Public

[18] Direct Testimony of Dr. Dismukes, p. 19 (December 4, 2009); Transcript of Hearing, Vol. I, p. 96 (December 17, 2009).
[19] Rebuttal Testimony of Buckner, p. 4 (December 11, 2009).

Utilities at Michigan State University which assists in training utility commission staff at "Camp NARUC."[20]

The theories underpinning decoupling in this proceeding are "academic" or "conceptual" in that they are based on a series of abstract assumptions which are without evidentiary support as applied to Piedmont's specific circumstances. In fact, the evidence in the record reveal quite to the contrary that Piedmont has performed quite well under traditional rate-making without a decoupling mechanism. In assessing the credibility of the concepts put forth by the Company underpinning the need for decoupling, the Authority must measure such theories with the facts of Piedmont's financial performance under the ratemaking process and the reality of the financial consequences of implementing decoupling.

1. The Need for Decoupling has no Evidentiary Basis in this Proceeding

Piedmont's primary conceptual or theoretical support for decoupling is sponsored by Mr. Russell Feingold's testimony. Mr. Feingold relies upon the abstract notion that traditional rate-making is no longer sufficient in light of the business challenges of weather, decline in per customer use, wholesale gas prices, bad debt expense, promotion of energy efficiency, and infrastructure replacement, all of which introduce "variablility, unpredictability and uncontrollability" related to a utility's recovery of fixed costs.[21]

Mr. Feingold alternately refers to these business challenges as constituting a "phenomenon" and "tremendous obstacles" which prohibit utilities from achieving the authorized rate of return.[22] The great disconnect of Mr. Feingold's opinion is that he made no specific analysis for how these factors affect Piedmont or how the MDT would affect Piedmont's

[20] Direct Testimony of Dr. Dismukes, p. 22-23 (December 4, 2009).
[21] Direct Testimony of Feingold, p. 5-6 (December 4, 2009).
[22] Rebuttal Testimony of Feingold, p. 10 (December 11, 2009).

earnings and impact consumers.[23] Without a decoupling mechanism, Piedmont has overcome all of the business challenges Mr. Feingold's opinion relies upon. Contrary to Mr. Feingold's opinion, under the current rate-making process and since its last rate case in 2003, Piedmont has earned near or above the Company's authorized return. There is simply no factual basis supporting Mr. Feingold's conceptual or theoretical opinion underpinning the Company's financial need for a decoupling mechanism.

A factual and practical examination, rather than a theoretical one, reveals the business challenges Mr. Feingold asserts support the need for decoupling represent nothing more than normal business risk. These challenges are not a "phenomenon", but rather business risks that have existed for decades. Furthermore, many of these risks which have already been mitigated or have been effectively managed by utilities in general and by Piedmont. For example, the WNA accounts for the risk of weather variability, thus is no longer an "uncontrollable risk" to Piedmont. Bad debt expense can no longer be considered a "tremendous obstacle" for Piedmont to overcome as uncollectible accounts are already recovered by Piedmont from Tennessee consumers. A trend in the decline in customer usage has been recognized for decades which can hardly be called a new "phenomenon" which inhibits the opportunity for Piedmont to achieve its authorized return given the Company's reported returns since its last rate case.

While wholesale gas prices did spike during periods between 2003-2007, the recent trend in market natural gas prices has been stable while sources of domestic supply have greatly increased. Furthermore, Congress and regulators have investigated the role of non-traditional speculators in the commodities market, including natural gas market speculation, as playing a role in price volatility while efforts have been made to curtail such activities.[24] Moreover

[23] Transcript of Hearing, Vol. I, p. 89 (December 17, 2009).
[24] Hearing Transcript, Vol. I p. 55-56; 69-70 (December 17, 2009).

increased labor costs and infrastructure replacement are not new business risks, but rather typical of any operating business, regulated monopoly or within the competitive market. As to the financial harm caused by promoting energy conservation, an estimated $20,000 in lost revenue is hardly an indicator of serious financial harm.[25]

Mr. Feingold states that the recommendations and opinion of Dr. Dismukes have no support as they relate to the Company's "specific situation." However, in fact, Mr. Feingold relies upon a conceptual argument which fails to take into account any Company specific data in the record. Moreover, his claim that declining use per customer, under the current rate-making process, will financially harm Piedmont is without any factual basis. The facts speak for themselves. Since 2003, Piedmont's last rate case, consumers have been using less natural gas.[26] Yet, the Company's reported returns have been stable, and at times earnings exceeded the authorized return, as illustrated by Mr. Buckner's pre-filed testimony and at the hearing in this matter.

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[25] Direct Testimony of Dr. Dismukes, p. 19 (December 4, 2009); Transcript of Hearing, Vol. I, p. 96 (December 17, 2009).

[26] Company Response to TRA Data Request #2 (August 7, 2009); Hearing Transcript Vol. I, p. 106 (December 17, 2009).

Office of the Attorney General - State of Tennessee
TRA Docket #09-00104
Piedmont Natural Gas
MDT Calculation Model - Effect on Rate of Return

Sched. CA - 1R

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	A/	B/	C/	(1)+((2)/(3))	A/	(4)/(5)	A/	D/
Year	Reported NOI	MDT Revenue Effect	Conversion Factor	Adjusted NOI	Rate Base	Adjusted Rate of Return	Reported Rate of Return	Allowed Rate of Return
2004	$ 24,441,122	$ 2,466,542	1.640709	$ 25,944,461	$ 252,469,164	10.28%	9.68%	7.92%
2005	$ 22,408,848	$ 3,098,766	1.640709	$ 24,297,523	$ 261,664,623	9.29%	8.56%	7.92%
2006	$ 20,201,347	$ 5,617,463	1.640709	$ 23,625,149	$ 268,446,395	8.80%	7.53%	7.92%
2007	$ 19,859,975	$ 5,487,084	1.640709	$ 23,204,312	$ 266,193,602	8.72%	7.46%	7.92%
2008	$ 26,688,028	$ 1,677,511	1.640709	$ 27,710,459	$ 270,786,463	10.23%	9.86%	7.92%
12 MTD Sept 2009	$ 20,047,505	$ 693,112	1.640709	$ 20,469,952	$ 268,398,127	7.63%	7.47%	7.27%

A/ Consumer Advocate Witness Dismukes, Exhibit DED-12, Page 2 of 2.
B/ Piedmont Response to Consumer Advocate Discovery #9, Attachment 1, Line 8 Minus Line 12. (Excludes WNA effect).
C/ TRA Docket #03-00313, Settlement Agreement page 3, 8(e).
D/ 2004-2008 reflects 50 basis point risk reduction, 12 MTD Sept. 2009 reflects change in capital structure and 50 basis point risk reduction.

Hearing Transcript, Vol. II, p. 298 (December 17, 2009); Direct Testimony of Buckner, p. 16-17 (December 4, 2009). In this particular graphic, the most relevant columns are six (6) and seven (7). Column 7 is the reported rate of return of Piedmont since the Company's last rate case in 2003 showing the Company both exceeding or approaching the approved rate of return of 8.42%. Column 6 applies the MDT and its revenue effect illustrated in Column 2 to Piedmont's reported returns since 2003 to show how the mechanism would have affected Company operations. Column 6 clearly illustrates how the MDT would have allowed the Company to earn well beyond the approved rate of return of 8.42%.

While Piedmont disputes Mr. Buckner's calculations, the Company admits its average reported rate of return since 2003 has been 8.43%, an average higher than the 8.42% authorized by the TRA six years ago even as consumer usage declined.[27] The relatively straightforward facts the Company ignores is that without decoupling, Piedmont has earned its return and at times exceeding the authorized level in the face of declining customer usage. Such facts cannot

[27] Transcript of Hearing, Vol. I, p. 144 (December 17, 2009).

so easily be cast aside. There simply is no credible or factual basis supporting the theory or concept that the current rate-making inhibits the opportunity for Piedmont to achieve its authorized rate of return. On the contrary, Piedmont has had only one rate case in the past ten years speaks to the merits and success of traditional rate making with Piedmont remaining profitable without a decoupling mechanism during a decade in which consumers used less, wholesale market prices spiked and major hurricanes affected supply from the Gulf region.

In support of the MDT, Piedmont also relies upon the concept that the Company has a disincentive to promote energy conservation under a volumetric rate design as the less natural gas it sells the less likely the company is to recover its fixed costs. As a regulated public utility, Piedmont does indeed have "fixed costs" as the term is used in regulatory accounting. An example of a fixed cost is depreciation expense for plant items, such as pipes used to deliver natural gas. However, Piedmont also has variable costs which shift up and down, such as employee salaries and pension expense.[28] As illustrated by the questions of the TRA Staff during the hearing, "costs" or expenses can go up and down while impacting the Company's reported return. [29]

While these variables affect the Company's return, they do not actually have a relationship with declining customer usage. In other words, many expenses will go up or down, affecting the Company's earnings, whether consumers are using less natural gas or not. While Piedmont admits such costs go up and down and that cost elements change, the Company is requesting a mechanism which will create a fixed revenue margin on a per customer basis. Thus, a fundamental question for the Authority is whether it should fix an abstract margin per customer to recover costs which constantly change in reality.

[28] Hearing Transcript, Vol. I, p. 61 (December 17, 2009)
[29]. Id., p. 58-62

Piedmont's MDT proposal uses a "benchmark" which will allow the Company to recover a "fixed level of margin" on a per customer basis. However, there is no evidence in the record supporting a conclusion that all of Piedmont's costs are "fixed" or identifying what portion of the "fixed margin" per customer goes toward recovering any "fixed cost." Just as the MDT makes no distinction between reduction in usage from utility sponsored conservation and reduction in usage due to price elasticity and economic conditions, the mechanism's proposed fixed margin per customer makes no distinction between recovery for fixed or variable costs. Despite the fact the Company's costs (employee level, debt service, etc.) have changed since 2003, Piedmont is asking the Authority for a mechanism which will raise rates based on the recovery of "fixed costs" which after so many years has no factual basis.[30]

Indeed, when the Authority approved the 2003 rate case settlement, no party can credibly claim to have done so expecting a "margin per customer" calculation would ever be utilized from the rate case six years later as a basis for a decoupling mechanism. Indeed, Piedmont's proposal goes well beyond accounting for the effects of utility conservation programs, but rather requests the Authority to guarantee a fixed level of revenue from only one class of customers. This is indeed a paradigm shift. Currently, rates are set on a forward going basis, using a test year and an attrition year for known and measurable changes. Using this methodology, the Authority sets rates which allow a utility the *opportunity* to earn a just and reasonable return on their investment.[31] Piedmont's proposal fundamentally alters and undermines the basic tenants of rate-making in giving a utility *entitlement* to a just and reasonable return to the detriment of consumers in the name of energy conservation.[32]

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[30] *Id.*, 146.
[31] Tennessee Regulatory Authority, Docket 08-00039, Order, p. 8 (January 13, 2009) citing *Bluefield v. Public Service Commission of West Virginia*, 262 U.S. 279, 43 S. Ct. 675 (1923).
[32] Direct Testimony of Dr. Dismukes, p. 21 (December 4, 2009).

2. The Side-Effects of Decoupling Mechanisms Include a Serious Erosion of the Incentive for Utilities to Control Costs While Providing Greater Potential for Overearnings

In a competitive free market, there is a rational incentive to control the price of a product and the cost of production in order to maximize earning potential and to survive in the struggle for the market.[33] A regulated public utility, on the other hand, serves as a monopoly without direct competition in which regulation is the substitute to maintain the relationship between prices and costs.[34] An important consideration before the Authority is that by allowing an arbitrary recovery of a fixed level of revenue on a per customer basis weakens the incentive of a utility to control costs. It is a basic economic fact that rational utility management has little incentive to control costs (operational and capital) if controlling costs has no effect on the utility's profits.[35] Indeed, in 2006 the Authority concluded decoupling mechanisms remove the incentive to control costs.[36]

A major cornerstone of rate-making is the concept of "regulatory lag", which in layman's terms is the natural mismatch between utility profits going above or below the authorized level and the time of an offsetting rate increase or decrease. As a regulated monopoly with fixed rates, public utilities cannot increase rates during those periods between rate cases. As their return is not guaranteed, public utilities have an incentive to control costs which increases or helps maintain profitability. Mr. Feingold dismisses this accepted principle, insisting regulatory lag is not an incentive to control costs.[37] In doing so Mr. Feingold cites Bonbright's treatise, *Principles of Public Utility Rates*, Inc. 2d Edition, while claiming regulatory lag only relates to

[33] Bonbright, James C., *Principles of Public Utility Rates*, Inc. 2d Edition, p. 53 (1988).
[34] *Id.*
[35] Direct Testimony of Dr. Dismukes, p. 22 (December 4, 2009).
[36] Direct Testimony of Dr. Dismukes, p. 28-29 (December 4, 2009); Docket 05-00258, Transcript of Proceeding, October 26, 2006, p. 13 referencing Director Miller's written motion, attached to the transcript (p. 15 of Director Miller's motion addresses the denial of the decoupling mechanism).
[37] Rebuttal of Feingold, p. 10 (December 11, 2009).

the overall earnings of a utility. [38] However, the same treatise he relies upon clearly considers regulatory lag as an incentive for utilities to control costs.

> In the regulation of public utility monopolies, the principle that rates should be set at levels designed to yield revenues covering cost including or plus a "fair rate of return" may be regarded as a substitute, though not a close substitute, for the tendency of prices and costs to come into accord under the forces of market competition. *But where is the efficiency-incentive counterpart?*
>
> Under prevailing methods of rate regulation, such incentives are, indeed, provided to a limited degree. First, private companies *receive no guaranty* of their ability to enjoy a "fair rate of return," with the result that they may be under more or less severe pressure to practice operating economies and to stimulate growth of demand for service in order to earn the officially sanctioned rate. Second the standards of a commission-fixed "fair rate of return" are themselves somewhat flexible, and some commissions, in setting these rates, try to make allowance for supposed relative efficiency or inefficiency of operation and of financial planning. *And third, there is the so-called "regulatory lag"* – 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 rate increase may be put into effect by commission order or otherwise. (emphasis added).

Bonbright, James C., *Principles of Public Utility Rates*, Inc. 2d Edition, p. 53 (1988). Thus, regulatory lag *and* the fact a utility's return is not guaranteed are indeed a positive incentive for regulated utilities to control costs in the absence of market competition.[39] Indeed, as already discussed within, the facts show that traditional rate-making, including the concept of regulatory lag, have in action resulted in Piedmont controlling costs and generating stable and sometimes higher than authorized reported returns in face of declining customer usage since 2003.[40]

While a decoupling mechanism focuses strictly on an arbitrary "margin" per customer basis, the Piedmont's decoupling proposal does not account for the additional revenue created by customer growth. The Consumer Advocate's opposition to decoupling mechanisms proposed by utilities in the past is the fact they did not consider the off-setting effect of revenue from

[38] *Id.*, p. 11

[39] James C. Bonbright, Principles of Public Utility Rates, p. 53 (2.ed 1988). This is the same edition cited by Mr. Feingold in his rebuttal testimony.

[40] Hearing Transcript, Vol. I, p. 106, 144.

customer growth, and even to an extent allowing over-earning in revenues and return on equity.[41] Another Tennessee natural gas utility, Atmos Energy has acknowledged that while customer growth had declined recently due to the downturn in the economy, historic growth rates have been "sufficient to overcome declining customer usage due to energy conservation and more efficient homes and appliances." [42] While customer growth may be slowed by the current economic downturn, customer growth will likely rebound as the economy begins to improve.

Decoupling mechanisms ignore offsetting factors such as new revenue generated from customer growth and increased utility efficiency in company operations (i.e. lower expenses) which increase earnings.[43]

3. Piedmont's Proposed MDT Does Not Comply With Tennessee's New Conservation Policy

Tennessee's new policy statement requires changes that must "sustain or enhance" the incentive of consumers to conserve energy. However, a basic fact of Piedmont's proposed true-up process within the MDT is that the mechanism will retroactively increase the bills of consumers if they are using less natural gas for any economic reason in a prior period. Currently, when consumers use less, they save on the commodity cost and on the volumetric charge. The MDT will recapture any savings on the volumetric charge consumers as a whole save. As noted by the Virginia Commission Staff, it is questionable whether decoupling meets

[41] See Docket 07-00105, Direct Testimony of Mike Chrysler (August 22, 2007); Docket 05-00258, Rebuttal Testimony of Dan W. McCormac (August 18, 2006).
[42] See Docket 08-00197, Direct Testimony of Mr. Kevin Akers, p. 4 (October 15, 2008).
[43] See Docket 07-00105, Direct Testimony of Mike Chrysler, p.16-17 referencing exhibit MDC-C1 (August 22, 2007).

the goal of preserving bill savings to consumers who conserve.[44] In fact, decoupling would in effect eliminate some customer savings associated with individual conservation efforts.[45]

Regardless of whether an individual consumer is conserving through his or her own efforts while another consumer does little to conserve, both households, indeed all residential consumers, pay the same rate increase under the MDT. Thus, the MDT is not a mechanism which "sustains or enhances utility customers' incentives to use energy more efficiently" as required by the new conservation policy. Rather it weakens the financial reward individual consumers reap when they conserve. As recognized by the Authority, volumetric charges are important to encouraging consumers to conserve natural resources.[46]

Piedmont's proposed MDT is an incredibly broad "solution" to the perceived disincentive of the utility to promote conservation. The MDT will recover much more than revenue loss attributable from Company energy conservation programs, but rather recover all lost revenue on a per customer basis while ignoring all other revenues, including revenue from customer growth. Piedmont's MDT is premised on Mr. Feingold's theory that Tennessee's new policy requires the removal of the "throughput" incentive. However, no such support exists.

The policy does not require the removal of any perceived disincentive of a utility has to promote conservation in way that shifts business risk to consumers or produces arbitrary rate increases. The policy in no way requires implementing a decoupling mechanism with a stale benchmark which would produce an immediate increase. The policy makes no reference to insuring a utility is insulated from economic or business risk. The policy makes no reference to recovery of "fixed" costs. Rather, the policy requires only that Piedmont's financial interests be

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[44] Virginia State Corporation Commission, Case No. PUE-2008-00060, Pre-filed Direct Testimony of Cody Walker, p. 17 (September 25, 2008).
[45] *Id.*
[46] Transcript of Authority Conference, p. 37 (May 18, 2009).

aligned with helping consumer's conserve energy in a way that sustains or enhances the incentive of consumers to conserve, which the Consumer Advocate submits is accomplished with a lost base revenue mechanism associated with the Company's energy conservation programs.

Indeed, Mr. Feingold's theory that utility energy conservation policy requires eliminating the through-put incentive has been rejected. An example which is relatively on point in terms of interpreting legislative conservation policy statements in the context of the "through put" disincentive is New Mexico's consideration of decoupling. Following the passage of the Efficient Use of Energy Act ("EUE") by New Mexico's state legislature, the New Mexico Public Regulation Commission considered a decoupling mechanism. The EUE policy statement is far more detailed than Tennessee's new conservation policy in that it discusses utility disincentives.

> It is the policy of the Efficient Use of Energy Act that public utilities, distribution cooperative utilities and municipal utilities include all cost-effective energy efficiency and load management programs in their energy resource portfolios, that regulatory disincentives to public utility development of cost-effective energy efficiency and load management be removed in a manner that balances the public interest, consumers' interests and investors' interests and that the commission provide public utilities an opportunity to earn a profit on cost-effective energy efficiency and load management resources that, with satisfactory program performance, is financially more attractive to the utility than supply-side resources.

NMSA 1978, Section 62-17-3 (2005). The New Mexico policy statement is explicit in that its requires the removal of regulatory disincentives for public utilities to engage in conservation. On behalf of Public Service Company of New Mexico ("PNM") which proposed a decoupling mechanism to comply with New Mexico's Efficient Use of Energy ("EUE") state policy, Mr. Feingold put forth his theory that the New Mexico policy statement required the removal of the "through-put" disincentive through a decoupling mechanism. The EUE policy does specifically require disincentives to public utility development of conservation measures to be removed in a manner that balances the interests of consumers. However, the New Mexico Commission rejected Mr. Feingold's opinion that the EUE requires decoupling to remove the "through-put incentive" based on the actual consequences of the proposed decoupling mechanism.

> The single-minded focus on use per customer ignores PNM's overall economic picture and has negative consequences for consumers. The EUE requires that a utility be made *financially neutral.* PNM's decoupling mechanism is designed to be a *financial windfall* instead. (emphasis added).

New Mexico Public Regulation Commission, Case No. 06-00210-UT, Hearing Examiner's Recommended Decision p. 116 (May 23, 2007). The Hearing Examiner noted that despite consumers using less natural gas, PNM's revenues continued to grow and, in fact, exceeded its corresponding rate case revenue by over $34 million without a decoupling mechanism.[47] Thus, Mr. Feingold's theory that traditional rate-making no longer works and that the throughput incentive must be eliminated to encourage conservation has been rejected as it simply is not supported by facts based in reality.

In fact, the theory that removing the perceived disincentive of utilities is a necessity to promote conservation is far from gospel. Rather, the "disincentive" and the actual impact of decoupling on conservation has been called into question in the face of the benefits decoupling provides to utilities. In rejecting decoupling for the natural gas operations of Narragansett Electric Company d/b/a National Grid, the Rhode Island Public Utilities Commission measured the perceived "disincentive" versus the benefits decoupling grants to utilities.

> The fact that decoupling may eliminate a disincentive for the Company to promote conservation, even if true, does not necessarily translate into any significant reduction in consumption above what would have been achieved as a result of local and national economic pressures, technology improvements, and other extrinsic factors. Regardless of decoupling, most customers will have an incentive to conserve because reduced usage translates into lower commodity

[47] New Mexico Public Regulation Commission, Case No. 06-00210-UT, Hearing Examiner's Recommended Decision, p. 114 (May 23, 2007)

> charges for the customer, and commodity costs currently account for two thirds of the average residential bill.
>
> Revenue decoupling would protect the Company from revenue declines attributable to any cause, not only energy conservation and efficiency efforts. Decoupling would reduce the Company's revenue risk to zero, and shift the risk of revenue variations to ratepayers. While the record includes substantial evidence of the benefits of decoupling to the Company, the evidence that decoupling will benefit ratepayers is largely speculative. (internal commission order citations omitted).

State of Rhode Island and Providence Plantations Public Utilities Commission, Decision and Order, p. 69-70 (January 29, 2009). In Iowa, decoupling has been rejected as the financial performance of natural gas utilities in that state does not show a direct correlation between net operating income and declining customer usage as a result of energy efficiency programs.[48] This finding is especially relevant in that Iowa's natural gas utilities have been required to implement conservation programs since 1990. Since 1990, Iowa's Board of Utilities ("Board") has concluded that based on the financial performance of its gas utilities has not harmed by the effects of encouraging conservation.[49] The theory a "through-put" disincentive is an obstacle to promoting energy conservation was simply unsupported.

> Based upon the information reviewed by the Board in this docket, the tension between energy efficiency and Iowa natural gas utilities' opportunity to earn their authorized rate of return does not appear to be a substantial problem in Iowa.

Iowa Utilities Board, Docket No. NOI-0601, *Order Addressing Issues and Closing Docket*, p. 3 (December 18, 2006). Indeed, as other public service commissions that have looked beyond the mere slogans that decoupling *is* conservation and examined in-depth the consequences of decoupling and rejected the mechanism, the Consumer Advocate urges the Authority to consider the factual, practical effects of the MDT rather than the theoretical or conceptual

[48] Iowa Utilities Board, Docket NO. NOI-0601, *Order Addressing Issues and Closing Docket*, p. 6 (December 18, 2006).
[49] *Id.*, 3-4.

pronouncements put forth by utilities. Given the financial benefits of decoupling for utilities versus the speculative and theoretical benefits for consumers, the Consumer Advocate submits the Company's proposed MDT goes well beyond the requirement of Tennessee's new conservation policy to "align" the financial interests of Piedmont with encouraging conservation.

On its face, Piedmont's presentation in this proceeding has been nearly uniform in claiming the Company has a disincentive to promote energy conservation and that decoupling aligns the financial interests of the utility to encourage conservation. However, concerning the disincentive issue, there have been mixed and conflicting signals from Piedmont's witnesses, Company actions and from other public statements that such a disincentive exists. The Company states in pre-filed testimony it has no direct control upon customer usage. Yet, Piedmont advises investors it is focusing on building load through encouraging customers with heat pumps and electric water heaters to switch to natural gas fueled equipment to mitigate declines in new residential and commercial customers.[50] Indeed, the Company's proposed rebate program may also accomplish building load if consumers switch out electric appliances for natural gas equipment.[51] While Piedmont claims it has a disincentive to promote energy conservation, the Company stresses it does not have an incentive to *discourage* energy conservation.

> Mr. Yoho: It's doing the right thing. And its hard to get beyond doing the right thing as a company for our customers. So I guess theoretically you could think something up, but it's kind of such a contrary thought at the end of the day. Long term both from our company's and, I think everybody's perspective you do the right thing for customers.

Transcript of Hearing, Vol. I, p. 44. The Consumer Advocate would agree with Mr. Yoho's opinion on this point.

[50] 2009 Form 10-K of Piedmont Natural Gas Company, Inc., p. 23 (filed with the SEC on December 23, 2009).
[51] Hearing Transcript, Vol. I, p. 43.

While the Company may have a positive corporate culture toward energy conservation, actions speak louder than words. During the hearing, Mr. Yoho suggested the rate-stablization process in South Carolina, in essence an annual rate review, amounts to decoupling that achieves removing the disincentive to encourage conservation and would comply with Tennessee's new energy conservation policy.[52] Given Mr. Yoho's opinion that annual rate reviews remove the disincentive for promoting conservation, one would assume the Company has implemented an energy conservation program in that state to assist consumers and encourage conservation. However, while the rate stabilization process in South Carolina was initiated by statute in 2005 and been in continuous effect for Piedmont since that time, the Company has not implemented a conservation program in South Carolina.[53] Thus, even as the Company discusses "doing the right thing for consumers", while the perceived disincentive to encourage energy conservation has been removed in South Carolina Piedmont has not acted to encourage conservation. North Carolina is the only state Piedmont operates in which the Company sponsors a conservation program.[54] In any event, the conservation programs that are in place in North Carolina have not had a significant impact on Piedmont's revenues.[55]

The financial disincentive for Piedmont in Tennessee from low-income weatherization and an appliance rebate program consists of an estimated $20,000 in lost non-gas revenue. The Company claims conservation education may have more of an impact.[56] No attempt was made to estimate the impact of a conservation education program. The specifics of a conservation education program have remained vague in this proceeding. Piedmont's conservation education

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[52] Hearing Transcript, Vol. I, p. 69

[53] Piedmont Response to Consumer Advocate Discovery Request 56(a), (October 30, 2009).

[54] *Id.*

[55] *Report of the North Carolina Utilities Commission to the Joint Legislative Utility Review Committee*, p. 6 (October 2, 2008).

[56] Transcript of Hearing, Vol. I, p. 44 (December 17, 2009).

efforts in Tennessee occurred in 2008 and resulted in spending of $164,000 on television advertisements focused on educating consumers on the benefits of natural gas over electricity, an exercise that has little to do with educating consumers in ways to use less natural gas.[57]

While Mr. Yoho testified that "feedback" from conservation education programs has been positive from Piedmont's consumers, no conservation education program is listed among the programs currently in operation in North Carolina.[58] Mr. Lisk's testimony mentions only Piedmont's experience with "similar" communications programs, although they are not described in any detail.[59] The Authority should consider whether the Company's proposed "conservation education" proposal is simply the promotional cost of advertising Piedmont's other energy conservation programs to its customers. If such is the case, again, Piedmont's proposed conservation programs will only cause $20,000 in financial harm to the utility. The Consumer Advocate submits the Company's "disincentive" for these programs can be remedied and Piedmont's financial interests aligned with the interests of Tennessee consumers through a performance based lost base revenue mechanism as described earlier in this brief.

Finally, it is worth noting that Piedmont has requested the Authority to make a fundamental change to traditional rate-making in the exact manner as proposed in legislation the General Assembly considered in 2009 and did not enact.[60] While the Company presumes the MDT complies with the new conservation policy, it remains as fact that the General Assembly considered and deferred for more study legislation that would have allowed Piedmont to petition the Authority without a rate case a decoupling mechanism with a benchmark from its last rate

[57] Transcript of Status Conference, p 21. (December 14, 2009).
[58] Piedmont Response to Consumer Advocate Discovery Request 56(a), (October 30, 2009).
[59] Direct Testimony of Steve Lisk, p. 4 (December 4, 2009).
[60] HB 1349 / SB 1375 introduced in the 2009 session of the 106th General Assembly.

case.[61] The proposed legislation would also have mandated the TRA to enact the proposal.[62] The Authority should take into account that the General Assembly was neither confident in nor convinced by the proposition of encouraging energy conservation through decoupling and annual rate reviews. Similarly, the Authority is under no statutory requirement to implement decoupling as state commissions such as Virginia have been required to do.

4. The Current Regulatory Framework and Natural Gas Market Provide Piedmont With the Financial Incentive to Encourage Conservation

As a provider of natural gas, Piedmont has a long term financial interest in encouraging conservation as a means toward creating downward pressure on wholesale market prices. Given that Piedmont must compete for the heating needs of new customers with providers of electricity, the Company has an inherent interest in encouraging stable market prices in order to attract new customers in a region dominated by the relatively low cost of electricity provided by the Tennessee Valley Authority. Indeed, Piedmont and its investors recognize that increases in the price of natural gas negatively affects earnings growth from customer growth, retaining existing customers and affects working capital costs.

> The supply and demand balance in natural gas markets could cause an increase in the price of natural gas. The prudently incurred cost we pay for natural gas is passed directly through to our customers. *Therefore, significant increases in the price of natural gas may cause existing customers to conserve or motivate them to switch to alternate sources of energy as well as cause new home developers, builders and new customers to select alternate sources of energy.* Decreases in volume of gas we sell could reduce our earnings in the absence of decoupled rate structures, and *a decline in new customers could impede growth of future earnings.* In addition, during periods when natural gas prices are higher than historical levels, our working capital costs could increase due to higher carrying costs if gas storage inventories, and customers may have trouble paying higher bills leading to bad debt expenses, which may reduce our earnings.

[61] *Id.*, Section 5.
[62] *Id.*

2009 Form 10-K of Piedmont Natural Gas Company, Inc. p.6, (filed with the SEC on December 23, 2009). While the Company may submit a decoupling mechanism is in the short term interests of stockholders, Piedmont recognizes that a business that is dependent upon the sale of a commodity naturally has a long term incentive in doing what it can to create downward pressure on the commodity price to insure customer growth and greater earnings. If a business can't attract new customers or even retain existing ones, the earnings potential of the business begins a downward spiral. Thus, the Company has an interest in energy conservation to the extent that conservation measures place downward pressure on wholesale market prices.

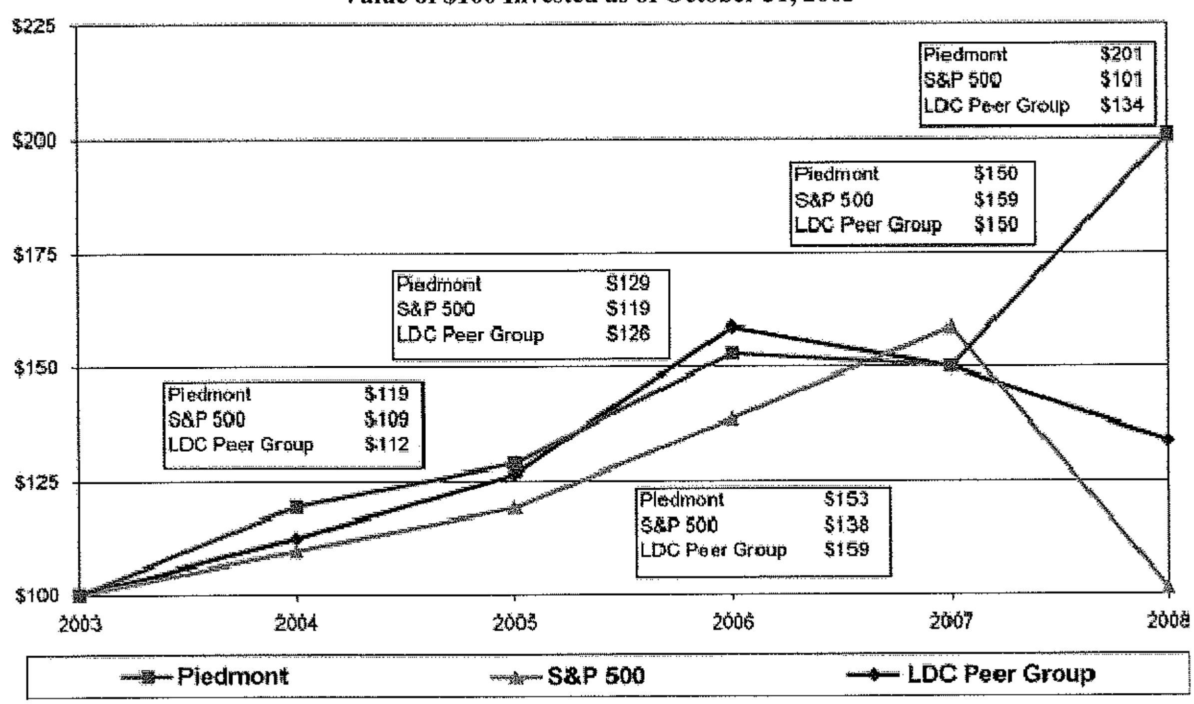
Moreover, Piedmont has a significant short term incentive to encourage conservation. A significant portion of Piedmont's business operations consists of non-regulated natural gas marketing, transportation and storage ventures. In fact, Piedmont has invested in and profited from in natural gas marketing and transportation ventures which is reported to have provided the Company with 16% of its earnings prior to taxes.[63] While the Company asserts in this proceeding it has no incentive to encourage consumers to use less natural gas, Piedmont does indeed have a financial stake in having natural gas assets available in order to market. Under Piedmont's natural gas asset management program, when consumers use less natural gas, there are more assets available to market. While consumers pay 100% of the cost for these assets, the Company retains 25% of the profits generated by these transactions with the remainder flowing back to consumers as credits on the commodity cost. Those profits retained by Piedmont do not count as regulated earnings and are therefore excluded from calculations of the Company's reported return.

[63] 2009 Form 10-K of Piedmont Natural Gas Company, Inc. p.1, (filed with the Securities and Exchange Commission ("SEC") on December 23, 2009).

A fairly basic fact is that if consumers are using less natural gas, naturally there are more assets to market and greater potential for more profits for Piedmont. Thus, a lucrative incentive already exists for Piedmont to encourage consumers to use less natural gas, especially given the increasing demand for natural gas for use in electric power generation. Given the environmental issues discussed nationwide and the relatively lower impact natural gas has on carbon emissions, demand for use of natural gas in electric generation is likely to grow.

Since 2003, Piedmont's overall financial performance has been impressive despite the economic downturn. As reported and illustrated in graph form by the Company in its annual 10-K from December of 2008 and reproduced below, between 2003 and 2008, Piedmont outperformed the S&P 500 four out of five years while outperforming peers three years out of five.

Comparisons of Five-Year Cumulative Total Returns
Value of $100 Invested as of October 31, 2003



This time period begins with 2003, the year of Piedmont's last rate case in Tennessee, covers the implementation of decoupling in North Carolina, the implementation of annual rate reviews in

South Carolina and the Company's expanded involvement in unregulated gas supply and marketing ventures. In Piedmont's most recent 10K filing covering 2009, Piedmont has again outperformed the S&P 500, returning an estimated value of $124 per $100 invested, while trailing the selected LDC peer group by a relatively insignificant amount.[64]

C. The "Colorado Model" Decoupling Mechanism

If the Authority concludes a decoupling mechanism is warranted, the Consumer Advocate would propose a mechanism based on the "Colorado Model." In 2007, the Colorado Public Utilities Commission ("Colorado Commission") considered a settlement agreement between Public Service Company of Colorado and the Office of Consumer Counsel, along with other parties. The terms of the proposed settlement agreement resolved a rate case authorized a decoupling mechanism, similar in design and intent to Piedmont's proposed MDT. The Colorado Commission expressed reservations with the decoupling mechanism agreed to by the parties. A major concern of the Colorado Commission was that decoupling mechanisms shift risk to consumers. The Commission also stressed the need, as a rate-making policy, to maintain the incentive of the utility to control costs. Indeed, these concerns were the primary drivers of the Commission to substantially modify the proposed decoupling mechanism.

> We find that the entire risk associated with declining per customer use should not be assigned entirely to Public Service's residential customers. We expect that Public Service is aware of this decline in use per customer, and should be undertaking its own internal cost reduction, becoming more efficient through process re-designs and seeking more productive uses of its labor and capital resources. Becoming more efficient in the face of declining demand for an enterprise's product is rational economic behavior for a firm.

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[64] 2009 Form 10-K of Piedmont Natural Gas Company, Inc., p. 18 (filed with the SEC on December 23, 2009). The Consumer Advocate could not utilize a similar graphic within this brief from the 2009 10K as it would have been blurred and unreadable.

Colorado Public Utilities Commission, No. 690-Gas, 06S-65G,CO7-0568, *Commission Order Approving Settlement Agreement with Modifications,* Paragraph 56 (June 18, 2007). In order to mitigate these concerns, on its own volition the Colorado Commission modified the decoupling mechanism subject to the settlement agreement.

The modification made in Colorado chiefly concerns the trigger for the decoupling mechanism to begin increasing the bills of consumers. The Colorado Commission set a threshold in which the decoupling mechanism would produce a rate increase only if customer usage declines by more than 1.3%, a value that equals half of the declining trend based on a five year average of customer usage.[65] In essence, revenue recovery is triggered only when usage per customer falls by more than 50% of a five year average of customer usage. The threshold does not remain stagnant, but rather moves in concert with historic trend with a cumulative impact. In year one the threshold is 1.3%. Reflecting a declining trend, the threshold in Colorado moves to 2.6% in year two and 3.9% in year three. [66]

The benefit of the Colorado Model is that it preserves the existing business risk relationships between the utility and consumers while taking into account the upside risk for utilities that may occur with the adoption of aggressive energy conservation measures.[67] Using a five year average for customer usage, applying the Colorado model to Piedmont would produce an initial threshold of 0.9%.[68] Using a projection based on historical figures, a Colorado style mechanism would not produce a rate increase until the third year it is in operation.[69] However, any upswing in natural gas prices or the continuing economic downturn could lower customer

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[65] Colorado Public Utilities Commission, No. 690-Gas, 06S-65G,CO7-0568, *Commission Order Approving Settlement Agreement with Modifications*, Paragraph 58 (June 18, 2007)
[66] *Id.*, paragraphs 60-62.
[67] Transcript of Hearing, Vol. II, p. 238 (December 18, 2009).
[68] Direct Testimony of Dismukes, p. 40 (December 4, 2009).
[69] *Id.*, 40-41; DED-10.

usage well beyond the annual rolling 0.9% threshold and trigger a rate increase. While the Colorado Model does not shift all business risk to consumers in the manner the Company's MDT would, a variation of the Colorado Model would offer Tennessee consumers some protection from arbitrary rate increases in the name of energy conservation.

D. Other Decoupling Safeguard Modifications

In the event the Authority adopts a decoupling mechanism, the Consumer Advocate recommends the adoption of additional safeguards to both mitigate the financial harm to consumers and encourage conservation. On behalf of the Consumer Advocate, Dr. David Dismukes proposes the following potential safeguards:

- Utilize the billing determinants estimated with more contemporaneous load and weather information that was provided by Dr. Dismukes in Exhibit DED-7.
- Include an ROE adjustment as recommended by Dr. Christopher Klein. See Argument within Issue 5 of this brief.
- Reject the Company's proposal to allow revenue recovery amounts to increase with customer growth.
- Include a consumer protection mechanism that would restrict decoupling revenue recovery amounts to only those amounts in excess of the recent changes in the Company's UPC. Revenue recovery should only occur if UPC changes by more than 0.9% percent per year and then, should be restricted to the difference between the actual UPC percent change and the 0.9 percent threshold level. *See* Discussion of the Colorado Model in subsection C of Issue 1.
- Include an additional consumer protection measure that restricts revenue decoupling accruals to no more than 2.0 percent of total revenues.
- Require a review of the decoupling mechanism in three years. The Company's decoupling mechanism should be evaluated against strong DSM performance goals. These goals should be based on the Company's performance in new, incremental energy efficiency programs that are implemented after the decoupling mechanism is initiated.

This review should include a regulatory presumption that the decoupling mechanism will be repealed in three years unless the Company has clearly demonstrated that the mechanism is not producing unjust rate increases while its disincentives for the promotion of energy efficiency have been eliminated.

- Define criteria for the decoupling review that would include: (1) an energy efficiency review; (2) a revenue deferrals and collections review; (3) a customer usage analysis; and (4) other mutually acceptable review criteria that are defined by the TRA, the Company, or other stakeholders.

Such safeguards insure a more balanced approach to encouraging energy conservation and removing the perceived "disincentive" of Piedmont to encourage conservation while protecting consumers from paying arbitrary decoupling rate adjustments.

E. Piedmont's Proposed Safeguards

Less than a week prior to the hearing in this matter, Piedmont made an "offer" to modify its proposal in the event the Authority had "concerns" implementing decoupling.[70] In rebuttal testimony on behalf of Piedmont filed on December 11, 2009, Mr. Yoho proposed a cap based on a reported return of 8.42%, an experimental period of three years and offered to fully fund conservation programs. At the hearing Mr. Yoho sponsored the proposed cap of an 8.42% return. Mr. Yoho is not an economist and is not an expert on the issue of proper rate of return and return on equity components of rate-making.[71]

In pre-filed sur-rebuttal testimony, Dr. Klein, an economist and former TRA staffer, testified on behalf of the Consumer Advocate that the proposed cap sponsored by Mr. Yoho would yield a return on equity of 11.98%. Based on available records, the Consumer Advocate submits the Authority has never authorized a return on equity of 11.98% for any regulated utility

[70] Rebuttal Testimony of Yoho, p.9-11 (December 11, 2009).
[71] Hearing Transcript, Vol. I, p. 55-56; 69-70 (December 17, 2009).

since the TRA was created in 1995. A cap that yields a return on equity of nearly 12% is not a realistic safeguard, but more akin to window dressing which will offer little if any protection for consumers.

Furthermore, the Company's offer to fund the proposed conservation programs is not so much a safeguard as it is a way to "sweeten the pot" to persuade or bargain with the Authority to adopt the MDT.[72] Indeed, Piedmont indicated very early in this proceeding that its commitment to funding is dependent upon approval of the Company's decoupling mechanism without modification.[73] In other words, if Piedmont's decoupling mechanism is not approved as proposed, the Company will reconsider contributing funds to the conservation programs. The Consumer Advocate respectfully submits that the determination of effective public policy is not a zero-sum game, but rather requires the balancing of interests for both the short and long term.

Moreover, it must be noted that implementing Tennessee's new conservation policy is not dependent upon nor envision shareholder funding for conservation, but rather calls for "timely cost recovery", a phrase implicating consumer funding, for cost-effective conservation programs that provide verifiable and measurable results. The Consumer Advocate is confident the Authority will not be persuaded by the relatively short-term benefit of company funding for conservation programs to justify a paradigm shift in rate-making policy which will have a

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[72] *Id.*, p. 183-184.

[73] Transcript of Status Conference, p. 17-18 (September 28, 2009); Piedmont Counsel: "And with respect to his proposed alternatives, I -- I guess one point that I would make is that in conjunction with this filing and in conjunction with the conservation programs that Piedmont has laid out there, they've also committed a fairly substantial amount of shareholder dollars to get those programs started. And those are -- I don't want to call them a gift, but they're essentially a donation by Piedmont to its customers to get those programs rolling and -- and to compensate for some of the initial costs of those. *You know, part of that -- the whole calculus I think involved here is that, you know, if this were a different kind of proceeding other than the way we view it, then, you know, that has the possibility to shift....*

One of the things I'm concerned about is that we go through a contested case and we get to the end of it and there's some major modification. Piedmont looks at it and goes, you know, I'm not sure we're still -- *we don't see the benefit, so I'm not sure, you know, we're willing to, you know, contribute the shareholder dollars.* And -- and that's an awkward situation for everybody to be in, particularly if we've -- if everybody's committed a bunch of effort to it." (emphasis added).

significant and long term financial impact for Tennessee consumers while yielding greater profits for natural gas utilities such as Piedmont.

ISSUE II. The Appropriate Benchmark for Any Approved Decoupling Mechanism

A decoupling mechanism requires a benchmark as a starting point for customer usage. As a tracking mechanism intended to adjust rates, by necessity there must be a benchmark from which to measure and compare customer usage in order to determine the rate adjustment for consumers. Piedmont's proposed MDT applies a benchmark based on a normalized customer usage level used to set rates during Docket 03-00313, the Company's last rate case in 2003. Six years have passed since that time. Customer usage levels have changed, weather patterns have been generally warmer and state of the economy is significantly different.

If the Authority determines decoupling is appropriate in this matter, the next question the TRA must consider is the appropriate benchmark to apply to the mechanism. The determination of the appropriate benchmark for a decoupling mechanism is an essential decision if a decoupling mechanism is approved. The Authority must consider whether it is just and reasonable to apply an old benchmark, which will have an immediate and significant increase in consumers bills or whether a recent benchmark, reflecting up to date weather data and reflecting the current economic conditions, is in the public interest.

An obvious concern in this matter is the prospect of allowing a decoupling mechanism to be implemented without a rate case while applying a stale benchmark used to set rates in 2003. This very scenario has been played out in neighboring Virginia with disappointing results for consumers pursuant to the Natural Gas Conservation Act enacted by Virginia's legislature in 2008. Under this very specific state statutory directive, regulated natural gas utilities are permitted to petition the Virginia State Corporation Commission ("Virginia Commission") for a decoupling mechanism without a rate case while permitting the use of benchmarks from previous rate-making proceedings. In 2008, the first decoupling mechanism approved by the Virginia Commission for Virginia Natural Gas Company applied a test year from 2005, as required by the new statute. The initial results of the mechanism has allowed VNG to collect additional revenue of nearly $4.7 million in its first year in operation, a result the Virginia Commission attributes to the use of a "stale test year" as required under the Natural Gas Conservation Act.[74]

In the context of applying a stale test year, the Virginia Commission further noted the disparity in the amount of revenue generated by the decoupling mechanism and the amount of natural gas estimated to have been conserved by the utility's conservation programs.

> In VNG's case, the test year used in establishing the annual, weather normalized nongas commodity revenue per customer was the twelve months ending March, 2005. VNG's average normalized non-gas revenue per customer has declined significantly since that time due, at least in part, to customer efficiency efforts. As noted above, VNG's decoupling mechanism will compensate the Company for energy reductions of approximately 10 million Ccfs while VNG's own estimates indicate that its programs have generated reductions of less than 116,000 Ccfs. As such, use of the specified non-gas revenue as required by the Natural Gas Conservation Act provides significant additional revenue to VNG over and above compensation needed to offset lost revenues attributable solely to VNG's efficiency efforts.

Virginia State Corporation Commission -*Report: Implementation of the Natural Gas Conservation and Ratemaking Efficiency Act*, p. 18 (December 1, 2009). Thus, by use of applying a stale test year, a utility will receive a financial windfall greatly out of proportion to the benefits consumers are estimated to have received from utility conservation programs. While utilities generally argue that decoupling "cuts both ways" and can produce credits for consumers if usage goes up, by using a stale test year a utility is assured that a decoupling mechanism will

[74] Virginia State Corporation Commission - *Report: Implementation of the Natural Gas Conservation and Ratemaking Efficiency Act*, p. 17-18 (December 1, 2009). Copy attached to Rebuttal Testimony of Buckner, (December 11, 2009).

overall create rate increases rather than credits for consumers. The effect of using a stale test year skews and enhances the benefits of the stockholders of Piedmont. While the Virginia Commission was specifically required to apply a stale test year under the Natural Gas Conservation Act, Tennessee's new conservation policy in no way ties the hands of the Authority to implement decoupling or in any way suggest authority to do so using a stale test year.

Piedmont's proposed MDT applies a benchmark from its last rate case in 2003, a benchmark which will raise consumers' rates and more than likely never produce refunds for consumers. Since 2003, Tennessee consumers have been using less natural gas through their own efforts. Given that consumers have already been using less natural gas, the result of applying Piedmont's stale benchmark has the undisputed financial impact of raising the bills of residential consumers and the company's revenues by $1.9 million.[75] Again, the wide disparity of the benefits of Piedmont's decoupling proposal is illustrated. Company revenues would grow by $1.9 million in the next twelve months, a sum more than over-compensating the estimated $20,000 in financial harm from the proposed conservation programs if the programs are successful.

In the event the Authority adopts the proposed MDT or a modified decoupling mechanism, the Consumer Advocate respectfully submits the agency should adopt a weather normalized usage level based on up to date data. The Consumer Advocate submits that if decoupling is adopted, at a minimum a test year ending September, 2009 is the most logical and sound benchmark available which more closely reflects the current economic conditions facing consumers and updated weather normalized customer usage data. The use of such a test year

[75] Direct Testimony of Buckner, p. 14 (December 4, 2009).

will have a significantly lower and immediate financial impact on the bills of Piedmont's residential consumers.[76]

The required components for the benchmark, whether using the Company's proposed mechanism or a modified decoupling mechanism, are Monthly Normal Heating Degree Days ("HDD"), a Base Load Factor, a Heat Sensitivity Factor and an R Factor which is the applicable volumetric rate.[77] The Consumer Advocate has calculated updated Base Load Factor, Heat Sensitivity Factors and R Factors. These components, in concert with an updated WNA, provide a benchmark/test year which produces a more balanced approach to provide some relief for consumers in that Piedmont is not guaranteed a financial windfall the first year the mechanism could go into effect.

ISSUE III. The Need For a Rate Case Prior to Implementing a Decoupling Mechanism

Piedmont's last rate case took place in 2003. In the last ten years, Piedmont has had only one rate case. During this time, Piedmont has earned near or exceeded its reported rate of return without a decoupling mechanism even as consumers used less natural gas.[78] In this proceeding, Piedmont is requesting a decoupling mechanism based on a "fixed margin" and cost of service determination dating from the 2003 rate case. When rates are set, the matching principle is utilized in order to match all expenses and investment in plant property with all revenues. [79] The rate-making formula for arriving at the revenue requirement used to set rates is as follows:

> Revenue Requirement = (Rate Base X Rate of Return) + Operations and Maintenance Expense + Depreciation Expense + Taxes.

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[76] Id., p. 11; Rebuttal Testimony of Buckner, p. 3 (December 11, 2009).
[77] Direct Testimony of Buckner, p. 9 (December 4, 2009).
[78] Id., 16-17: Direct Testimony of Dr. Dismukes, DED 12, p.2 of 2 (December 4, 2009); Hearing Transcript, Vol. I, p. 144 (December 17, 2009).
[79] Direct Testimony of Buckner, p. 6-7 (December 4, 2009).

A test year is utilized to show expenses and revenues which produce a snap shot for a specific period. An attrition year, going forward, is then projected with adjustments to both revenues and expenses for known and measurable changes.[80] Using a snapshot in time, expenses, revenues and the return are all matched to arrive at the revenue requirement. Each component is dynamic and *will* change. Indeed, various components of used to fix the revenue requirement in 2003 in Piedmont's 2003 rate case have changed.[81] The record in this matter does not show the multitude of elements of the revenue requirement that have changed or that they remain just and reasonable. The Company is in essence asking the Authority to conclude the cost of service and revenue requirement authorized in 2003 remains just and reasonable without a factual basis or a review.

It is known that Piedmont has incurred more 33% more long term debt which changes the capital structure of the Company.[82] For utility consumers, debt is generally cheaper than the return paid for utility equity. In the same vein, the interest rate approved for Piedmont's long term debt are lower than the interest rate built into the cost of service set in 2003.[83] It also known that Piedmont's overall workforce has decreased by some 200 employees.[84] How all other elements that were used to develop the 2003 revenue requirement have changed and whether Piedmont's current expenses are prudently incurred, just and reasonable are unknown based on the record. Yet, Piedmont is asking the Authority to accept on faith a review of the cost of service and the Company's earnings are not needed.

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[80] *Id.*
[81] Transcript of Hearing, Vol. I, p. 146 (December 17, 2009).
[82] *Id.*, 145.
[83] *Id.*, 145-16.
[84] *Id.*, 154.

Decoupling mechanisms track only one rate-making facet, the "margin" per customer based on the 2003 rate case settlement. The mechanism does not track revenues from the commercial or industrial classes, but rather the rate increases the MDT will produce will fall squarely on the residential class. In this proceeding, no other facet of revenues or levels of expenses are examined. This is by definition "single issue" or piece-meal rate-making. Single issue rate-making is generally prohibited outside the context of a rate-making proceeding, as it is improper to adjust rates for one expense or investment in isolation *without* looking at other elements that go into calculating the revenue requirement. *Business and Professional People for the Public Interest v. Illinois Commerce Commission*, 585 N.E. 2d 1032, 1061-1062 (Ill.1991).

In other words, adjusting rates or implementing a rate tracking mechanism without a rate case simply because one expense or revenue category goes up or down without looking at the entire litany of revenues, expenses and rate of return is not permitted. Piedmont's proposed MDT is an extreme form of single issue rate-making is that the proposal is not based on any isolated or rising expenses, but rather based on guaranteeing revenue with a "fixed level of margin" starting in 2010 based on a cost of service which was set in 2003 that has not been reviewed for changes or reasonableness. This proposed form of piece-meal rate-making has been recognized as a major concern. In 2006, the Nebraska Commission recognized the possibilities of increased rates and risk shifting from decoupling:

> Automatic rate mechanisms raise concerns of piecemeal rate making by adjusting for only one element of cost without accounting for other increases and decreases in costs incurred by the utility. Such automatic mechanisms can lead to excessive rates, an inappropriate shifting of risks from stockholders to ratepayers, and decreased incentives to operate efficiently. Therefore, their use should be limited."[85]

[85] In the matter of Aquila, Inc. d/b/a Aquila Networks (Aquila) Omaha, seeking individual rate increases for Aquila's Rate Area One, Rate Area Two, and Rate Area Three. Before the Nebraska Public Service Commission. Application No. NG-0041. July 24, 2007.

Nebraska Public Service Commission, Application No. NG-0041. (July 24, 2007). In response to these arguments, Piedmont put forth the proposition that a rate case is not needed as MDT recovers the "margin" per customer was authorized by the Authority in the 2003 rate case. This self-serving argument fails to consider that the cost of service approved in 2003 has changed. The Consumer Advocate is concerned Piedmont's proposal is simply a way to avoid scrutiny of their rates and the MDT will function more as a "bridge" between rate cases than encourage energy conservation.[86] Piedmont addresses this concern by arguing rate cases are expensive for consumers and only benefit "lawyers and consultants." However, rate case expense should be considered in its proper context. Piedmont's last rate case included approximately $300,000 in rate case expense. This amount was recovered from consumers on an amortized basis over three years, roughly $100,000 annually.

This figure pales in comparison to the $1.9 million Piedmont would receive within the next twelve months should the MDT be approved without any scrutiny of the Company's earnings, other revenues and expenses. In fact the rate case expense from 2003 is swallowed whole by the $19 million the Company would have collected had the MDT been approved in 2003. Furthermore, there is no evidence decoupling will reduce the need for rate cases. In 2008, after three years of decoupling, Piedmont requested a $40 million rate increase and a return on equity of 12% in North Carolina. The Company settled for far less with a $15 million increase and a return on equity of 10.6%. [87]

Of course, rate case expense is entirely controllable. Factors that can drive higher rate case expense include when utilities request unreasonably high rate increases and rates of return

[86] Transcript of Hearing Vol. I, p. 47-48 (December 17, 2009).
[87] *Id.*, p. 162-163.

and returns on equity which the Authority has never approved.[88] Factors that can lower rate case expense include settlements prior to a contested hearing which, fortunately, seven of the last ten natural gas rate cases in Tennessee during the previous decade have ended with Authority approval of settlements between utilities and the Consumer Advocate. Furthermore, if rate case expense is unreasonable, the Authority has the discretion to disallow all or any portion of the sought after expense.

ISSUE IV. The Implementation of a Decoupling Mechanism Shifts Business Risk from Piedmont to Consumers Which Requires Adjustments to the Company's Return on Equity

Dr. Chris Klein provided pre-filed testimony concerning the effects that decoupling would have on the return Piedmont should be authorized to receive. He concluded that two separate adjustments to Piedmont's return would be required to offset the effects of implementing the decoupling mechanism originally sought by Piedmont. Those were a 100 basis point downward adjustment to return on equity (ROE) to offset the immediate effects of decoupling and a 50 basis point downward adjustment to ROE because of the reduced risk faced by Piedmont.[89] Those adjustments were independent of one another and cumulative.

The modified proposal made by Mr. Yoho in his rebuttal testimony included a cap on Piedmont's ROE which Dr. Klein concluded eliminated the need for the 100 basis point reduction in ROE. However it did not eliminate the need for the 50 basis point reduction in ROE caused by the reduced risk faced by Piedmont if the decoupling proposal is implemented.[90] The

[88] For example, Piedmont settled the 2003 rate case for a $10 million increase, a sum significantly less than the nearly $20 million increase the Company sought.
[89] Direct Testimony of Klein, p. 6 (December 4, 2009)

[90] Sur-Rebuttal Testimony of Klein, p. 3 (December 15, 2009)

rationale for and calculation of the remaining 50 basis point reduction in ROE is explained more fully herein.

Dr. Klein used Piedmont's own initial filings to examine whether the guarantee of Piedmont recovering a set margin per customer under the decoupling mechanism sought by Piedmont reduces the business risk faced by Piedmont. As Dr. Klein explained in his direct testimony, Piedmont's own words showed that Piedmont "does intend for the decoupling mechanism to reduce its business risk."[91] According to Dr. Klein, the conflict between the positions of Piedmont and the Consumer Advocate was on the significance of that reduction in risk.

Dr. Klein's conclusion was challenged in the rebuttal testimony filed on behalf of Piedmont by Mr. David Dzuricky. Mr. Dzuricky is the Senior Vice President and Chief Financial Officer (CFO) of Piedmont and in that position he is responsible for accessing the capital markets to raise the capital that Piedmont needs to fund its ongoing projects.[92] He states that it is his opinion that the presence or absence of a decoupling mechanism has "never been specifically identified as a general business risk mitigator" by the capital markets.[93] He went on to say that he had never been asked by a risk rating analyst about decoupling and that he concluded that it was not a "critical factor" in their overall analysis of natural gas distribution companies.[94]

On cross-examination, Mr. Dzuricky was shown Exhibit 5, a review of Piedmont by Standard & Poors, one of the premier rating agencies. That report favorably mentioned the

[91] Direct Testimony of Klein, p. 10 (December 4, 2009)

[92] Rebuttal Testimony of Dzuricky, p. 1, 3 (December 11, 2009)

[93] *Id.*, p. 3 (December 11, 2009)

[94] *Id.*, p. 3.

reduced volatility of cash flow caused by Piedmont's decoupling mechanism in North Carolina and went on to say that operations with more volatile cash flow were viewed as more risky. Mr. Dzuricky initially dismissed the Standard & Poors report and indicated that he had other knowledge that outweighed the words in the report.[95] However, upon further questioning Mr. Dzuricky finally accepted the proposition that where all other risk factors are held constant, as with Piedmont's proposal since it is not part of a general rate case allowing a review of all factors affecting risk, that guaranteeing Piedmont's margin for all residential customers would reduce its risk. He continued to assert that any such reduction was not significant.[96] He offered no other evidence to support his conclusion other than his experience in dealing with capital markets.

Once it is accepted that adoption of the decoupling mechanism will guarantee Piedmont its called for margin for each customer and thereby reduce or eliminate its risk that it will fail to recover that margin, then all that is left is to quantify that reduction in risk. Neither Mr. Dzuricky nor any other Piedmont witness made any attempt to provide any evidence of the size of the risk reduction, leaving only Dr. Klein's regression analysis to clarify the effect that decoupling has on Piedmont's business risk.[97]

In order to isolate the effect that one variable, in this case the effect of decoupling, has on an outcome, a linear regression analysis is called for. Dr. Klein, an economist by training and profession did just such an analysis to isolate and quantify the reduction in business risk that Piedmont will face if the Authority adopts the proposed decoupling mechanism.[98] In his direct

[95] Hearing Transcript, Vol. II, p. 212-3 (December 18, 2009)

[96] Hearing Transcript, Vol. II, p. 218-9 (December 18, 2009)

[97] Rebuttal Testimony of Dzuricky, p. 6 (December 11, 2009)

[98] Direct Testimony of Klein, p. 13 (December 4, 2009)

testimony Dr. Klein lays out the analysis he performed to run the linear regression analysis. He first utilized the Capital Asset Pricing Model (CAPM) to derive the change in ROE caused by implementing the decoupling mechanism. He then ran a regression analysis to isolate the changes in the standard deviation when the variation caused by variations in residential customer usage is removed by the decoupling mechanism.[99] From these analyses, Dr. Klein reached his conclusion on the appropriate reduction to ROE necessitated by the reduction in risk flowing from the decoupling mechanism.

After finding that a risk reduction of 10% is a conservative one, Dr. Klein's analysis found that a 10% risk reduction yields a change in ROE of between 48 and 62 basis points. Accordingly, Dr. Klein recommends that the Authority reduce Piedmont's allowable ROE by 50 basis points to offset the effects decoupling has on the business risk faced by Piedmont.[100] This reduction in ROE would lead to a reduction to Piedmonts Rate of Return (ROR) to 7.27%. This is well below the 8.42% ROR cap proposed by Mr. Yoho and illustrates why Piedmont's amended proposal provides only illusory protections for consumers.[101]

In summary, Piedmont initially, through Mr. Dzuricky, asserts that the capital markets do not consider decoupling as a "critical factor" in assessing the risk faced by natural gas companies like Piedmont. However, when faced with the evidence that at least one rating agency (Standard & Poors) found it to be significant enough to specifically mention in its review of Piedmont, as well as the inescapable logic that where one risk is reduced and all others held constant that the overall risk to a company has to decrease, Piedmont conceded that decoupling might reduce risk.

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[99] Direct Testimony of Klein, p. 12 (December 4, 2009)

[100] Direct Testimony of Klein, p. 15 (December 4, 2009)

[101] Sur-Rebuttal Testimony of Klein, p. 3 (December 15, 2009)

Piedmont continued to assert that any such reduction was not significant but provided no evidence of quantification. Dr. Klein provided the proper economic and analytical framework for a review of the reduction in risk. Using the tools available to an economist he isolated the effect on ROE caused by eliminating the risk of not meeting the margin per customer and found that a 50 basis point reduction in ROE is called for to balance the reduced risk faced by Piedmont if decoupling is ordered by the Authority. He further calculated that would result in an appropriate ROR of 7.27% and that Piedmont's offer to cap ROR at 8.42% provided no protection for consumers.

Should the Authority find that Piedmont's amended proposal is both warranted and consistent with Tennessee's Energy Conservation Policy, then a reduction in Piedmont's allowed ROE of 50 basis points is required to keep Piedmont from being handed a windfall at consumers' expense.

ISSUE V. Tennessee's Energy Conservation Policy Requires Cost-Effective, Measurable and Verifiable Energy Conservation Programs

As part of its Petition, Piedmont has offered to implement three different programs aimed at encouraging energy conservation. The three are: (1) a residential low-income program; (2) a high efficiency equipment rebate program; and (3) a customer education program.[102] Piedmont originally called for the programs to be paid partly by Piedmont and partly by consumers. However, the proposal was subsequently amended to require the entire amount for the programs to be paid by Piedmont.[103] While these programs are somewhat specific, they are neither fully verifiable nor accurately measurable, and do not justify the implementation of a decoupling

[102] Direct Testimony of Lisk, p. 2 (December 4, 2009)

[103] Rebuttal Testimony of Yoho, p. 10 (December 11, 2009)

mechanism and the consequent fundamental change in rate structure that Piedmont is asking the Authority to approve.

The first program proposed by Piedmont is a residential low-income program which is designed to provide weatherization assistance to 40 to 50 consumers each year at an annual cost of $150,000. It is patterned after the Federal Weatherization Assistance program and Piedmont's own experience in operating a similar program in North Carolina.[104] Despite the fact that the proposed program is modeled on existing programs, Piedmont is unable to provide any Tennessee-specific estimates or data to quantify any savings attributable to the program. Piedmont, through Mr. Lisk, did offer some general national statistics on the benefits of the federal program, but none of the savings data was analyzed to show what, if any, savings would flow from the program in a climate like that in Tennessee.[105] Savings will, of course depend on the severity of winter weather, cost of gas and many other regional factors that are simply not accounted for in the general federal data that Piedmont provides as support for this program. Even with its own experience in neighboring North Carolina, Piedmont was unable to provide any specific data, targets or goals for savings attributable to helping 40 to 50 families weatherize their homes each year. While any help to low income families is laudable, the program proposed by Piedmont is not a measurable or verifiable program that warrants a change in the way Tennesseans pay for their natural gas.

The second program is a high efficiency equipment rebate program. Piedmont proposes to spend $100,000 on rebates, varying from $50.00 to $300.00, to qualifying customers who buy high efficiency appliances. For this program Piedmont does provide some basis to analyze the

[104] Direct Testimony of Lisk, p. 3 (December 4, 2009)

[105] Hearing Transcript, Vol. I, p. 170-2 (December 17, 2009)

effectiveness of the program. However, the analysis omits a majority of the standard tests for such programs. The cost effectiveness of equipment rebate programs is best measured by the methods spelled out in the California Standard Practices Manual.[106] As the testimony bears out, the California Standard Practice Manual has five separate tests to measure the cost effectiveness of the program. These tests are: (1) the participant cost test (PCT) which measures the costs to people who participate in the program; (2) the utility cost test (UCT) which measures the costs to the utility; (3) the ratepayer impact test (RIM) which measures the effect on ratepayers generally; (4) the total resource cost test (TRC) which blends all cost factors; and (5) the societal cost test (SCT) which measures the costs to society as a whole.[107]

Piedmont chose to run only the utility cost test (UCT) which measures the costs to the utility (Piedmont) and the total resource cost test (TRC) which is a blend of all factors. Both of these tests showed a positive cost effectiveness for the program. However, Piedmont did not see fit to run the tests called for in the California Standard Practices manual that tested the costs to program participants (PCT), ratepayers (RIM) or society at large (SCT).[108] Piedmont sees fit to measure the costs to themselves, but did not provide the Authority with any measurement of the cost effectiveness of the program to the individual participants, ratepayers in general or to society. The only measurement besides how cost effective it was to Piedmont was the TRC test which blended all factors, including the effect on Piedmont. By focusing on the effects of the program on itself, Piedmont has not provided the Authority with sufficient ability to measure and

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[106] Direct Testimony of Dismukes, p. 64-7 (December 4, 2009); Rebuttal Testimony of Lisk, p. 1 (December 11, 2009)

[107] Rebuttal Testimony of Lisk, p. 2 (December 11, 2009)

[108] Hearing Transcript, Vol. I, p. 172-4 (December 17, 2009)

verify the effect the proposed program will have on customers and ratepayers to satisfy the requirement that the energy efficiency programs be measurable and verifiable.

The final program that Piedmont proposes is consumer education. Piedmont proposes to spend $100,000 on targeted marketing techniques to promote energy efficiency and to publicize available programs.[109] Piedmont did not attempt to provide any cost effectiveness testing for this program.[110] Therefore, Piedmont has not given the authority any means to measure or verify the effectiveness of this program. Once again, Piedmont has not justified the change in rate structure that it seeks.

Finally, Piedmont proposes to do "after the fact" evaluation of the three programs to justify their adoption. However, Piedmont provides no specifics about who will do the testing or even what the tests will be. Rather Piedmont offers that it will "contract with a third party consultant to perform appropriate Evaluation, Measurement and Verification" of the weatherization and the equipment rebate programs.[111] No company or testing procedures have been selected at his point.[112]

Piedmont is asking the Authority to change the way Tennessee ratepayers are billed for services the Company performs, all in the name of energy efficiency. The specific programs it offers to increase energy efficiency are neither measurable nor verifiable. Piedmont has not justified the change it seeks.

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[109] Direct Testimony of Lisk, p. 4 (December 4, 2009)

[110] Rebuttal Testimony of Lisk, p. 4 (December 11, 2009)

[111] Rebuttal Testimony of Lisk, p. 8 (December 11, 2009)

[112] Hearing Transcript, Vol. I, p. 176-7 (December 17, 2009)

ISSUE VI. The 2007 PURPA Standards

During this expedited proceeding, neither the Company nor the Consumer Advocate has had a great deal of time to consider and study the standards. The Consumer Advocate submits the PURPA standards are fairly broad. Adoption requires an examination of the standards their application to consumers and public utilities. On this point, the Consumer Advocate and the natural gas industry agree.[113] In regard to the revenue decoupling standard the PURPA requires the Authority to consider, the Consumer Advocate urges the TRA to reject the standard for the reasons briefed herein. Furthermore, the Authority should be wary of adopting federal standards as doing so weakens the discretion the state legislature has bestowed upon the TRA to regulate the state's public utilities.[114]

CONCLUSION

The Consumer Advocate submits that a performance based revenue mechanism that makes Piedmont whole from revenue loss attributable to Company conservation programs aligns the financial interests of Piedmont with helping consumer use less natural gas. Moreover, if Piedmont's conservation programs are cost-effective and produce verifiable and measurable results, the Consumer Advocate supports the development of a financial incentive based the savings such programs produce for consumers. The Consumer Advocate opposes Piedmont's MDT as the mechanism goes well beyond Tennessee's new policy and over corrects any perceived disincentive to promote energy conservation.

Implementing decoupling mechanisms for Tennessee's natural gas utilities in the name of energy conservation is an action which constitutes a paradigm shift in how such utilities are regulated. In rejecting decoupling, the New Mexico Public Regulation Commission warned

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[113] See Comments of Piedmont, Atmos Energy, Chattanooga Gas and the Consumer Advocate in Docket 09-00065.
[114] Hearing Transcript, Vol. II, p. 246 (December 18, 2009).

against such "new paradigms" that have proven expensive, noting the experience of those states that were convinced by the theory electric deregulation would lower rates only to have endured major electric rate increases and a failed and ultimately very unpopular policy.[115]

The Authority must not make the mistake of concluding that decoupling is "revenue neutral" or will not increase the bills of consumers. When the Virginia Commission approved decoupling under very specific requirements of legislation in 2008, the fact that consumers would pay more weighted heavily on the Commission.

> If a customer's bill goes up, calling it a sales adjustment- as opposed to a rate increase- does not change the fact that the customer's bill is higher than it otherwise would have been. As a result we must acknowledge that while customers' "rates" technically may not change as a matter of legal analysis under the Act, the actual effect of VNG's sales adjustment clause (i.e., the RNA rider) may be increases in many customers' bills versus what they would have been under the PBR Plan, which we approved in 2006 with the expectation that we were ensuring "rate certainty" as represented by VNG....This is especially relevant at a time of economic hardship when many of VNG's customers are struggling to pay their monthly bills and may be facing tremendous uncertainty about their employment security.

Order Approving Natural Gas Conservation and Ratemaking Efficiency Plan, p. 26, Virginia State Corporation Commission, Case No. PUE-2008-00060 (December 23, 2008). Indeed, the Virginia Commission has reported that VNG's decoupling mechanism has produced $4.7 million in additional revenue for the utility in the year the mechanism has been in effect while the "estimated" impact of the utility's conservation program has been relatively minimal.[116] Piedmont's proposed MDT will increase the bills of Tennessee consumers by an estimated $1.9 million in the next twelve months while Piedmont *may* suffer $20,000 in lost revenue if the proposed conservation programs are successful.

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[115] New Mexico Public Regulation Commission, Case No. 06-00210-UT, p. 118 (May 23, 2007).
[116] Virginia State Corporation Commission - *Report: Implementation of the Natural Gas Conservation and Ratemaking Efficiency Act*, p. 17 (December 1, 2009).

The Authority must take into account the disproportionate benefits in favor of stockholders that Piedmont's proposal entails to the detriment of consumers. The current economic conditions for consumers are unyielding with rising unemployment and home foreclosurer rates. The Authority must consider whether implementing Piedmont's MDT is a balanced approach for not only the reasons described herein, but also the economic conditions facing residential consumers. While decoupling mechanisms have been framed by the natural gas industry as an issue that is essential to energy conservation, it is incumbent upon the Authority to delve into the details of the actual financial consequences of decoupling, its actual impact on energy conservation and its real effect of shifting business and economic risk to consumers.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

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

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