

**STATEMENT OF THE CONSUMER ADVOCATE DIVISION OF THE OFFICE  
OF THE ATTORNEY GENERAL REGARDING HOUSE BILL 1349**

**Presented to the House Utilities and Banking Subcommittee on March 31, 2009**

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Good morning. I'm Joe Shirley with the Attorney General's Office and I appreciate the opportunity to address you regarding House Bill 1349. I'm appearing here today in the Attorney General's role as the state's Consumer Advocate. The General Assembly has charged the Attorney General, through the Consumer Advocate Division, with the responsibility of representing the interests of public utility consumers in administrative and judicial matters, and in legislative proceedings as well. So I'm here to fulfill this responsibility that you have given us and to speak to you on behalf of the 350,000 homes and businesses that we believe would be adversely impacted if this proposed legislation is enacted. We are here today because this bill represents, as its supporters have said, "a paradigm shift" in the way we set utility rates in Tennessee. This concept could be extended to other regulated monopolies and, since there is a national debate under way on this, what we do in Tennessee could serve as a model for other states. Therefore, it's important to get it right.

The Consumer Advocate cannot support this bill because it will lead to unwarranted and inappropriate increases in the gas utility bills of thousands of Tennesseans. And we feel that it's especially unjustified to implement policy changes that will needlessly drive up the costs of utilities in the face of today's tough economy – a time when many households and businesses are already struggling with some of the worst financial hardships that we've experienced since the 1930s. And while many Tennesseans are suffering financially, the natural gas industry in Tennessee remains financially strong and viable. It's important to keep in mind that these utilities are monopolies that have been granted an exclusive franchise to sell and distribute

natural gas in their respective service territories. We're not dealing here with traditional marketplace concerns; Tennesseans have no choice for their natural gas service other than their public utility. This is the very reason you have granted general ratemaking authority to the TRA – so that it can balance the utility's need to recover its costs and earn a fair profit with the public's need for affordable natural gas service. Because our current ratemaking policies and procedures provide our natural gas utilities with sufficient remedies to address their own financial concerns, we believe fundamental changes in regulations, such as those proposed in this bill, should be very carefully studied and the concerns of all stakeholders should be seriously considered before such sweeping changes are mandated.

We would respectfully submit that the proposed legislation is not an appropriate response to the energy conservation concerns the bill purports to address. I can assure you that the Consumer Advocate is generally supportive of energy conservation measures and we've previously expressed that support in prior cases in front of the TRA; and we even believe that legitimate debate can be had about the need to isolate the impact of conservation on the utility's revenues and to take appropriate action to stabilize those revenues. But not every conservation proposal is a good one. This bill, for instance, is touted as an energy conservation measure; however, we see it more as an energy conservation penalty on consumers. And that's because the particular mechanisms proposed in the bill will operate to provide a financial windfall to the utilities at the expense of consumers.

For example, the conservation plan provisions in the bill would require consumers to pay incentive bonuses to the gas utilities. The bill's clarification of the TRA's authority to mandate consumer funding for conservation programs may be necessary. However, we cannot support the bill's provision that allows the gas utilities to retain a bonus of up to 15% of the estimated

economic benefits of conservation plans, especially since consumers are required under the bill to fund these plans dollar-for-dollar. Because consumers are required to pay for all of the costs, any economic benefits generated from such plans should flow to consumers rather than the utilities.

Additionally, the decoupling mechanism proposed in this bill will cause unjustified price increases for consumers. Now I know that “decoupling” is a technical term, but the concept of decoupling is rather simple – it merely attempts to allow the utility to recoup the revenues it loses due to reduced usage from energy conservation by customers. So if the utility’s revenues remain stable even if customers conserve energy and use less gas, then the utility is not harmed by conservation efforts and programs, which we admit is a laudable goal. But decoupling has been subject to extensive national debate; and, in practice, decoupling mechanisms have been controversial and, certainly, not uniformly accepted. For example, decoupling mechanisms have been recently rejected in Iowa and New Mexico.

One of the chief flaws of many decoupling programs, like the one proposed in this bill, is the focus on conservation and usage patterns on a **per customer basis**, as opposed to the conservation and usage of **all the utility’s customers**. Because utility revenues depend on the total number of customers and the total amount of gas delivered to all of those customers, any decoupling measure should take into account all the gas delivered to all the customers to determine whether revenues are harmed by reduced usage from conservation or other factors. But when a decoupling program focuses strictly on the usage of an **“average customer,”** it leaves out the fact that the utility’s revenues are constantly growing because new customers are continually being added to the system year after year. And because the revenues coming in from

customer growth are ignored in “**per customer**” decoupling mechanisms, they invariably lead to an over-correction of conservation’s effect on revenues.

So instead of merely restoring the utility’s revenues, decoupling mechanisms based on **per customer** data actually overcompensate the utility by allowing it to collect more revenues than necessary to offset losses from conservation by customers. Of course, these extra revenues are collected from consumers in the form of unwarranted price increases. The decoupling mechanism proposed in this bill suffers from this flaw, which is one of the main reasons the Consumer Advocate cannot support it.

Separate from decoupling, this legislation also authorizes the adoption of an annual rate review mechanism. We do not support this provision because the annual rate review mechanism will seriously weaken the voices of individual and business consumers, as well as the TRA, in the utility rate-setting process. First of all, the procedures mandated in the bill do not afford consumers a fair opportunity for review of the TRA’s decision on the utility’s election of an annual rate review mechanism; the order establishing this mechanism is not reviewable unless and until there’s a full-blown utility rate case – a procedure which seriously undermines anyone’s participation in the very process that sets up the annual rate review mechanism.

And significantly, after the annual rate review mechanism is in operation, it will reduce the TRA’s discretion to set utility rates in light of prevailing business and economic conditions. Under the proposed mechanism, the TRA is allowed to conduct only a limited review to determine whether the annual rate filing is arithmetically correct and in compliance with the annual rate review mechanism procedures. After the TRA’s limited review, the new utility rates will go into effect. And only after the new prices are already ordered and added to the bill could

consumers request an evidentiary hearing. But this hearing is also limited to issues regarding mathematical errors and compliance with the annual rate review mechanism.

Another significant flaw with the proposed annual rate review mechanism is that it allows the utility to implement increases of up to **4% of “total revenue”** without a full rate case. As more clearly demonstrated in the attached exhibit, a 4% increase in “total revenue” collected by the utility would actually translate into increases of **12% to 16%** in the utility’s tariffed base rates on file at the TRA. It is the revenues collected through these tariffs, as opposed to the utility’s “total revenues,” that are the subject of rate case proceedings before the TRA. The “total revenues” collected by the utility not only include the tariffed base rates the utility charges for recovery of its distribution costs and fair rate of return (or fair profit), but “total revenues” also include the monies the utility collects to cover the costs of the natural gas itself, which is simply passed on to consumers dollar-for-dollar. By allowing the utility increases of up to 4% of “total revenues,” the rates the utility charges for recovery of its costs and fair profit could increase by as much as 16% annually, based on the utilities’ figures for 2008. While at first glance the 4% provision may appear reasonable, in practice this provision would not prevent annual double-digit increases in tariffed customer rates.

So what we see is an annual rate mechanism that does not provide individual and business consumers with a fair opportunity to have input in the development of their utility rates; that does not provide the TRA with the flexibility it needs to adjust rates in light of the business environment; and that’s not amenable to correction and review. Quite frankly, we think this mechanism unduly favors the industry to the detriment of individual and business consumers. And let’s not forget that it’s the consumers’ money that’s at stake here; each year Tennesseans pay hundreds of millions of dollars for their natural gas utility service; so ratemaking is no small

matter to them or their household and business budgets. Now we realize that administrative efficiency is a legitimate topic for debate, but any ratemaking process that's established in the name of efficiency or otherwise should at the very least allow the people paying the bills a fair opportunity to be heard.

The last area that I'd like to address is the bill's limitation on the TRA's discretion to consider whether the revenue stabilization brought about by the decoupling and annual rate review mechanisms would affect the utility's return on equity. The determination of an appropriate return on equity is an important factor in deciding the fair rate of return the utility is allowed to earn on its investment. The reason this is such an important point is that a utility's fair rate of return on its investment is a significant driver of utility rates; even small changes in the return on equity and fair rate of return can often have a material impact on the price customers pay for utility service.

The Consumer Advocate holds the view that revenue stabilization programs like decoupling and annual rate mechanisms reduce the utility's risk of losing money, and that this reduced risk should be factored into the return on equity analysis. We're not the only ones who hold this view; this very point has been debated nationally and even some industry representatives have recognized the validity of the relationship between such revenue stabilization programs and the return on equity. For instance, in one of the cases in the TRA where the utility was proposing both decoupling and utility rate adjustment mechanisms, the utility's own expert economist testified that these mechanisms would reduce the utility's risk and that the utility's return on equity should decline accordingly. So the impact of these types of mechanisms on return on equity is certainly open to fair debate, and we feel that it's inappropriate to remove this issue from the TRA's jurisdiction.

The TRA has the professional and technical expertise to address the industry's concerns with regard to decoupling and rate review mechanisms, and we would respectfully urge you to allow the TRA to sort through these issues and fashion policies that balance the industry's needs with the interests of consumers. So we don't see the need for any legislation at this time; and, for the reasons I've outlined, we cannot support this bill. However, we are not "just saying no" to changes in the current system. We look forward to working with all stakeholders to identify issues and craft solutions that include safeguards for residential and commercial ratepayers. For example, if there's any doubt as to the TRA's power to address the industry's concerns, we would suggest that the only legislation that's needed at this time is a general grant of authority to the TRA to decide these issues. In fact, there's another legislative initiative before you, House Bill 738, which would clarify the TRA's jurisdiction regarding energy conservation programs. A similar approach could clarify the TRA's authority to change, or, in the alternative, study and report to the General Assembly on ways to improve administrative efficiency in ratemaking.

I very much appreciate the opportunity to address you on behalf of consumers regarding our concerns, and I would respectfully urge you to consider these concerns as you deliberate the merits of this bill.

**The 4% cap allows natural gas companies to raise rates for their distribution service by 12% to 16% each year under the annual rate review**

	(1)	(2)	(3)	(4)	(5)
Company	Total Revenues	Revenues - Gas Only	Revenues - Distribution (TRA Tariffs)	4% Increase - Total Revenues	Effective % Increase - TRA Tariff Rates
Atmos Energy	(a) \$190	(c) \$140	\$50	\$7.6	15.3%
Chattanooga Gas	(a) \$124	(d) \$93	\$31	\$5.0	16.0%
Piedmont Natural Gas	(b) \$306	(e) \$206	\$100	\$12.2	12.2%

(a) Line 5, column F of the Dec. 2008 TRA 3.03 Surveillance Report.  
 (b) Line 5, column F of the Nov. 2008 TRA 3.03 Surveillance Report.  
 (c) Line 6, column F of the Dec. 2008 TRA 3.03 Surveillance Report.  
 (d) Line 7, column F of the Dec. 2008 TRA 3.03 Surveillance Report.  
 (e) Line 6, column F of the Nov. 2008 TRA 3.03 Surveillance Report.

Revenue (\$millions)

