

IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:)	
)	
PETITION OF PIEDMONT)	
NATURAL GAS COMPANY, INC.)	DOCKET NO. 14-00086
FOR APPROVAL OF A CNG)	
INFRASTRUCTURE RIDER TO)	
ITS APPROVED RATE)	
SCHEDULES AND SERVICE)	
REGULATIONS)	

POST-HEARING BRIEF OF THE CONSUMER ADVOCATE

The Consumer Advocate and Protection Division of the Office of the Attorney General (“Consumer Advocate”) respectfully submits this Post-Hearing Brief in Tennessee Regulatory Authority (“TRA” or “Authority”) Docket No. 14-00086, *Petition of Piedmont Natural Gas Company, Inc. for Approval of a [Compressed Natural Gas (“CNG”)] Infrastructure Rider to its Approved Rate Schedules and Service Regulation* (“Petition”), as consolidated with TRA Docket 14-00087, *Petition of Piedmont Natural Gas Company, Inc. regarding a Tariff to Revise the Natural Gas Vehicle Fuel Tariff and Introduce an Experimental Motor Vehicle Fuel Service Tariff* (“Tariff Filing”), pursuant to an *Order Consolidating Dockets and Amending Procedural Schedule* filed on November 6, 2014.

I. INTRODUCTION

Piedmont Natural Gas Company, Inc. (“Piedmont” or “Company”) is a public utility regulated by the Authority and is engaged in the business of transporting,

distributing, and selling natural gas in the State of Tennessee.¹ This is Piedmont's second petition under the new alternative regulation statute, as codified at Tenn. Code Ann. § 65-5-103(d). In TRA Docket 13-00118, Piedmont sought and, after working with the Consumer Advocate, obtained approval from the Authority for an Integrity Management Rider under the alternative regulation statute. In this TRA Docket 14-00086, Piedmont again seeks to utilize the alternative regulation statute. In this case, Piedmont requests approval of a CNG infrastructure rider that would enable it to charge regulated natural gas customers – the rate payers who use natural gas to heat their homes and cook their meals – increased rates that would be used by Piedmont to build and operate CNG fueling stations to service CNG retail customers.

In addition, Piedmont seeks to amend an existing rate schedule to establish rates that would enable Piedmont to provide CNG services to CNG customers at CNG facilities operated by Piedmont. Piedmont further proposes to add a new rate schedule that would assist in determining the relative need for CNG-related services and additional CNG facilities, as well as facilitate wholesale natural gas sales and services to customers who intend to compress the gas using their own equipment.

The Consumer Advocate contends that Piedmont's proposed infrastructure rider does not meet the requirements of the alternative regulation statute. Furthermore, even if the TRA determines that the technical requirements of the statute are met, Piedmont has failed to meet its burden of proof that the

¹ Petition, page 2, paragraph 2.

infrastructure rider would be in the public interest because the infrastructure rider (i) would create a subsidy without quantified counterbalancing benefits, (ii) would be harmful to the development of the competitive CNG market, and (iii) would create barriers to entry to that market. Finally, in view of the competitive characteristics of the CNG market and the CNG product, Piedmont has not shown that the CNG business should be considered a regulated business. Consequently, the Consumer Advocate respectfully recommends that the Authority deny Piedmont's request for the infrastructure rider to build and operate CNG stations, as currently written; discontinue and terminate the existing rate schedule with respect to Piedmont providing CNG services to CNG customers at CNG facilities operated by Piedmont; and approve the new rate schedule that would assist in assessing the CNG market and would facilitate wholesale natural gas sales and services.

II. BACKGROUND

A. TRA Docket 14-00086 – The Infrastructure Rider Petition

On August 29, 2014, Piedmont filed the Petition asking the TRA to approve a new CNG infrastructure rider in its tariff to allow it to recover capital expenditures incurred as the result of two already built CNG filling stations and the construction of two new CNG filling stations in the Nashville area.² Piedmont states that it has spent approximately \$4.7 million in building and upgrading the two initial CNG filling stations³ and desires to spend an additional \$4.6 million to build two

² Petition, page 3, paragraph 5.

³ See Petition, pages 5-6, paragraphs 8-10.

additional CNG filling stations.⁴ According to Piedmont, the proposed CNG infrastructure rider would enable it to continue to explore the potential to construct, own, and operate additional CNG filling stations in the Nashville area and provide an economic bridge from the time period in which revenues do not offset costs generated by the investment described above to the next rate case.⁵

Piedmont has proposed that the new CNG infrastructure rider tariff be implemented through proposed Service Schedule 318.⁶ This would result in Piedmont's recovery of its investment in CNG vehicle fueling facilities by immediately adding this investment to the regulated rate base and raising its rates to regulated rate payers by approximately \$558,000 annually.⁷ The cost of the new infrastructure rider would "be allocated to [Piedmont's] customer classes based upon the revenue allocations in Piedmont's last general rate proceeding. The increment within each customer group [would] be applied to the customer's volumetric usage rates relying on annual determinants established in the most recent rate proceeding."⁸ About 60% of the increase in rates would be paid by residential rate payers⁹ – none of whom use Piedmont's CNG services.¹⁰

Piedmont's Petition asserts that the CNG infrastructure rider is authorized by Tenn. Code Ann. § 65-5-103(d), which authorizes the TRA to approve alternative

⁴ *Id.*

⁵ See Petition, pages 6-7, paragraphs 10-13.

⁶ Petition, page 3, paragraph 5, and Exhibit A to the Petition.

⁷ Exhibit PKP-3, Page 1

⁸ Petition, page 7, paragraph 14.

⁹ See Piedmont's Conditional CNG Infrastructure Rider Annual Filing, as filed on September 30, 2014, at page 1 (Computation of the CNG Infrastructure Adjustment).

¹⁰ See Piedmont's Response to TRA Staff Discovery Request No. 21, provided by Piedmont on October 23, 2014 ("Piedmont does not currently provide natural gas for motor vehicle fuel purposes to any customer served under Rate Schedule 301.")

regulation mechanisms that would allow utilities to recover the cost and expenses associated with infrastructure and equipment associated with alternative motor vehicle transportation fuel, if the Authority finds that such mechanisms are in the public interest.¹¹ To support its public interest claim, Piedmont's Petition cites Tennessee legislation,¹² a U.S. governmental energy report,¹³ and a memorandum of understanding¹⁴ among several states.

B. TRA Docket 14-00087 – Revised Rate Schedule 342 and New Rate Schedule 343

In TRA Docket 14-00087,¹⁵ Piedmont requested approval of two proposed rate schedules. Rate Schedule 342 (Natural Gas Vehicle Fuel) was proposed to replace a prior Rate Schedule 342 (“Old Rate Schedule 342”) that had been approved in TRA Docket 11-00144.¹⁶ The Rate Schedule 342 proposed in this TRA Docket 14-00086 (“Proposed Rate Schedule 342”) would enable CNG service at “[c]ompany-operated public stations to [c]ustomers seeking to obtain [g]as for placement into the fuel tank of a motor vehicle.” Rate Schedule 343 (Experimental Motor Vehicle Fuel Service) was proposed as “experimental in nature and designed to determine the relative need for sales/transportation service to meet the natural gas motor vehicle needs of customers and to determine the level of need for additional CNG facilities”

¹¹ Petition, page 2, paragraph 3.

¹² See Petition pages 3-4, paragraph 6 (*citing* the Energy Independence Act of 2013).

¹³ See Petition page 4, paragraph 7 (*citing* an Annual Energy Outlook 2014, in which the U.S. Energy Information Agency makes projections with respect to natural gas use).

¹⁴ See Petition, page 4, paragraph 8 (*citing* a Memorandum of Understanding signed by Governor Haslam and the governors of fifteen other States).

¹⁵ Filed with the Authority on September 4, 2014, and consolidated into TRA Docket 14-00086 pursuant to an *Order Consolidating Dockets and Amending Procedural Schedule* filed on November 6, 2014.

¹⁶ Approved on April 18, 2012.

and “also is targeted to facilitate wholesale natural gas sales and transportation services to customers who will then compress the gas for use as CNG using their own equipment.”¹⁷

III. PIEDMONT’S REQUEST FOR A CNG INFRASTRUCTURE RIDER, AS CURRENTLY WRITTEN, FAILS TO MEET THE REQUIREMENTS OF TENN. CODE ANN. § 65-5-103(d)(3)(A)

A. Tenn. Code Ann. § 65-5-103(d)(3)(A) Does Not Permit Recovery For Costs and Expenses Beyond the Meter at the CNG Facility

Tenn. Code Ann. § 65-5-103(d)(3)(A) enables a utility to recover costs and expenses related to the expansion of utility infrastructure for the purpose of economic development -- *if* those costs and expenses are in the public interest. Specifically, the statute provides:

(3)(A) A public utility may request and the authority may authorize a mechanism to recover the operational expenses, capital costs or both related to the expansion of infrastructure for the purpose of economic development, if such expenses or costs are found by the authority to be in the public interest. Expansion of economic development infrastructure may include, but is not limited to, the following:

(i) Infrastructure and equipment associated with alternative motor vehicle transportation fuel; . . .

On its face, the statute does not specifically permit recovery on the non-utility assets that Piedmont seeks to add to its rate base under the Petition – that is, assets beyond the CNG facility’s meter. The terms “infrastructure and equipment” are not defined as assets used in a market-based, non-monopoly environment, and it would strain reason to conclude that the Tennessee legislature intended to revolutionize regulatory law by permitting recovery on non-utility assets.

¹⁷ Supplemental Testimony of Ken Valentine in TRA Docket 14-00086 (“Valentine Supplemental Testimony”), filed October 31, 2014, page 7, lines 18-21.

Piedmont's Petition, though, stretches the definitions and limits of "infrastructure and equipment" in an attempt to include those assets in utility assets, even when they are used in a non-monopoly, market-based business. However, the application of basic principles of statutory construction and regulatory law establishes the impropriety of Piedmont's attempt.

Tennessee case law provides that a statute should be construed "in a way that avoids conflict and facilitates the harmonious operation of the law."¹⁸ With that guidance, it is important to consider in the context of this proceeding that utilities are essentially provided with a monopoly with respect to the sale or provision of certain goods or services in exchange for regulation by a surrogate for what otherwise would be the operation of the market – in this case that surrogate would be the Authority. Some have referred to that as the regulatory compact.¹⁹

Here, there is a monopoly as to providing natural gas, but there is no monopoly with respect to providing CNG services. Piedmont admits this.²⁰ Since there is no CNG monopoly – there is, in fact, a market for CNG services²¹ -- CNG services should not properly be the subject of regulation at the point the CNG market begins. In this case, that would be at the meter dividing Piedmont's regulated, monopoly natural gas business and the market-based CNG business.

¹⁸ *Lee Medical, Inc. v. Beecher*, 312 S.W.3d 515, 527 (Tenn. 2010); see also *Anderson Fish & Oyster Company, Inc. v. Olds*, 277 S.W.2d 344, 345 (Tenn. 1955) (it is presumed "that the Legislature used each word in the statute purposely and that the use of these words conveyed some intent and had a meaning and purpose.")

¹⁹ See McDermott, Karl, *Cost of Service Regulations*, 2012, at page 5 *et. seq.*

²⁰ See Piedmont's Response to Consumer Advocate's Supplemental Discovery Requests Nos. 7 and 10.

²¹ Piedmont demonstrates that CNG is a market-based business when it requests, in Proposed Rate Schedule 342 and proposed new Rate Schedule 343 that it be allowed, at its discretion, to offer a rate discount to customers in order to compete with other alternative fuel providers.

Consequently, the statute, to be given proper meaning, must read the words “infrastructure and equipment” in a manner that is consistent with the existence of a monopoly with respect to Piedmont’s traditional natural gas business and the existence of a functioning market with respect to the CNG business. That reading would result in regulation applying only up to and including the meter at the CNG facility. Up to that meter, Piedmont would be able to implement an infrastructure rider under Tenn. Code Ann. § 65-5-103(d)(3)(A). Beyond that meter, the statute would not apply and the market would operate with respect to the CNG business. This limitation on the infrastructure rider to up to and including the CNG meter is the only reasoned approach that “avoids conflict and facilitates the harmonious operation of the law” in the context of Tenn. Code Ann. § 65-5-103(d)(3)(A).

B. Piedmont’s Proposed Infrastructure Rider Would Constitute a Subsidy That Does Not Meet the Public Interest Requirement of Tenn. Code Ann. § 65-5-103(d)(3)(A)

Piedmont’s proposed CNG infrastructure rider fails to meet the alternative regulation statute’s public interest requirement because it creates a subsidy for which there are no quantifiable counterbalancing benefits. In other words, even if Piedmont’s infrastructure rider is determined to meet the literal language of the statute and, thereby, to extend beyond the meter at the CNG facility, that rider would fail to meet the requirement that such rider be in the public interest as required by Tenn. Code Ann. § 65-5-103(d)(3)(A). To be in the public interest, as the statute’s legislative history shows, the alternative regulation statute requires an

economic analysis that demonstrates that any subsidy created must be counterbalanced by quantified benefits.

1. **The Public Interest Requirement of Tenn. Code Ann. § 65-5-103(d)(3)(A) Is Evaluated Based on Economic Criteria and the Creation of a Subsidy Would Not Be in the Public Interest**

Tenn. Code Ann. § 65-5-103(d)(3)(A) would allow recovery of expenses and costs under the infrastructure rider as proposed by Piedmont only if “. . . such expenses or costs are found by the authority to be in the public interest.” Public interest, though not defined in every context, is defined in the context of this proceeding.²² In a proceeding concerning alternative motor vehicle transportation fuel, the legislative history of the alternative regulation statute establishes that economic criteria should form the basis for a public interest analysis and that rate payers should not subsidize that business.²³ Specifically, TRA Chairman Jim Allison testified before the Tennessee General Assembly that the proposed alternative regulation legislation would not produce a subsidy or cross-subsidy from regulated gas company rate payers to retail CNG operations. At the March 6, 2013,

²² Piedmont’s apparent interpretation of the public interest requirement lacks clarity and ignores a plain reading of the alternative regulation statute’s legislative history – that an economic analysis should form the basis for the public interest determination. Piedmont’s witnesses do not even articulate a framework upon which the public interest requirement should be evaluated – though they generally refer to bridges to a CNG future, environmental benefits, and other potential benefits drawn from various materials – without offering a quantified economic analysis of those purported benefits. See, e.g., Testimony of Ken Valentine, at page 8, lines 17-20, Supplemental Testimony of Ken Valentine, at page 3, line 19, through page 4, line 2, and Rebuttal Testimony of Ken Valentine, at pages 10-15. Thus, Piedmont offers neither a framework to analyze the requirement, nor meaningful economic analysis demonstrating the quantified benefits that might potentially counterbalance the direct subsidy that Piedmont’s proposed infrastructure rider would create.

²³ See Pre-Filed Direct Testimony of Christopher C. Klein, Ph.D. (“Klein Direct Testimony”), filed December 5, 2014, at page 7, line 9, through page 8, line 34 (quoting TRA Chairman Jim Allison’s testimony before the House Business and Utilities Subcommittee on March 6, 2013, and before the House Finance Ways and Means Subcommittee on March 13, 2013).

meeting of the House Business and Utilities Subcommittee (transcript attached as Attachment A), the following exchange took place:

Chairman Pat Marsh: I have one other question that might be a little off. I was asked to ask this by the Fuel and Convenience Store Association, is it the intent of this legislation to permit regulated, natural gas companies to subsidize their retail or wholesale alternative motor vehicle transportation fuel operations with rate payer funds?

Jim Allison: The answer to that is no. The Bill, again, is procedural in nature, there's no substantive change to policy to the State of Tennessee other than the fact that it will hopefully streamline the regulatory process.²⁴

Then, on March 13, 2013, before the House Finance Ways and Means Subcommittee (transcript attached as Attachment B), the following exchange occurred:

Representative Charles Sargent: Chairman, thank you for that. For those, I just wanted to make sure that we had that on the record. The other question I have is under Section 5. Section 5 as you know where natural gas companies would be able to set up, and there's been a lot of talk about this, set up their own substation or sell natural gas for cars and trucks. Is that, do you see that as the intent of the legislation?

Representative Gerald McCormick: You know Chairman, this is one that just came up yesterday and I hate to make this last any longer but I don't want to give you the wrong answer. If I have the Committee's permission I'd like to call up possibly Chairman Allison to address that question, if that's okay with the Chairman too and both Chairmen.

Chairman Michael Harrison: Without objection we're out of session. If you would, come forward and state your name for the record.

²⁴ Piedmont's witness appears to view this exchange as a question about whether the *statute would create* a subsidy, rather than whether a *proposed mechanism*, such as Piedmont's proposed infrastructure rider, *would constitute a subsidy that did not satisfy the public interest requirement* of the statute. See Rebuttal Testimony of Pia K. Powers, at page 12, lines 5-14. In the Consumer Advocate's view, Chairman Allison was simply confirming Tennessee's policy against subsidies and that the statute would not change that policy. In other words, the statute deals with procedural mechanisms and such, but was not intended to alter the policy against subsidies in the context of the public interest requirement of the statute.

Jim Allison: I'm Jim Allison, I'm the Chairman of the Tennessee Regulatory Authority. The answer to your question is what it deals with is a procedural change in how we will go about looking at those rates. It does not guarantee recovery, it does not say that there will be any cross- subsidization of the fuel, motor fuel dispenser by residential consumers or anything of that nature but the alternative rate making procedures, all of them, are permissive and it would require that finding that the public interest, like the Leader stated.

Chairman Michael Harrison: You're recognized.

Representative Charles Sargent: Thank you Mr. Chairman. My question is, is it the intent of natural gas companies to go into set up, I'll say natural gas stations through-out the state and have the rate payers paying for that infrastructure and not as a commercial entity? Is there, I want to make sure we don't have rate payers paying for infrastructure where we have commercial entities out there that have to basically pay for their own infrastructure.

Jim Allison: There is no intent in this legislation to allow any other class of consumers to subsidize the facilities that would go into providing natural gas as a motor fuel.

Thus, Chairman Allison's testimony establishes that economic criteria would serve as the basis for an analysis of the public interest requirement of the alternative regulation statute and, further, that the public interest requirement would not be satisfied if a proposed alternative regulation mechanism created a subsidy or cross-subsidy.

2. **Piedmont's Proposed Infrastructure Rider Would Create a Subsidy in Which Piedmont's CNG Services Costs Would Exceed Revenues**

Piedmont admits that the proposed infrastructure rider would generate more costs than revenues.²⁵ Since those costs would be recovered through the proposed infrastructure rider, Piedmont's residential and other regulated natural gas

²⁵ Testimony of Ken Valentine ("Valentine Testimony") filed on October 7, 2014, at page 6.

customers would pay²⁶ for infrastructure that they likely would not use,²⁷ while Piedmont's CNG customers would receive the benefits from -- but would not bear the cost of -- that infrastructure and equipment. As discussed by Dr. Klein in his testimony:

As explained in the initial testimony of Piedmont's witness Ken Valentine (p. 6), "...like most new investment the incremental cost of service associated with these facilities exceeds the initial revenues generated by these facilities." The CNG IR proposed by Piedmont requires regulated ratepayers to cover the capital costs of CNG vehicle fueling stations rather than recovering those costs from CNG vehicle fuel customers. Hence, regulated ratepayers who are not CNG customers will subsidize Piedmont's CNG retail operation by approximately \$558,000 annually.²⁸

Thus, Piedmont's infrastructure rider would create a subsidy.

3. **Piedmont Does Not Meet Its Burden to Prove that the Subsidy Created by Piedmont's Proposed Infrastructure Rider Would Be in the Public Interest**

Though basic economic analysis and Piedmont's admission demonstrate that the proposed infrastructure rider would be a subsidy, it is important to consider any positive externalities, or positive benefits, that demonstrably accrue as a result of the subsidy in evaluating the subsidy²⁹ -- that is, in evaluating whether Piedmont has met its burden of proof that the proposed infrastructure rider is in the public

²⁶ On the subsidy issue, Piedmont's approach seems to vary between, essentially, assertions that it is too complicated to determine outside of a general rate case and a lack of knowledge as to whether a subsidy exists and there is not enough evidence to determine whether a subsidy exists. See Rebuttal Testimony of Pia K. Powers, as filed on December 22, 2014, at pages 4-7. In that approach, Piedmont ignores that the subsidy created by the proposed infrastructure rider is a *direct subsidy imposed on the existing rate payers* that is readily calculated, is imposed on the current rate payers proportionally by class, and is evaluated by sound economic analysis -- all as described in more detail in this brief.

²⁷ See Piedmont's Response to TRA Staff Discovery Request No. 21, provided by Piedmont on October 23, 2014 ("Piedmont does not currently provide natural gas for motor vehicle fuel purposes to any customer served under Rate Schedule 301.")

²⁸ Klein Direct Testimony, at page 7, lines 1-8.

²⁹ Klein Direct Testimony, at page 6, lines 12-23.

interest.³⁰ The positive externalities provided by Piedmont are environmental benefits associated with the use of CNG as a motor vehicle fuel. Piedmont's witness Ken Valentine states that: "... CNG has 25% less CO₂ emissions than gasoline and diesel, 70% less carbon monoxide, and 87% less nitrogen oxides . . ."³¹ Piedmont, however, does not quantify the value of those benefits.³² Other potential positive externalities and other supporting materials put forward by Piedmont are similarly unquantified and vague in terms of value.³³ Since Piedmont fails to quantify the value of these positive externalities and other supporting materials, they are essentially meaningless to Piedmont's required showing that the positive externalities exceed the subsidy created by the infrastructure rider.³⁴ Further,

³⁰ Piedmont's burden of proof in this proceeding is reflected in TRA Rule 1220-1-2-.16 Evidence - Testimony and Burden of Proof ("The burden of proof shall be on the party asserting the affirmative of an issue . . .").

³¹ Valentine Supplemental Testimony, at page 3, lines 19-21.

³² See Klein Direct Testimony, page 9, lines 3-8 (*citing* Piedmont's Responses to Consumer Advocates Supplemental Discovery Requests Nos. 2 and 3).

³³ Dr. Klein notes that that "anyone in the general vicinity traversed by vehicles fueled at Piedmont's stations will benefit, . . ." and, in addition to questioning "whether it is fair for Piedmont ratepayers to bear all of the cost of the subsidy[.]" adds that "even when the subsidy may be justified by the general external benefits, it may not be justified by the benefits accruing only to Piedmont's ratepayers." Klein Direct Testimony, at page 9, lines 9-14. The Tennessee legislation, U.S. governmental energy report, and a memorandum of understanding among several states cited, and described above, are not quantified and, consequently, do not provide evidence of meaningful positive externalities.

³⁴ This is not to say that such materials are not at times helpful – it is important to note, however, that while Piedmont provided materials supporting their position, other policy materials could be produced that call into question the merits of CNG and its future as a motor vehicle fuel. Here, in view of the importance of economic analysis with respect to the public interest requirement, it is not necessary to get into dueling materials. As Mr. Novak noted in his testimony at the hearing on this docket, "And what you've heard today from the company and their witness – they speak quite – quite a bit about the benefits of CNG and the public policy benefits, and we can certainly play the public policy game all day long. We can say high-efficiency furnaces are in the public policy and the company should go out and put a high-efficiency furnace in every customer's home, and that may be good public policy, and there may be reasons that we want to do that, but that would be terrible utility policy because some customers already have high efficiency furnaces while some don't, and some customers don't want to pay higher rates for high-efficiency furnaces." Transcript of Proceedings, Volume I A, at the Hearing on TRA Docket 14-00086, on January 12, 2015, at page 48, lines 3-15.

Piedmont's claim of savings by buyers of CNG fuel, over comparable gasoline or diesel purchases by those buyers, would not justify the subsidy created by Piedmont's infrastructure rider.³⁵ Those savings would be nothing more than transfer payments from Piedmont's rate payers to Piedmont's CNG fuel customers.³⁶ Since Piedmont has not demonstrated that the value of the positive externalities that would result from the subsidy exceed the stated value of the subsidy, Piedmont fails to meet its burden to prove that its infrastructure rider meets the public interest requirement of Tenn. Code Ann. § 65-5-103(d)(3)(A).³⁷

IV. THE AUTHORITY SHOULD DETERMINE THAT PIEDMONT'S CNG BUSINESS IS NOT A REGULATED BUSINESS

A. Piedmont's CNG Business Is Not a Monopoly and Should Not Be Regulated

Piedmont admits that the CNG vehicle fuel market is not a monopoly,³⁸ and that the "retail CNG vehicle fuel market does not possess the natural monopoly characteristics that would justify public utility regulation."³⁹ Stated another way,

³⁵ As described by Dr. Klein:

Any cost savings of this type represent a transfer from Piedmont's ratepayers to CNG vehicle fuel customers. If CNG vehicle users buy CNG at a price lower than that available without the subsidy, the difference is made up by Piedmont's regulated service customers. In fact, the subsidy could exceed the cost savings realized by CNG vehicle operators. Consequently, there is no additional net benefit generated. In fact, the subsidy could be detrimental to the development of the CNG vehicle fuel market in and around Piedmont's Tennessee service territory.

Klein Direct Testimony, at page 10, lines 6-12.

³⁶ *Id.*

³⁷ It is worth noting that to the extent the benefits of CNG are meaningful on some level, achieving those benefits is not dependent on Piedmont. Even if Piedmont does not offer CNG services, from a market-based perspective, the Consumer Advocate believes that if the demand for CNG grows, then the marketplace will grow because providers will step forward to meet CNG demand. Piedmont as a CNG provider is not the proverbial missing link.

³⁸ See Piedmont's Response to Consumer Advocate's Supplemental Discovery Requests Nos. 7 and 10.

³⁹ Klein Direct Testimony, at page 10, lines 16-20 (*citing* Piedmont's Response to Consumer Advocate's Supplemental Discovery Requests Nos. 7 and 10).

the “infrastructure and equipment” that Piedmont proposes to use in its CNG business would not be used in a monopoly. Since the infrastructure and equipment would not be used in a monopoly, they would not be used in an activity warranting the protections afforded to consumers through regulation. In the absence of a need for regulation, there is no reason to allow Piedmont to recover those costs and expenses through rates charged to regulated utility customers. Those costs and expenses should properly be charged, as in any market-based business, to Piedmont’s CNG customers who use the CNG sales and services.⁴⁰ As applied to this case, the costs and expenses related to the CNG business after the meter at the CNG facility should not be treated as a regulated – and, consequently, Piedmont’s CNG business should be treated as unregulated.

B. Treating Piedmont’s CNG Business as Regulated Would Retard the Development of the CNG Market and Would Create Barriers to Entry to the CNG Market

The sale of natural gas up to and including the meter is a monopoly and subject to regulation. As such, Piedmont receives certain advantages, including recovery on the utility assets used in that business. While Piedmont’s recovery on those assets is not guaranteed, recovery on the assets on the other side of the CNG meter – the assets at risk in the CNG market – have no assurance of any return on those assets. Allowing Piedmont an infrastructure rider (“IR”) beyond the meter at

⁴⁰ Piedmont appears to recognize this implicitly when it asks the Authority to approve Piedmont’s granting of discounts, without prior approval or subsequent review by the TRA, to enable Piedmont to compete in the CNG fuel market. See Proposed Rate Schedule 342 and proposed new Rate Schedule 343. In view of the requested discounting authority, it would be appropriate that costs and expenses related to the CNG fuel being discounted should be properly allocated to those customers who could receive the market-based discounts.

the CNG facility would allow Piedmont to earn a regulation-based return in a market-based environment. That imbalance would be harmful to the operation of the CNG market. In short, allowing Piedmont to impose the infrastructure rider beyond the meter would retard the development of the retail CNG fuel market.⁴¹ As described by Dr. Chris Klein in his testimony:

Piedmont's CNG IR subsidizes its retail CNG vehicle fuel stations by shifting the capital costs associated with these stations to regulated (non-CNG) service ratepayers. Piedmont's retail CNG vehicle fuel stations will not have to recover the associated capital costs from retail CNG revenues. Any competing retail CNG vehicle fuel station operated by any entity other than Piedmont, however, will have to recover its capital costs from retail CNG revenues. Hence, Piedmont will have a cost advantage over all other actual or potential competitors in the retail CNG vehicle fuel market in or near Piedmont's Tennessee service territory. This will discourage and likely prevent the entry of competing retail CNG vehicle fuel stations in or near Piedmont's Tennessee service territory. Deterring entry into the retail CNG vehicle fuel market will retard the development of the market, resulting in less use of CNG as a vehicle fuel and reducing the external benefits to Tennessee residents than would occur otherwise.⁴²

Further, expanding the infrastructure rider to beyond the meter would enable Piedmont to engage in a vertical price squeeze, subsidized by regulated rate payers, which also would discourage further entry into the CNG market. As described by Dr. Klein:

A vertical price squeeze requires that a single firm sell a good or service that is an essential input to another good or service at the wholesale level and also sell the finished good or service produced using the essential input at the retail level. If Piedmont's proposal is approved, Piedmont will sell natural gas at wholesale to CNG vehicle fuel stations and will also sell CNG vehicle fuel at retail. The squeeze is implemented by the wholesale firm selling the retail good or service at a price that will not cover the full cost of production over and above

⁴¹ Piedmont offers no meaningful contradictory economic analysis.

⁴² Klein Direct Testimony, at page 11, lines 5-16.

the wholesale cost of the essential input. The CNG IR will make a price squeeze practical for Piedmont, since any shortfall in revenues at the retail CNG level will be covered by regulated ratepayers up to the amount of the retail CNG capital costs. This possibility further reduces the likelihood of entry by competitors into the retail CNG vehicle fuel market.⁴³

Dr. Klein elaborated, in response to a discovery request by Piedmont, on how even the potential for implementation of the proposed CNG infrastructure rider would “retard the development of the retail CNG fuel market and reduce the external benefits from CNG as a vehicle fuel relative to the case without the subsidy.”⁴⁴ His starting point was that the ability to engage in a vertical price squeeze, under Proposed Rate Schedule 342, would discourage entry in to the CNG market.⁴⁵ Dr. Klein stated:

Moreover, the ability of Piedmont to engage in a vertical price squeeze using the pricing flexibility in Rate Schedule 342, a price squeeze that is subsidized by regulated rate payers, will further discourage entry. Piedmont does not have to actually implement such a strategy for the potential of using it to deter entry. No potential competitor will want to enter the market to compete with Piedmont, when Piedmont can reduce its retail price such that the margin between the retail price and the cost of gas purchased from Piedmont is insufficient to repay the investment in retail CNG vehicle fueling stations. Ordinarily, such a strategy could hurt the squeezer as much as the squeezed, but Piedmont’s CNG IR allows regulated ratepayers to cover Piedmont’s investment in retail CNG vehicle fueling stations, such that the strategy is viable for Piedmont. However, if the development of the retail CNG market is retarded in this way, less CNG will be sold, and fewer environmental benefits from substituting CNG for gasoline or diesel fuel will be realized. In the absence of the CNG IR subsidy, the price squeeze strategy is much less viable for Piedmont. Consequently, entry is less likely to be deterred and the market is more likely to

⁴³ Klein Direct Testimony, at page 11, line 18, through page 12, line 6.

⁴⁴ Discovery Request of Piedmont Natural Gas to the Consumer Advocate No. 2, filed December 16, 2014.

⁴⁵ Responses of the Consumer Advocate and Protection Division to Discovery Request of Piedmont Natural Gas, filed December 23, 2014, Response to Request No. 2, at pages 2-4.

develop, resulting in more CNG sales and greater environmental benefits.⁴⁶

Further, responding to a discovery request from Piedmont,⁴⁷ Dr. Klein explained how, even if both wholesale and retail CNG services were regulated, as requested by Piedmont, the potential of a vertical price squeeze remained viable because the maximum proposed rate might not cover Piedmont's operating cost and the cost of investment in CNG fueling station and that, in any event, Piedmont's requested discounting mechanism could enable Piedmont to implement a vertical price squeeze without review by the Authority.⁴⁸ Dr. Klein replied:

Ordinarily, regulation of the prices of both natural gas at wholesale and CNG at retail would greatly reduce the potential for a vertical price squeeze, but the special characteristics of Piedmont's Rate Schedules 342 and 343 make a vertical price squeeze viable in the presence of the proposed CNG IR. First, the proposed retail margin of \$0.50 per therm above the wholesale cost of gas proposed in Rate Schedule 342 may or may not be sufficient to recover the operating cost as well as the cost of the investment in retail CNG vehicle fueling stations. Hence, a vertical price squeeze may result at the maximum proposed rate. Even if the \$0.50 per therm retail margin is sufficient, proposed Rate Schedule 342 allows Piedmont, "at its discretion" (that is, without TRA review and approval) to "...offer a rate discount on a not unduly discriminatory basis to customers, up to the [\$0.50] per therm compression charge referenced above, in order to compete with alternative fuel providers and further develop the market demand for natural gas vehicular fuel or the facilities available to serve such demand." Similar flexibility in Rate Schedule 343 applies to customers "...using Company owned and maintained compression facilities and related equipment..." This flexibility allows Piedmont to implement a vertical price squeeze without TRA review. Therefore, regulation of natural gas for use as a vehicle fuel at both wholesale and retail levels,

⁴⁶ *Id.*

⁴⁷ Discovery Request of Piedmont Natural Gas to the Consumer Advocate No. 8, filed December 16, 2014.

⁴⁸ Responses of the Consumer Advocate and Protection Division to Discovery Request of Piedmont Natural Gas, filed December 23, 2014, Response to Request No. 8, at pages 7-8.

under the conditions proposed by Piedmont, does not prevent Piedmont from implementing a vertical price squeeze.⁴⁹

Thus, the implementation of the CNG infrastructure rider, in concert with Proposed Rate Schedule 342, would retard the development of the CNG market, and would create barriers to entry that would occur even if Piedmont's CNG business were regulated.⁵⁰ To avoid the problems and concerns described above that could harm the developing CNG market, that market should be unregulated.

C. CNG Is a Different Product Than Natural Gas and Should Be Treated as an Unregulated Product Consistent with Its Defining Characteristics

CNG as a product exhibits different characteristics than regulated natural gas and should be treated as an unregulated product consistent with those characteristics. In addition to CNG being compressed to facilitate its use as an unregulated motor fuel, unlike the regulated natural gas used in homes and businesses, the distinguishing characteristics include having different customers and pricing structures.⁵¹ As Mr. Novak explained:

The customer base for natural gas is captive since Piedmont is a monopoly utility provider – if customers do not buy natural gas from Piedmont, they cannot buy it from any other source in Piedmont's service territory. On the other hand, the customer base for CNG is intended to be whoever stops at the CNG facility. Piedmont admits

⁴⁹ *Id.*

⁵⁰ Piedmont offers no meaningful contradictory economic analysis.

⁵¹ Piedmont appears to ignore the product differences described in Mr. Novak's testimony, other than the compression difference. See Supplemental Testimony of Ken Valentine, at page 8, lines 16-18 ("The only distinguishing characteristic of CNG is that it is compressed to a level necessary to allow its use as a motor fuel."). In so doing, Piedmont would seem to indicate that it has no answer to the clear differentiation between the products made by Mr. Novak's market and customer based analyses.

that it is not a monopoly provider of CNG,⁵² so any CNG customer is not limited to buying from Piedmont. In the context of the overall supply chain for natural gas that is then compressed into CNG, Piedmont is essentially a wholesale provider of natural gas to retail providers of CNG. The Company confirms the characterization where it states that it "...is the only entity currently able to provide wholesale gas supplies [for CNG] within its service area."⁵³

The differing pricing mechanisms also support this distinction between natural gas and CNG. The price for natural gas sold by Piedmont in its monopoly service territory is set by tariff. If Piedmont wants to change that price, it must first request approval from the TRA. On the other hand, the retail price for CNG, although set by tariff at the wholesale level, can fluctuate up or down as determined by Piedmont, and not by the TRA. This price distinction means that Piedmont "...may at its discretion offer a rate discount on a not unduly discriminatory basis to customers, up to the per therm compression charge referenced above, in order to compete with alternative fuel providers and further develop the market demand for natural gas vehicular fuel or the facilities available to serve such demand."⁵⁴

By analogy to a related unregulated business, it should be noted that natural gas can also be converted into other forms such as liquefied natural gas ("LNG") which can then be used in motor vehicles. However, at this time, the Tennessee legislature has not given the TRA the authority to regulate rates for the sale of LNG, even though that product also originates from natural gas. Further, since LNG is a product along the same lines as CNG from a regulatory perspective and has similar customers and a pricing structure more similar to CNG than natural gas, CNG appears to be more akin to unregulated LNG than to regulated natural gas.⁵⁵

Thus, the comparison of the characteristics of regulated natural gas to unregulated CNG demonstrates the significant differences between them, and the

⁵² Direct Testimony of William H. Novak ("Novak Direct Testimony"), filed December 5, 2014, at page 4, line 22 (*citing* Piedmont's Response to the Consumer Advocate's Supplemental Discovery Request No. 7).

⁵³ Novak Direct Testimony, at page 5, line 6 (*quoting* Piedmont's Response to the Consumer Advocate's Supplemental Discovery Request No. 11).

⁵⁴ Novak Direct Testimony, at page 5, line 18 (*quoting* Piedmont's proposed tariff as originally filed in TRA Docket 14-00087, on page 1 of Rate Schedule 342).

⁵⁵ Novak Direct Testimony, at page 4, line 18, through page 6, line 6.

similarities between CNG and unregulated products. Consequently, CNG should be treated as an unregulated product.

D. Piedmont's Old Rate Schedule 342 as Approved in TRA Docket 11-00144 Does Not Provide a Basis for Continued Regulation of CNG When the Facts and Expectations in that Docket No Longer Exist

The authority of the TRA to fix and change rates, fares, and schedules is clear from a plain reading of Tenn. Code Ann. §§ 65-5-101 and 65-5-103, as well as Tennessee case law.⁵⁶ Applied here, the Authority has the discretion to determine that a business that has been treated as regulated, under the facts and expectations when that determination was made, should be treated as unregulated when those underlying facts and expectation change. In Old Rate Schedule 342, Piedmont and the Consumer Advocate agreed to, and TRA approved, rates for a sideline business.⁵⁷ As discussed above, Piedmont offers no evidence that Old Rate Schedule 342 was intended, at the time that it was approved, as anything more. Mr. Novak, who was a witness in the docket in which Old Rate Schedule 342 was approved, offered testimony in this docket about the circumstances under which Old Rate Schedule 342 was approved:

In the Company's last rate case, the TRA approved the current Rate Schedule 342 for Natural Gas Vehicle Fuel.⁵⁸ In that case, I included the following statement in my testimony regarding the proposed natural gas vehicle tariff:

⁵⁶ See, e.g., *United Cities Gas Co. v. Tennessee Public Serv. Com'n*, 789 S.W. 2d 256, 259 (Tenn. 1990) (citing *Public Service Commission v. General Telephone Company, etc.*, 555 S.W.2d 395 (Tenn. 1977)) ("[T]he administrative body is and must be free to change its mind and, if there is substantial and material evidence to justify the change, the courts have no reason to overturn the new holding.").

⁵⁷ See Novak Direct Testimony, at page 8, line 15-19.

⁵⁸ Novak Direct Testimony, at page 8, line 2 (referring to TRA Docket 11-00144).

*"The Company has proposed a new Rate Schedule 342 for Natural Gas Vehicle Fuel. The Company has also proposed a monthly customer charge of \$40 and a consumption charge of \$0.23109 per therm. The CAPD believes that the prospects for the natural gas fuel market are good and that this customer group may eventually develop and contribute to the recovery of the Company's common costs. The CAPD therefore supports the Company's initial proposal for this rate schedule until the next rate case."*⁵⁹

However, the TRA's approval of Rate Schedule 342 in the Company's last rate case involved no anticipated incremental rate base investment, no anticipated incremental operating expenses and no anticipated incremental revenue. Instead, my recollection, as a witness in that rate case, was that the Company's proposal only included existing facilities for its own vehicle fleet that were already included in rate base and that the natural gas vehicle tariff would only be a small sideline business. Otherwise, I would have recommended that the Consumer Advocate insist that this unregulated business activity be excluded from the rate case.

It is now apparent that the scope and scale of the Company's plans for CNG exceed that of the sideline business activity that was anticipated in their last rate case. . . .⁶⁰

Thus, the mere fact that Piedmont and the Consumer Advocate agreed, and the TRA approved, rates for a sideline CNG business does not provide a basis for continued regulation of CNG when the facts and expectations of the parties have clearly changed with respect to CNG. As demonstrated above in Mr. Novak's testimony (and below), in this docket those facts and expectations have changed such that the characteristics of Piedmont's CNG business are those of an unregulated business. Consequently, the Authority is within its power to -- and should -- determine that Old Rate Schedule 342 is no longer valid and discontinue

⁵⁹ Novak Direct Testimony, at page 8, line 12 (*quoting* Direct Testimony of William H. Novak, TRA Docket 11-00144, at page 17).

⁶⁰ Novak Direct Testimony, at page 8, lines 1-25.

and terminate it, and further determine that Piedmont's CNG business is no longer a regulated business.

The comparison of other sideline business to the business apparently contemplated by Old Rate Schedule 342 supports this position. For example, prior approvals by the TRA of sideline businesses involving unregulated merchandise and jobbing ("M&J") activity and the sale of liquefied natural gas ("LNG") were essentially determinations that it was more efficient to include the direct revenues and expenses associated with those activities within a rate base calculation, rather than allocate utility overheads to those unregulated operations.⁶¹ In accounting terms, in the M&J and LNG activities, direct revenues exceeded direct costs of the unregulated activities. In contrast, Piedmont's proposed infrastructure rider would require a \$558,000 annual operating subsidy to be economically feasible,⁶² so the infrastructure rider could hardly continue to be called a sideline business like that which has been previously approved by the TRA. Thus, since the proposed infrastructure rider and market-based CNG business to be operated through the proposed Rate Schedule 342 bear no resemblance to a sideline business, the Authority should characterize the proposed activities as unregulated.

Further, Piedmont's claim that the expenditures that it made on infrastructure were nothing more than extensions of the regulatory treatment afforded it under Old Rate Schedule 342 is not supported by the record. As Mr. Novak notes in his testimony:

⁶¹ See Novak Direct Testimony, at page 10, lines 12-23.

⁶² See Novak Direct Testimony, at page 11, lines 2-6.

This docket represents this first time that the Company has notified the TRA of its material investment in CNG infrastructure. In addition to my earlier assertions about CNG being unregulated, if the Company truly expected to earn a return and recover its cost associated with its CNG investment, then Piedmont never provided the required notice to the TRA in accordance with Rule 1220-4-1-.01(1)(a) regarding capital additions budgets of utilities which reads as follows:

(1) All public utilities operating in the State of Tennessee shall submit one (1) copy of the following information on an annual basis, to be filed no later than ninety (90) days after the beginning of the current fiscal year with the Chief, Utilities Division or as otherwise agreed upon.

(a) Projected expenditures on capital construction projects both routine and specific for the current year.

The Company never provided the TRA with the required information regarding its budgeted capital expenditures for CNG infrastructure in its last rate case or since that time.⁶³ Since the Company failed to inform the TRA of their CNG expansion plans at any one of several pre-set notification points, the risk of rate recovery falls squarely on the shoulders of the shareholders. As a result, it should not be a surprise for the Company to now learn that the subsidies it is now seeking to recover through its CNG tariff are inappropriate and not in the public interest.⁶⁴

Further, there appears to be no other evidence in the record to support Piedmont's claim that the infrastructure was in any way planned or anticipated at the time that Old Rate Schedule 342 was approved. For example, Piedmont offers no corporate minutes, contemporaneous studies, or other potential evidence that the CNG infrastructure-related expenditures were connected to the regulated natural gas business. Surely Piedmont would have produced that evidence, if it exists, to support its claim that the infrastructure was potentially going to be included in

⁶³ Novak Direct Testimony, at page 9, line 11 (*referencing Piedmont's Response to the Consumer Advocate's Supplemental Discovery Request No. 19*).

⁶⁴ Novak Direct Testimony, at page 11, line 10, through page 12, line 3.

Piedmont's rate base. And, curiously, the first time that the assertion is made -- that Piedmont's CNG infrastructure is already regulated -- is not in Piedmont's Petition or the initial testimony of its witnesses, but rather is in response to discovery requests of the Consumer Advocate and Tennessee Fuel and Convenience Store Association ("TFCSA").⁶⁵

From the above it appears that Piedmont entered into a sideline business and at some point sought to expand aspects of that business through infrastructure expenditures. For reasons that are not clear from the record, though one could surmise that the necessity, to be economically feasible, of a \$558,000 annual operating subsidy may have been one impetus, Piedmont appears to have decided to attempt to bootstrap its CNG business into its regulated natural gas service. In other words, Piedmont appears to seek to bootstrap an unregulated business onto a regulated business -- to earn the regulated return on that investment -- and then presumably when the regulated business becomes profitable, Piedmont would ask that the business be unregulated,⁶⁶ so that its shareholders could benefit. In essence, Piedmont's Petition and proposed rate schedules demonstrate an apparent

⁶⁵ See, e.g., Piedmont's Response to Consumer Advocate's Discovery Request No. 1.b., filed on October 23, 2014, and Piedmont's Response to TFCSA's Discovery Request No. 1, filed on October 23, 2014. Contrast the direct statements in those responses with, for example, the absence of an *existing* regulatory or jurisdictional basis in the listing of the attributes supporting the infrastructure rider in the Testimony of Pia K. Powers ("Powers Testimony"), filed on October 7, 2014, at page 6, lines 5-13. Further, in describing the legal basis for Piedmont's proposed infrastructure rider, Piedmont's witness makes no mention of Old Rate Schedule 342, citing only the alternative regulation statute as a basis. See Powers Testimony, at page 4, line 18, through page 5, line 6. Likewise, Piedmont's other witness does not mention the Old Rate Schedule 342 in his initial testimony -- the only schedule mentioned is proposed Service Schedule 318. See Valentine Testimony, at page 8, line 17.

⁶⁶ Piedmont's witness, at the TRA hearing on this case, arguably implied as much. Transcript of Proceedings, Volume I A, at the Hearing on TRA Docket 14-00086, on January 12, 2015, at page 39, lines 20-22 ("We acknowledge that at some point the CNG market might be sufficiently competitive to justify deregulation of our service, . . .").

desire on Piedmont's part to have the best of both worlds – a reasonably assured return now and upside potential down the road. But while Piedmont may have that desire, Piedmont has not shown that Old Rate Schedule 342 provides a basis for continued regulation of CNG in view of the changes to Piedmont's prior sideline business as reflected in the Petition and related rate schedules.

Thus, Piedmont's requests in its Petition and proposed rate schedules, its references to its CNG business potentially becoming unregulated, its substantial expenditures that have already been incurred and that are planned, and the growth of the CNG market itself, as demonstrated by Piedmont's need for rate discounting approval, demonstrate that Piedmont's CNG business has grown beyond the sideline business that was anticipated in the facts and expectations when Old Rate Schedule 342 was approved. Since those original facts and expectations no longer exist, Piedmont's former sideline business should now be treated as – and determined by the Authority to be -- a market-based, unregulated business. Consequently, Old Rate Schedule 342 should be discontinued and terminated. Proposed new Rate Schedule 343, though, should be approved as "experimental" and as it will promote the development of the retail CNG vehicle fuel market, and with any Piedmont or affiliate sales for resale as CNG being captured under this proposed new schedule.

E. Piedmont's CNG Business Should Not Be Regulated Merely Because Piedmont's Natural Gas Business Is Regulated

Along the lines of its apparent reliance on Old Rate Schedule 342, in its effort to bootstrap its CNG business into its regulated natural gas service, Piedmont

appears to argue that its CNG business should be regulated because Piedmont's natural gas business is regulated. Piedmont's rationale, though, is inconsistent. For example, using Old Rate Schedule 342, at one point Piedmont appears to say that *once* a type of service is regulated, it is *always* regulated for any purpose.⁶⁷ At another point, Piedmont says that it's not the type of service that determines if a service is regulated, it's whether the entity providing the services is regulated.⁶⁸ On these points, Mr. Novak's testimony provides useful guidance:

Piedmont asserts in its testimony that CNG retail sales should be regulated because the Company's natural gas service business is regulated – in other words, because the natural gas entity is regulated, everything the entity does is regulated.⁶⁹ Aside from the practical problems that this interpretation could present with respect to fitting businesses into entities for the purpose of avoiding or attaining a regulated or unregulated status, I do not believe that you have to look any further than each instance in which Piedmont makes that assertion in order to refute it – specifically each time Piedmont makes such an assertion, it qualifies it with the word “currently” or something similar.

In this case, it appears that the Company is attempting to establish a standard that the status of the entity controls the regulated versus unregulated status to place the burden of the retail CNG infrastructure cost on ratepayers (by currently classifying it as regulated), while leaving open the future argument that the CNG activity and related entity could become unregulated. Additionally, Piedmont's assertion ignores the fundamental differences between CNG and natural gas, and the differences between their respective customer bases and pricing mechanisms, regardless of the entity that

⁶⁷ See Piedmont's Response to the Consumer Advocate's Discovery Request No. 1.b. (“Piedmont currently provides CNG services . . . on a regulated basis pursuant to its TRA approved [Old] Rate Schedule 342 and has done so since that rate schedule was approved in TRA Docket No. 11-00144. Piedmont's proposals in this docket [14-00086] and related TRA Docket 14-00087 do not seek any change in the jurisdictional status of that service.”).

⁶⁸ See, e.g., Piedmont's Response to the Consumer Advocate's Supplemental Discovery Request No. 14 (“it is the status of the entity providing the CNG services as opposed to the market that currently dictates whether the services are regulated or not.”).

⁶⁹ Novak Direct Testimony, at page 9, line 11 (*citing* Piedmont's Response to the Consumer Advocate's Supplemental Discovery Request No. 14).

conducts the activity. Further, Piedmont does not appear to follow its apparent standard with respect to all of the businesses under its corporate umbrella – for example, Piedmont’s SouthStar business venture is unregulated, even though Piedmont itself is regulated. To state the obvious, under Piedmont’s assertion, neither Piedmont nor any other regulated utility could ever have an unregulated business associated with it or under its corporate umbrella.⁷⁰

With Mr. Novak’s testimony in mind, there are possible problems if utilities could essentially cherry pick regulation versus non-regulation based on the entity into which a utility put an early stage or fledgling business. One problem would be that an otherwise traditionally unregulated business could start out being included in a regulated entity -- where it could earn a return on the backs of rate paying customers until the market for the business became profitable. At the point the business became profitable, that business could be taken out of the regulated entity and put into an unregulated entity so that shareholders could enjoy the upside.⁷¹ Another problem – that would not be apparent unless the start-up business became successful – would be how to compensate rate payers for their payments, through higher rates, that enabled the early stage or fledgling business to get off the ground. Piedmont’s witnesses do not address this problem. Dr. Klein, in his testimony, does address this problem and provides safeguards (including the payment of compensation to rate payers) that should be put into place if the Authority were to grant Piedmont’s requests.⁷² In view of Mr. Novak’s testimony and to avoid the

⁷⁰ Novak Direct Testimony, at page 9, line 8, through page 10, line 3.

⁷¹ Piedmont repeatedly allows for the possibility that the CNG business may be unregulated at some point. *See, e.g.*, Transcript of Proceedings, Volume I A, at the Hearing on TRA Docket 14-00086, on January 12, 2015, at page 39, lines 20-22 (“We acknowledge that at some point the CNG market might be sufficiently competitive to justify deregulation of our service, . . .”).

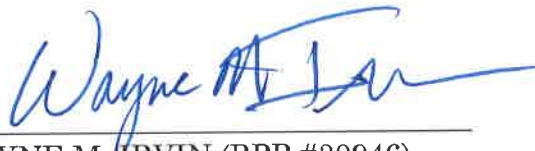
⁷² *See* Klein Direct Testimony, at pages 12-14.

problems raised in connection with cherry picking regulated or unregulated status, Piedmont's argument that its CNG business is regulated merely because its natural gas business is regulated should be rejected.

IV. CONCLUSION

For the foregoing reasons, the Consumer Advocate recommends that the infrastructure rider, in proposed Rate Schedule 318, should be denied. Further, since CNG should be considered an unregulated business, the Advocate recommends that Piedmont's Old Rate Schedule 342 be discontinued and terminated, and replaced by proposed Rate Schedule 343, and further, that any Company or affiliate sales for resale as CNG should be captured under Rate Schedule 343.

RESPECTFULLY SUBMITTED,



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Dated: January 22nd, 2015.

CERTIFICATE OF SERVICE

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


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This the 22nd day of January, 2015.



Wayne M. Irvin

ATTACHMENT A

TENNESSEE GENERAL ASSEMBLY

House Business and Utilities Sub Committee, March 6, 2013

Chairman Pat Marsh: Alright, we'll go to item number seven, House Bill 191. Leader McCormick, you're recognized.

Representative Gerald McCormick: thank you Mr. Chairman and I thought I'd come up here because we'll probably need to call on a couple of folks to come up here and give their opinions on the Bill, of course, with the permission of the Committee. This is the TRA Bill that's brought really jointly by the Administration and the TRA and it does several things and if I could, I'll go over the basic outline of it and focus in on one section that I think will have the most discussion on but I think this is the place to have the discussion. There are basically 5 sections that make changes, Section 1 would say that the TRA Directors are eligible for state employee health insurance benefits and those type things. That was the original intention and this makes that more clear. The second Section also clarifies some, there's actually some ambiguity relative to the conflict of interest prohibitions for the Directors, this does not make it easier, it just makes it clearer what they can and can't do and it's clean up language. Section 3 talks about implementing optional cost based services at the request of the utility and cover the cost for doing so. Again, that's not a huge change. Section 4 will realign the fee structure basically to reflect who is being regulated and let them pay the fees rather than have companies that are not being regulated, any or very much, and reduce their fees. This will also result in a savings of a little over a million dollars a year in the budget, which the TRA has worked very hard to make sure they could meet that and hopefully save rate payers over a million dollars a year in the process. Now, Section 5 is the section that I'm sure that our folks here will want to focus in on and what this does, it creates a new section authorizing the implementation of alternative regulatory methods for utility rate reviews and cost recovery. And this is in lieu of the current process where they have general rate cases every few years. Sometimes they settle them, sometimes they hire lots of lawyers and spend lots of money and take a lot of time and we read a lot about it in the newspaper and they have very contentious issues. Basically, what they are wanting to do in this is have more of an annual review and rather than having those big rate cases. Now, it won't keep us from having rate cases, we can still have them, but hopefully, we'll have less of them. In my opinion, I think a good way to say it is, is we're bringing in CPAs to review it more regularly and probably not using lawyers as much to have big rate review cases.

Chairman Pat Marsh: We have a motion on the Bill, do I hear a second? We have a motion and second. And we do have an amendment on it; do you want to talk about it?

Representative Gerald McCormick: I believe that's what I just explained, was the amendment.

Chairman Pat Marsh: Ok, alright do we have a motion on the amendment? We have a motion and second on the amendment. Does anybody have any questions on the amendment? Representative Pody?

Representative Mark Pody: Uh, yes, I've got one. Where it says it's going to empower the TRA to make these rules, are these rules come before Gov Ops? Who oversees the rules that they're making to make sure, who check them?

Representative Gerald McCormick: I think all rules have to come through Gov Ops at some point for review.

Representative Mark Pody: Even the TRA, so these rules will come? Okay.

Representative Gerald McCormick: Yes, they'll come through and I'll let them, if that's not correct they'll get a chance in a second. That is correct. And Mr. Chairman, I think it's only fair, we have had some objections to the Bill, especially for that last Section, from the Attorney General's office and with your permission I'd like to have them come up and state their case and then hopefully have the TRA Directors come up and state theirs.

Chairman Pat Marsh: We want to go ahead; do we have any more questions on the amendment? If not, I think we're going to go ahead and vote the amendment. Without objection, we'll go ahead and vote on the amendment. All in favor say aye, opposed? And that is amendment number 3640. The amendment passes, now we're back on the Bill. I think if it's okay with you Leader we'll go out of recess and hear from whoever you want to bring up or however you want to work it. We want to hear from the Attorney General? Is anybody here from the Attorney General's Office? Would you all like to come up and let us hear from you please? If you wouldn't mind stating your name and your position and then we'll hear your testimony. Turn your microphone on please sir.

Vance Broemel: My name's Vance Broemel, I'm with the Consumer Advocate and Protection Division of the Office of the Attorney General and with me here today is Ryan McGehee who is also from the Consumer Advocate and Protection Division and under the statute that created us we have the duty and authority to have cases at the Tennessee Regulatory Authority and also to participate in legislative and judicial proceedings and that's why we're here today here on this House Bill 191 and in particular, Section 5. As Leader McCormick pointed out there are numerous sections here. We are not speaking on the inspection fee portion of the Bill which has to do with fees paid by regulated companies, they're going down for some and up for others but we're not speaking on that. We simply note that those fees whatever they are can be recovered by the companies by rate payers. We're here today to speak on Section 5 which changes greatly the way rates will be set in Tennessee if it's passed. What this does, in our opinion, is make it more likely that rates will increase for businesses and households who are customers of regulated companies. And the reason for this is that this Bill greatly reduces the risk that the regulated companies/utilities, gas and water in particular, will have as businesses because they'll be allowed to recover, virtually immediately, their expenses in capital investments. Now heretofore, as was pointed out by Leader McCormick we had rate cases and in that you have a general hearing, you consider all the expenses, all the capital investments of a company and

then you project going forward what they think their expenses will be for the coming year and a rate is set on that with the addition that any investment that the company has made they get to recover a rate of return on that. And this is similar to any business. If you have a start-up company and it's difficult to attract capital you would want a high rate of return. Similarly, if you had a safe investment in bonds or a CD the rate of return would be less. What the TRA does is look at the company and decide what level of risk does it have and then that's expressed as a percentage, usually, let say just take a round figure, a utility could get a rate of return of 10%, that means that on all their investments, if they have \$50 million in investments, they get their projected expenses plus a rate of return on that \$50 million and each side presents testimony, our group has accountants that we have, now they are contract accountants and they present testimony, the TRA has a hearing and then decides the case, sets the rates. What this Bill does, is it takes the last rate case and that's still in effect, that's still there but in addition it allows companies to come and say we want recovery for this expense, we had some new project or whatever, well in traditional rate cases all those things are suppose to be figured into their projected rates and they're covered in the rates. Here what we're afraid of is that the risk, since the company is recovering these expenses virtually immediately, the risk should go down but there's nothing in the Bill to reflect that decrease or decline in risk. Therefore, we think rates will be unnecessarily high for consumers. We would point out that the TRA has full authority to do this without this Bill. They have set what's called alternative rate making mechanisms in the past, they could do this today and we think it would be better to do that because then you'd have input from concerned persons. You would have more flexibility and it wouldn't necessarily be the Legislature's framework, it would be the TRA, who, that's their responsibility to set rates and they have expertise to say how this should be done. We think it would be better in that kind of hearing. We would also point out, and I know this is fairly complicated, this Office did send a letter with a memo attached and we hope you all have it and if not we'd be glad to get it to you and the idea is that we are concerned about this potential increase in rates and we would also point out that by and large, the utilities of Tennessee, particularly the larger ones are doing very well financially. If you look at their stock prices from 2008 to the present in some cases it's virtually doubled and so they're not under financial stress, there's no idea in the Bill that that is the reason it is being done. Our concern, another one of our major concerns is not only will this likely increase rates but the way rate cases work, once this rate is set and you have a rate of return on it, if the company can become more efficient they get the benefit of the savings. In other words if you set a rate and the customer is charged say \$50 a month and the company gets real efficient and can do things for, you know, it costs them less than they projected, they get that savings. Under this system where they just simply submit a Bill and say we want reimbursement, we think they'll lose that efficiency. So in summary, that's our concern that this is a really big shift in the way rates are set. I know there's been some concern about rate case expense we agree that that can be a problem. We think that can be addressed at the TRA. I would point out that we've had three major cases with Tennessee American Water, Atmos, and Piedmont in the last few years. We've settled them. There were no hearings. The expenses were rather minimal. The expenses come when there's problems in discovery as we call it, it's kind of a legal term, we try to get information from the company. But that, we're very aware of that, we're very conscious of it and we do try to hold the expenses down. So, if there are any

questions, we'd be glad to entertain them. Either myself or Mr. McGehee. That concludes our remarks.

Chairman Pat Marsh: Okay. Mr. Broemel, in your testimony I thought you just said that they can currently do this now?

Vance Broemel: Yes.

Chairman Pat Marsh: If they can do it now, why do you object to them doing it in the Bill?

Vance Broemel: Well, because we think that it would be more input from more concerned parties and there could be more flexibility. In the Bill itself, it states that they can develop rules and procedures. We think it would be better to do that all at the same time. In the past, there was a Bill here about something called decoupling where the idea was that if consumers conserve there was concern that the companies would not be making their projected rate of return, the Legislature made a general policy statement about the TRA should hear cases where the companies can present this concern with conservation and then they will make a determination and they did that and they developed a system to cover those cases. So in other words until you really have a full case with all the implications, we think it is not a wise idea to set this kind of framework as it were in a vacuum. It would be better to have them do it when there's much more to consider.

Ryan McGehee: If I may, if you lock in the specific mechanisms that you have here now, with the guaranteeing the return on equity along those, the procedures that encompass that, it makes it difficult for the TRA and our office to present safeguards for consumers, to prevent over-earning, to adjust the return on equity because the risk is being shifted to the customers. Here you're locking them in under the old system when they were slightly more riskier. Here we're moving to a system where you are shifting the risk and there should be an adjustment there, the return on equity. We actually had a company on the record agree with us in the past case that these things do shift risk but this Bill does address that and does not allow for that flexibility. Another aspect of this, of the Bill, is that it does not have a rate cap which previous legislation, in 2009, legislation or this Committee or the Commerce Committee chose to put a summer study. There was a rate cap in there but there's not one here so there are some things that are locked-in that are going to limit flexibility in the future.

Chairman Pat Marsh: I believe we have a question from Representative Curtiss?

Representative Charles Curtiss: Thank you Mr. Chairman. Toward the end of your statement you made the, I believe I heard this correctly, that in estimating what their expenses are going to be they could end up overestimating what their expense is going to be and if they were to conserve and had a savings they would keep that, retain that profit.

Vance Broemel: Right.

Representative Charles Curtiss: Then I understood that correctly. Is there anything that you can think of, we're giving through the rule making authority; the TRA is going to have to go through rule making procedures. Is there anything in this statute that's being proposed that would prevent them through rule making to recapture that money?

Vance Broemel: I don't, it's ah, I suppose they could try it but it, there's nothing in the statute that allows them to do that and we just don't know how that would work.

Representative Charles Curtiss: I'll just ask that question when they're presenting.

Chairman Pat Marsh: Leader McCormick.

Representative Gerald McCormick: Thank you Mr. Chairman and I've got a couple of questions. Did y'all say that the TRA could do this without legislation? They could basically implement this program right now? Or just that Section?

Vance Broemel: A large part, Section 5, in the past they have done extensive regulation in I believe it was the early 90s with phone companies going to what we would call an alternative form of rate making where they allowed them to have a projected rate of return and if they were over earning then they would have a review of that and recapture it. They did that all without legislation, yes.

Representative Gerald McCormick: Okay.

Ryan McGehee: There are a number of items they've already done as well like the commodity cost of gas is passed on to consumers, rates are adjusted annually for gas companies based on the weather, you know if you have a mild winter the rates go up if you have a very cold winter the rates can go down. There are already a number of pass-throughs already in effect and that's all without legislative authority. Specific, ...

Representative Gerald McCormick: And I'll ask the same question when the TRA folks get up but if they can go ahead and implement this without legislation I'd rather get 3 votes than 50 so we'll see what the TRA folks say about that. I know in Section c of 5 it says, talking about recovery operational expenses, capital cost or both associated with the investment in other programs including the rate of return approved by the Authority at the public utility's most recent general rate case, now could I take that to mean that if, let's say that the water company's electric rates go up because TVA raises them and the power board raises them in return, and they have to pay an extra \$10,000 you know, in their Bill next year, are you saying that they'll be able to charge \$11,000 if they get a 10% rate of return on a simple Bill, a simple expense like that? Or is it just things that have to do with capital improvements.

Vance Broemel: Yeah, I think it would be capital improvements and they would get a recovery of that increase, perhaps, depending on the circumstances and that's one of our concerns. When you have a rate case you take into consideration all the expenses.

Here they're singling out one that went up but see they may have gotten more efficient with their labor cost and that's gone down but there's no provision in this Bill to look at what went down. It's only what goes up and that's our concern. In a rate case you look at all expenses, some go up, some go down, you come to a global understanding but here, that's a good example. Say if electric went up they could come in with a high electric Bill and say we need to raise rates but they wouldn't be telling you that they've got a new computer system or smart meters that read meters more efficiently and they don't need as many people doing that and there's no off-set. So that's the very kind of thing we're very concerned with. About just looking at what goes up.

Representative Gerald McCormick: Would the TRA not be able to take that into account? Or would they be legally prohibited from taking that into account?

Vance Broemel: Well, there's nothing in the Bill, it just talks about you're authorized to get this expense. And in fact, it just says you look at the rate of the last rate case, there's nothing about other expenses. That's another concern, when you quoted the last rate case, we all know that capital markets can change. Some of these companies haven't been in for years and years, they might have a rate of return of say 12% and the TRA is prohibited from adjusting that and so you need, this Bill says you look at what happened at the last rate case and as we all know with the economy you need much more current financial data. And that's another concern of ours.

Representative Gerald McCormick: Okay so you're saying if a company had a good rate case 5 or 6 years ago they might never want a rate case.

Vance Broemel: Right.

Representative Gerald McCormick: But I suppose you guys could initiate a rate case, couldn't you?

Vance Broemel: We have in the past, I mean it's getting into kind of history I suppose, but we did it once with Atmos, it was expensive and very contentious, if I can use that word in the sense that they were over earning some \$5 or \$6 million a year. We did do that and brought it in and did reduce their rates so we do have that power at the current time but with this annual rate review and these trackers, it's to me, very unclear whether we'll be able to do that in the future.

Ryan McGehee: and Leader McCormick another big concern here is that not every company can decide to do annual rate review. They can cherry pick with a specific tracker and the rest of their rates would not be looked at, it would just be those expenses that flow into that tracker and the return that's guaranteed on that.

Representative Gerald McCormick: But you could still initiate a rate review but you're saying it would be very expensive and very...

Vance Broemel: Well, and it would really be a cross-purpose with this Bill. I think the company's would complain that they've chosen an annual rate review and these trackers

and they don't need to have a rate case and I, you know, I guess it just would be up in the air what would happen. We would probably ask for one but whether we would get it, I'll point out with the Atmos case, our initial request that those rates be reduced was dismissed and we had to come back again so if anybody knows the law you can make an argument, whether the agency will accept it, I don't know.

Representative Gerald McCormick: Okay. I would certainly want to have the legislative intent that a company couldn't take advantage, well for instance we had a long period of low interest rates and cheap capital and if somebody's hanging on to 14% rate of return from ten years ago, that's something we'd need to guard against and make sure in the legislative intent and if this were to pass we would want to do that. One other question is the rate cap you're talking about, what would be a reasonable rate cap as far as annual increases go, do you think? And again, put it in the law.

Ryan McGehee: I would like to see or at least I would, this is me speaking, I haven't discussed this with General Cooper specifically, you know, a rate cap not only on the annual rate review but also on the trackers themselves and you know I think just off the top of my head, a 3% cap would be good.

Representative Gerald McCormick: Well, you're not old enough to remember the 70s but if you'd done that in 1974 you could have wiped out some of these, even being monopolies, you could have wiped them out based on that.

Ryan McGehee: I know a lot of people speculate that we're heading back that way but you know we're not in that kind of inflationary period just yet.

Representative Gerald McCormick: It's coming. Thank you Mr. Chairman.

Chairman Pat Marsh: Representative Pody.

Representative Mark Pody: Thank you Mr. Chairman. I want to go back to the TRA. I thought if somebody came for a rate increase the TRA had the right to look at their entire budget, their entire profit/loss, they're not going to just look at one section so I'm not following where this would happen. If they had a profit in one area because they recouped that money, the next time they came for a rate increase that would be taken into account. Is that not correct?

Vance Broemel: That's correct under the current situation; under a rate case but this Bill changes that entirely. It, for 2 or 3 pages, it goes on and on about all, you can recover for a singled out expense, it will not look at its total expense, no.

Representative Mark Pody: So if this goes though the TRA would not have that authority?

Vance Broemel: No. I mean, whether they have the, under this Bill they wouldn't. We were speaking to Leader McCormick I suppose we could ask for an entirely new rate case but the intent of this Bill is to avoid or not have rate cases which means you

would not be looking at their entire expenses.

Ryan McGehee: And there are several mechanisms under the Bill, not just annual rate review that would allow the company to cherry pick where you don't look at the other operations and revenues.

Representative Mark Pody: Thank you.

Vance Broemel: I'd just like to point out that this Office is very concerned about investments in Tennessee and to the best of my recollection we've never opposed a capital project to put in pipes, valves, whatever, particularly with a water company in Chattanooga, so it's not that we want to cut down on recovery of capital expenses we just want to do it in a way that we think is fair to all parties.

Chairman Pat Marsh: Okay. Do we have any other questions? If not, we will let you all go back and ask the other side to come up and give their side. Is it going to be you Mr. Allison? And Tim?

Jim Allison: I'm Jim Allison, I'm the Chairman of the Tennessee Regulatory Authority and with me today are Jean Stone, our General Counsel and Ed Taylor, our Executive Director. I'll make some comments and we'll do our best to answer any comments you may have. This Bill basically does 2 things. The first thing it does is reduce the regulatory burden on the utility companies in the state of Tennessee by about \$1.1 million a year by reducing our regulatory fees. The second primary piece of the Bill is what was just discussed, the alternative regulation. I want to make it clear to the Committee that this is not new stuff. Georgia, South Carolina, Mississippi, Alabama, Virginia and a whole host of other states across this country have already done a number of these things. It's procedural in nature. It does not substantively change what the TRA can do or cannot do. Now the Attorney General's office is focused in a very narrow sense of what the Bill says on the rate of return. What they've missed is that before the Regulatory Authority will allow a company to enter into one of these alternative rate making processes is that we have to go through a process to establish and conclude that going into one of these alternative methods is in the public interest. In doing that, we will look at a whole variety of things, including the rate of return. Now, there's another piece of the alternative field that will permit company's and it's all permissive, none of the company's have to do any of this and the TRA does not have to accept any of this, we have to agree that it's in the public interest before we enter into any of these alternative methods. But another piece of the Bill would require, if a company opts into it, is annual rate, an annual rate filings. By making an annual rate filing, it will keep up more up to date on the cost, the returns, the expenses of all of these companies so that when we're dealing with the rate of return issue that was brought up earlier we're not going to being a apposition of not having looked at it for 5 or 6 or 8 years, in fact, the law requires them to have a general rate case in the last 5 years to enter into this rate review, so we'll be looking at their rates every year if they opt into this annual rate review. If their rate of review gets out of kilter with the current market conditions then the Authority can, and we have in the past, brought proceedings to open up the entire rate spectrum and we can do that here even if they go into this. As far as the trackers are concerned, again these are

in wide use around the country, it's an effort to streamline the regulatory process, the example that was used here earlier was a good one. If a water company uses a lot of power to pump their water, has a major rate increase from TVA, why open up every piece of their rates just to look at that? Now, again we would have to certify that it's in the public interest before we do that, but why not have a proceeding that would allow you to just look at that one piece. You may have just had a general rate increase last year, again we can stay on top of that on a regular basis by this annual review and we will look at that. We've got a staff that will be looking at that on a regular basis. If the rate of return gets out of kilter we can open up a rate case to look at the rate of return. There's nothing in here that prohibits us from doing that and we will continue to do that just like we've done in the past. I'm going to kind of shut-up and try to answer any questions you have but the bottom line is that the Authority has looked at this we're very comfortable that we can continue to carry out our responsibilities with this Bill as it's written. Again, it's permissive, both on the part of the utility system to opt into it and it's permissive on our part to allow them to opt into it because we have to certify that it's in the public interest.

Chairman Pat Marsh: Thank you very much. I have a question, when I heard about some of the parts of this Bill I understood that this change should help do away with a lot of legal expenses on both sides by bringing up a host of lawyers to argue and all that savings, as I understand it will go back to the rate payers? Is that correct?

Jim Allison: That's correct. The intent of this Bill is to make the process more accounting driven, analyst driven more than it is attorney driven. Again, I know there's a lot of attorneys in the Legislature so I don't want to say too much bad about attorneys but, I've been on both sides of rate cases now. I've spent my career working in the utility district, I've testified before regulatory agencies in 6 states. I know how frustrating it is to write those million dollar checks to the law firms and I also know how frustrating it is on the part of the regulator for us to have to say, okay, it's okay for you to go recover that million dollar check that you wrote to the law firm from your rate payers and what we're interested in doing is trying to make government more efficient, more streamlined and we're prepared to do everything we can at the Tennessee Regulatory Authority to make that happen and we think this Bill moves us in that direction.

Chairman Pat Marsh: I have one other question that might be a little off. I was asked to ask this by the Fuel and Convenience Store Association, is it the intent of this legislation to permit regulated, natural gas companies to subsidize their retail or wholesale alternative motor vehicle transportation fuel operations with rate payer funds?

Jim Allison: The answer to that is no. The Bill, again, is procedural in nature, there's no substantive change to policy to the State of Tennessee other than the fact that it will hopefully streamline the regulatory process.

Chairman Pat Marsh: Thank you. Leader McCormick.

Representative Gerald McCormick: Thank you Mr. Chairman and I need to ask

some questions. I'm the sponsor of the Bill and I support the Bill but also have an obligation, well not only to the rate payers of my area but to the members of my caucus and the General Assembly so I want to ask a couple of questions along those lines. You talked a minute ago, let's say about Chattanooga, the water company had a bigger electric Bill and it went up and you can look at the line item and see where it went up, would that be considered an operational expense?

Jim Allison: That is an operational expense, yes sir.

Representative Gerald McCormick: Well the law says that any operational expenses can be recovered plus the rate of return so if they're going to make it 10% or 12% profit on paying their water Bill? That's what I'm reading here.

Jim Allison: No sir. The rate of return is on invested capital. It's intended to cover for the cost of the capital, is the way we apply it to a rate case so if there is a capital component to that and I don't specifically what section you're looking at but it involves operating expenses as well as capital expenditure but the rate of return is on capital expenses not operating expenses.

Representative Gerald McCormick: Well I better read it to you then, it's in Sections 5 c and it says the Authority shall grant recovery and shall authorize a separate recovery mechanism or adjust rates to recovery operational expenses, capital costs, or both, association with the investment of other programs. So maybe that's how you get out of just paying the Bill, but certainly if I were the company I would say that my light Bill is associated investment and other programs including the rate of return approved by the Authority at the public utility's most recent rate case. Maybe we need to get somebody from the industry to come up here and say that if your light Bill goes up by \$10,000 are you going to give us a Bill for \$11,000 and let the rate payers pay for it, that's the real question.

Jim Allison: If you want the industry to address it you're welcome but it's well settled in rate case methodology that the rate of return is applied only to capital expenditures and it involves both debt as well as equity return so you have both elements of the return in there.

Representative Gerald McCormick: It may be well settled but we're changing it with this right here from the way I'm reading it, but I'm not a lawyer we may need to go to the senate and find some lawyers to come over here but I mean that's what it says so I think we probably need to find out if it says what it means or if it means something else but it specifically says recover operational expenses including the rate of return approved by the Authority of a public utility's most recent general rate case so I'll ask some of the people that are with some of these companies maybe after the meeting if they can give me some feedback.

Jim Allison: Well our attorney is here with us, she can address it more detailed if you wish too but the rate of return is intended to apply to the capital cost piece of that

paragraph. It says to recover operational expenses capital cost or both including the rate of return approved by the Authority at the public utility's most recent general rate case pursuant to, that rate of return would apply only to the capital investment not the operation expenses.

Representative Gerald McCormick: Okay. Thank you very much.

Chairman Pat Marsh: Representative Curtis.

Representative Charles Curtiss: Thank you Mr. Chairman. You heard the question I asked the Attorney General's office, they made the comment that an entity before the TRA on a rate review case they would say they were going to do some capital expenditures, there's going to be X amount of dollars and the rate was based upon that but through efficiencies they brought in way under the budget uh, you would have the ability to still look at that, that they calculated that incorrectly? I mean without that ability the incentive would be to always overestimate your expenditures to have a higher rate and reap the profits.

Jim Allison: Not only will we still have the opportunity we'll have an enhanced opportunity with the annual rate filing. Otherwise in the current situation we may look at it every three, four, five, six years now all of our utilities except 1 have been in within a fairly recent period of time for a general rate case so we don't have anybody out there that's gone 20 years without a general rate case or anything like that but this Bill would give us an enhanced opportunity to look at those expenses.

Representative Charles Curtiss: Right. The other thing that occurred to me while they were testifying, you're not preventing the Attorney General's office to ask questions about a rate setting or something of that nature? They're still going to have the ability to bring something to your attention, am I correct?

Jim Allison: That's correct and at any time and we focused earlier on some comments on the rate of return, anytime they feel like a company's rate of return is excessive they are certainly permitted by statute to file a petition requesting us to look at that and we have historically have always accepted those.

Representative Charles Curtiss: Thank you sir. I think the fact there's a little bit, it seems like it's vague, the Bill, in places but the fact that you're going to have rule making authority, that's not preventing you from being able to address all these areas that are not spelled out.

Jim Allison: That's correct sir.

Representative Charles Curtiss: Thank you.

Chairman Pat Marsh: Representative Hill.

Representative Hill: Thank you Mr. Chairman and of course Mr. Chairman thank you

so much for being here and I appreciate the intent of the legislation. Just a couple of quick questions, you said earlier in your statement, you said that this is really conforming into what other states are doing? And that, you know I think some of the questions on, I believe it's Section 5 of the legislation, do other states do that as well? As it sits?

Jim Allison: Yes, they, and I don't have the exact number but it's a long list of states that have entered into some of these alternative rate making and the Attorney General quoted our last audit report in theirs with some comments. If you read the entire paragraph it will say in there that this is clearly a national trend to move in this direction.

Representative Hill: Okay. Thank you so much.

Chairman Pat Marsh: Representative Pody.

Representative Mark Pody: Two questions. One, what would you say is a good rate of return right now that would be approved?

Jim Allison: The overall rate of return will reflect both the cost of debt as well as the cost of equity. The debt cost right now are fairly low, we've seen some rate cases and I'm going to look to staff to correct me if I misspeak here, where the overall rate of return is around 6-7% but the debt component of that is on the low end of that, the equity number's up on the higher end of that. It's set in an individual case depending on the riskiness of it. We've got some utilities that are well established with relatively low equity numbers, return numbers. We've got others that are fairly risky propositions. We've got one that just bought a company out of bankruptcy and it's a pretty risky proposition and has a higher equity rate of return than the others.

Representative Mark Pody: Ok and my last question, you said that most of the utilities are fairly current in their, you've audited and such, what's the one that's oldest? What's the longest one out there?

Jim Allison: Again, I'm going to ask the staff to correct me if I misspeak but I believe it's Kingsport Power, the electric utility we regulate up in upper East Tennessee and I believe they are somewhere around 8 or 9 years out.

Jean Stone: I believe they are more like 18 or 19 years at this point but they're rates are extremely low in comparison with other electric rates in that area.

Chairman Pat Marsh: Do we have any other questions while we're out of session? Leader McCormick.

Representative Gerald McCormick: Thank you Mr. Chairman and one more and you may have answered this and I was in a sidebar conversation but my question is in Section 5 can the TRA, do you have the authority to this without a vote of the Legislature? To make these changes?

Jim Allison: We have instituted some trackers in some fairly limited situation and again I'll defer to our attorney to comment on the legalities of it, but we feel like it's prudent to clarify the nature of these and get legislative authorization before we go further with it and that's the reason we're supporting the Bill. We think it clarifies it and resolves any questions about whether or not instituting some of these trackers is appropriate or not but I would invite Ms. Stone to comment on the legality piece of it.

Jean Stone: I think that's absolutely correct and I will just add that rate setting is traditionally a legislative function and so it is entirely appropriate in my opinion to come to the Legislature to ask you all to set the policy and the perimeters for rate setting including alternative methods.

Representative Gerald McCormick: Thank you.

Chairman Pat Marsh: Do we have any other questions while we're out of session? If not, we'll go back in session. Thank you all for coming up. Representative Towne's we're glad to see you come in today. Welcome. We're back on the Bill do we have any other discussions on the Bill? If not, are we ready to vote on the Bill? All in favor please say aye, opposed? Aye's have it. This Bill moves out to Finance Ways and Means.

ATTACHMENT B

TENNESSEE GENERAL ASSEMBLY

House Finance Ways & Means Subcommittee, March 13, 2013

Chairman Michael Harrison: Okay we'll take item 39, House Bill 191 out of order. Leader McCormick you're recognized.

Representative Gerald McCormick: Thank you Mr. Chairman. House Bill 191 is an administration bill in cooperation with the TRA. It has several components but basically it realigns the TRA's funding mechanism which will result in over \$1 Million in fee reductions passed down to utilities and hopefully to the consumers too. It also enables the adoption of best practices for more efficient rate reviews which means we're going to bring in and see...

Chairman Michael Harrison: Bill's been moved and properly seconded. Do we have questions on the bill? Chairman Sargent, you're recognized.

Representative Charles Sargent: thank you Mr. Chairman. Leader McCormick, let me, I have two questions I'd like to ask and I think you probably know what they are. One of these, we're going to do an annual rate review and normally we did a review after 4 or 5 years and they had a full blown hearing. When we do this will there actually be a review or is it just going to be that they ask for a half percent or a ¾ percent of an increase is that going to be automatic or will they actually have an annual review and see why they need that increase?

Representative Gerald McCormick: That's a good question. What they're going to do, as you know in the past, they'd wait several years, 3 to 5 years and longer sometimes and then go in and have a full blown case where a lot of lawyers were hired and a lot of fights and negotiating positions and that type thing. What this does is gives the TRA the ability to really on a constant basis keep an eye on these companies and give them some rate, usually increases I suspect, based on some expenses that they really don't have any control over. It'll be more of, I'd say, a CPA driven process rather than a legal driven process but with the clear understanding that it could turn into a legal process if the system breaks down. So, it has the safeguards of the old system but some efficiencies in the new system.

Representative Charles Sargent: You feel doing it like this, the consumers are still going to be protected and have all the protections they had before?

Representative Gerald McCormick: I do feel like it and I had some questions myself. I'm carrying the legislation but I think we need to ask tough questions about legislation that we carry not just other people's legislation and something that keeps cropping up that reassures me is that the Commission will have the ability and as the words are written to act in the public interest. Which is vaguely defined which I think gives them a lot of authority to go in if the system is being abused to step in and change things if they need to in the public interest.

Representative Charles Sargent: Chairman, thank you for that. For those, I just wanted to make sure that we had that on the record. The other question I have is under Section 5. Section 5 as you know where natural gas companies would be able to set up, and there's been a lot of talk about this, set up their own substation or sell natural gas for cars and trucks. Is that, do you see that as the intent of the legislation?

Representative Gerald McCormick: You know Chairman, this is one that just came up yesterday and I hate to make this last any longer but I don't want to give you the wrong answer. If I have the Committee's permission I'd like to call up possibly Chairman Allison to address that question, if that's okay with the Chairman too and both Chairmen.

Chairman Michael Harrison: Without objection we're out of session. If you would, come forward and state your name for the record.

Jim Allison: I'm Jim Allison, I'm the Chairman of the Tennessee Regulatory Authority. The answer to your question is what it deals with is a procedural change in how we will go about looking at those rates. It does not guarantee recovery, it does not say that there will be any cross-subsidization of the fuel, motor fuel dispenser by residential consumers or anything of that nature but the alternative rate making procedures, all of them, are permissive and it would require that finding that the public interest, like the Leader stated.

Chairman Michael Harrison: You're recognized.

Representative Charles Sargent: Thank you Mr. Chairman. My question is, is it the intent of natural gas companies to go into set up, I'll say natural gas stations through-out the state and have the rate payers paying for that infrastructure and not as a commercial entity? Is there, I want to make sure we don't have rate payers paying for infrastructure where we have commercial entities out there that have to basically pay for their own infrastructure.

Jim Allison: There is no intent in this legislation to allow any other class of consumers to subsidize the facilities that would go into providing natural gas as a motor fuel.

Representative Charles Sargent: And is also your understanding that natural gas companies do not intend to set up stations throughout the state? And they're going to lead back to the retailers of the Mapcos and the Exxons and the Shell stations of the world to do that?

Jim Allison: I can't really address what the intentions of the natural gas companies are but as the Regulatory Authority we will assure there is no cross-subsidization going on as we implement the various rates.

Representative Charles Sargent: Okay. Thank you. Thank you Mr. Chairman.

Chairman Michael Harrison: Representative Armstrong, you're recognized.

Representative Joe Armstrong: Thank you Mr. Chairman and Chairman Sargent brings up a very interesting question as it relates to, you know, natural gas vehicles and of course, realizing that natural gas is becoming the transportation fuel. Certainly I didn't know if the agency had looked at the conversion from petroleum based fuel to natural gas and setting up the rules and regulations along that line. Even if you look at the available information that's out there, all our utilities, they're converting the coal fired plants, the TVA's just converted to natural gas at some of their largest, some of their largest facilities over to natural gas and then with all of the reports about how much natural gas is available in this country with all the findings (?) or the shale gas and the fracking and all of this, have we looked at a comprehensive study of Tennessee looking at the use of natural gas and also as a transportation fuel? Because I think the last statistic that I saw that natural gas on a BTU level would cost about \$1.29 per gallon if we switched over from gas that's costing what \$4.40 a gallon now. Has this agency looked at going in that direction for natural gas fueling and for

providing those infrastructures?

Jim Allison: There's a lot of talk nationally about, not only natural gas, but other alternative fuels. For example, I drove up here from Shelbyville in an electric car yesterday. So, it's an emerging part of the technology of our country. At the TRA we have had some limited experience with natural gas as a motor fuel, we do have at least one and I think perhaps 2 natural gas companies that have established refueling stations. They are not on the side of the interstate where everybody knows where they are but they are for people who have limited natural gas vehicles already and we've established tariffs for those dispensing facilities already so we have looked at it in a limited sense but I would have to say in a comprehensive sense we have not had a formal study like you're suggesting.

Representative Joe Armstrong: And when you mention tariffs, we know we've got taxes on our fuel to pay for road costs but when it comes to electric vehicles, when it comes to natural gas vehicles, there's no money being collected for the infrastructure and I'm kind of following along with the Chairman was talking about. Certainly we can even get into how other states actually distribute gas to not only commercial but to residential, you know, in Georgia an individual gets to choose which company, which market they buy gas from and the utility is only the deliverer of that. In Tennessee we've got a different type of structure and I didn't know if you were looking at that, where the utility only charges you for the transportation but you pay a commodity price from someone else. And Texas has a totally deregulating both electric and natural gas. Are we looking at some of these because there's a significant difference in natural gas prices to consumers in Georgia is a big difference than what we pay here in Tennessee. In Tennessee we pay different rates in between different consumers. The only ones subject to any type of hedge, whether it's low or high, are the private companies but certainly those utilities out here that are making money off the commodity price, have we looked at basically talking to them and saying, hey, put in your infrastructure cost and let the consumer have a choice and let the businesses have a choice where they buy their natural gas?

Jim Allison: There is some of that going on in the natural gas industry all, already in Tennessee. For example, we have a number of large users of natural gas that buy directly from alternative sources and then use the local distribution company just for a delivery mechanism so there are situations in place in Tennessee where that's occurring as well. It hasn't been penetrated to the individual homeowner level. I used to work in Georgia it's got its pluses and minuses, to deal with that. It becomes a very complex arena but it hasn't penetrated down to the individual level here in Tennessee yet but we do have a number of large consumers who already do just that.

Representative Joe Armstrong: Okay, but your experience in Georgia, certainly, I think it would benefit the residential consumers to look at that option and see if it would be some savings on that residential user. And I didn't know if you had plans within the TRA to look at things of that nature.

Jim Allison: We don't have anything specifically planned but we'll certainly talk about it after the discussion today.

Chairman Michael Harrison: Any further questions for the Chairman? Seeing none. Thank you for being with us today. Without objection, we're back in session. Leader McCormick?

Representative Gerald McCormick: I renew my motion Mr. Chairman.

Chairman Michael Harrison: Any further questions. Seeing none. Is there objections to questions? Hearing none, all in favor of moving house bill 191 to full finance, say aye, those opposed. Bill moves out.