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August 29, 2008

Luly Massaro
Clerk
Public Utilities Commission
89 Jefferson Boulevard
Warwick, RI 02888

Re: National Grid Gas – Docket No. 3943
Surrebuttal Testimony of John Farley submitted on behalf of Intervenor The Energy Council of Rhode Island (TEC-RI).

Dear Luly:

As you know, this office represents The Energy Council of Rhode Island (TEC-RI). Enclosed for filing in this matter are an original and seven copies of the surrebuttal testimony of John Farley submitted on behalf of TEC-RI.

If you have any questions, please feel free to call.

Very truly yours,

Michael R. McElroy

MRMc:tmg
cc: Service List

TEC-RI/37436/Massaro4

BEFORE THE

STATE OF RHODE ISLAND
AND PROVIDENCE PLANTATIONS

PUBLIC UTILITIES COMMISSION

In Re: NATIONAL GRID RHODE ISLAND GAS	))))	**Docket No. 3943** **Request for a Change of Gas Distribution Rates**

SURREBUTTAL TESTIMONY

of

JOHN FARLEY

Submitted on Behalf of The Energy Council of Rhode Island (TEC-RI)

August 29, 2008

Surrebuttal Testimony of John Farley
Submitted on Behalf of The Energy Council of Rhode Island (TEC-RI)
Docket No. 3943

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INTRODUCTION

Purpose

Q. Are you the same John Farley who previously filed Direct Testimony in this proceeding?

A. Yes I am. I provided Direct Testimony dated July 25, 2008 on behalf of The Energy Council of Rhode Island (TEC-RI).

Q. What is the purpose of this surrebuttal testimony?

A. The purpose of my surrebuttal testimony is twofold.

The first purpose is to respond to (1) the Rebuttal Testimony of James D. Simpson on behalf of National Grid RI –Gas ("the Company"), filed August 15, 2008; (2) the Rebuttal Testimony of Peter C. Czekanski on behalf of National Grid RI -Gas, filed August 15,2008; (3) the Rebuttal Testimony of Michael D. Laflamme on behalf of National Grid RI -Gas, filed August 15,2008; and (4) the Comments of Environment Northeast ("ENE") concerning National Grid's Decoupling proposal, filed July 25, 2008. My silence on any issues should not be construed as agreement with any particular recommendation or position.

The second purpose of this surrebuttal testimony is to provide an addendum herein to comply with the First Commission Data Request direction to all intervenors and the Division of Public Utilities and Carriers, dated August 7, 2008. The Commission has directed each intervenor to include a list of each item where the party disagrees with the positions of the Company or other parties to the docket. We are to include the financial impact of each item in dispute.

Overview of Testimony

Q. Please provide an overview of your surrebuttal testimony.

A. My surrebuttal testimony is organized in six sections:

- First, I will provide an overview of my surrebuttal testimony;
- Second, I will comment on the Company's rebuttal testimony concerning the non-firm tariff;
- Third, I will respond to the other parties including the Company on the matter of decoupling;
- Fourth, I will comment on the Company's rebuttal testimony concerning the low income discount;
- Fifth, I will summarize my testimony;
- Sixth, I will provide the addendum addressing the Commission's data request.

I. NON-FIRM TARIFF ISSUES

Q. What is the first issue you are addressing, and what testimony are you commenting on?

A. The first issue is the non-firm tariff issue. I will be responding to the rebuttal testimony of Mr. Peter Czekanski of National Grid.

Q. Is the non-firm issue primarily a policy issue, as Mr. Czekanski states on page 3 of his rebuttal testimony?

A. No, we respectfully disagree with Mr. Czekanski's characterization. The non-firm tariff issue is primarily a rate design issue that ought to be decided on the basis of sound ratemaking principles.

Mr. Czekanski noted on page 8 of his testimony that TEC-RI (along with the Division and SilentSherpa) did not discuss the need to apply a pricing policy that maximizes benefits to firm customers. That's the right issue, and there is a good reason why we did not do so: we do not think that is good pricing policy!

Yes, the current pricing structure makes sure the interests of firm service customers are served by maximizing the value of the capacity. It must be noted that the pricing strategy of maximizing the value to the firm ratepayer also maximizes the margins that flow to the Company.

As Mr. Czekanski correctly and repeatedly points out, the Company's proposal for the non-firm class stands or falls on one premise: that the purpose of the non-firm rate is to maximize value for firm ratepayers.

But is that sound ratemaking? Is maximizing the value for one set of ratepayers at the expense of another group of ratepayers proper ratemaking?

Is the function of setting regulated utility rates for one class of customers to maximize the value for the rest of the ratepayers?

To figure out the answer, consider what would happen if this principle were applied to other classes of customer. Would for instance the resulting rates be just and reasonable if the residential heating rate were set at the price that would maximize value to all other ratepayers? After all, the residential heating customer has alternative fuels they can turn to as well.

I trust that the answer is becoming obvious. The reason that regulated utility distribution rates are not set this way is because the utility is a monopoly. When it comes to purchasing natural gas distribution services, there is no choice except the utility. Therefore, it would be unjust and unreasonable to set prices for that service using the principle of maximizing value.

Of course charging one group of customers the highest possible rate and then turning 75% of the margins over to the rest of the customers (keeping 25% for yourself) helps the rest of the customers.

But that does not mean it is the right thing to do.

The real issue is this: what rate design best meets the rate objectives of fairness, reasonableness, and stability?

Mr. Czekanski is correct that the opposing parties including TEC-RI are requesting that the Commission make a significant change in the pricing structure for non-firm distribution service[1]. However the change we have in mind is from an unstable pricing structure that produces arbitrary and unreasonable results to a stable, fair pricing structure.

Q. In his rebuttal testimony, Mr. Czekanski presents a view of the non-firm customer. Do you agree with his characterization?

A. No, there are several characterizations that I do not agree with.

[1] Rebuttal testimony of Peter Czekanski, page 4, lines 6-8.

First of all, Mr. Czekanski characterizes the non-firm customer as using the distribution system "when it is to their advantage to do so."[2] But this characterization is at odds with the Company's own tariff language. Section 6, Schedule A, Sheet 1, found in attachment NG-PCC-5 (Volume 4 Page 259), 1.0 B states:

" The customer agrees to discontinue service, when in the sole discretion of the Company, such discontinuance is necessary to continue to serve the needs of firm customers at such time".

Second, Mr. Czekanski states that non-firm customers do not pay the Company's distribution rates, and therefore do not incur any of the costs of constructing and maintaining the distribution capacity over the long term.

Here's the reality: for the past year, non-firm customers have been paying the Company's distribution rates...and then some!

The Company's recent Distribution Adjustment Charge (DAC) filing in docket 3977 (August 2008) reveals that for fiscal year 2008, non-firm customers have paid an average of $1.91 per dekatherm for distribution service.

[2] Czekanski rebuttal testimony, page 5 line 16.

Data filed for the test year in this docket, docket 3943, show that Large and Extra Large firm customers paid an average of $1.46 per dekatherm.

Remember, non-firm customers get interrupted in the winter time. Firm customers do not.

Price paid for distribution services, $ per dekatherm

	Sales service	Transportation service	Combined
Firm customers[3]	$2.08	$1.23	$1.46
Non-Firm customers[4]	$3.00	$1.20	$1.91

If you look at the entire Large/Extra Large group, using the most recent data filed by the Company, non-firm customers are paying significantly more for their distribution services than firm customers are. Yes, this relies on test year data for

[3] Large and Extra Large classes are combined. Period is the Test Year, October 2006 through September 2007. Source is Attachment NG-PCC-2 in this docket.
[4] Period is July 2007 through May 2008. Source is Attachment PCC-5 in docket 3977 page 2 of 12. Sales revenues are less gas costs.

firm customers, but their base rates are the same in 2008 as they were in the test year.

Non-firm customers are paying 31% more per dekatherm for distribution service than firm customers are!

It is hard to fathom how the Company can maintain that non-firm members are avoiding paying the cost for the system, like firm customers do, in times when non-firm customers are paying MORE per therm for their distribution services than firm customers are paying!!!

How can a good corporate citizen, who allows the utility to interrupt their service for the benefit of the system, and is paying MORE for distribution services than other similar customers who do NOT allow the utility to interrupt their service... how can these customers possibly be considered opportunists?

Non-firm revenues are used to offset distribution rates for firm service customers. Firm service customers pay for the distribution system through distribution rates. Therefore non–firm customers help pay for the system.

Third, on page 10 of his rebuttal testimony, Mr. Czekanski states that without the value of service pricing mechanism, dual fuel customers "would bypass the gas distribution system" and use their alternative fuel because it offers them a price advantage.

It is not correct to apply the term "bypass" to non-firm customers. Bypass refers to taking service directly from the interstate pipeline, and thereby "bypassing" the local distribution system. This is not what non-firm customers do.

Non-firm customers allow the Company, at the Company's sole discretion, to discontinue their gas service to meet the needs of firm customers.

And the record shows that the non-firm option does provide system benefits for firm customers.

There are non-firm customers today who are interrupted for the entire winter season. The Company's response to Division Data Request DIV 5-4 shows that for the entire winter period November 1, 2007 through March 31, 2008, four non-firm customers in Westerly were interrupted for the entire 151 day period because of capacity constraints at the city gate.

I was amused by Mr. Czekanski's characterization of one of my statements as turning reality on its head [page 11 line 17 of his rebuttal testimony]. I wrote that because the non-firm customer gives up certain rights and service levels that the firm customer enjoys, the rate for non-firm service should be set at an appropriate discount.

Now remember the source of the dispute: I think that non-firm service should be set at a discount to firm service. Mr. Czekanski disagrees.

Here is Mr. Czekanski's reasoning:

1. Non-firm customers are not giving anything up for the benefit of firm service customers.

2. The reason is that firm service customers require uninterrupted service and they pay for it through distribution rates.
3. Non-firm service customers have chosen to utilize system capacity only in the off peak period so that "they can avoid incurring a share of the total system costs that would be proportionate to their full-time use of the system."[5]

Please take a look at that last statement, and compare it to the source of our disagreement.

[5] Czekanski rebuttal page 12 lines 6-8.

"avoid incurring a share of the total system costs that would be proportionate to their full-time use of the system."

Doesn't that sound like a discount?

The only way I can avoid incurring a share of the costs that are embedded in firm distribution rates is if my rate is lower than the firm rate.

Yet that is precisely the premise that Mr. Czekanski sets out to deny.

I certainly do not avoid any share of costs if my rate is higher than the firm rate!

Mr. Czekanski is denying that non-firm customers should get a discount. Yet his characterization of the non-firm customer implies that they do get a discount.

In a world where the firm customer is paying $1.46 per dekatherm and the non-firm customer is paying $1.91 per dekatherm, to say that the non-firm customer is avoiding costs that the firm customer is incurring – THAT'S turning reality on its head! (Couldn't resist, Peter!)

Saying that someone who is being charged $1.46 is paying for the system, while someone who is being charged $1.91 is not paying for the system is another neat twist.

Choosing to use system capacity only in the off-peak period is choosing a lesser quality service.

Avoiding a share of total system costs implies a discount.

It appears that Mr. Czekanski ends up landing in the same position TEC-RI is taking, albeit after a couple of rhetorical summersaults!

The non-firm customers are not opportunists. They are customers. They are no more opportunists than the residential customers who cook with gas and heat their home with oil.

Non-firm customers did not invent the non-firm tariff; they just chose it as the best fit with their needs among the menu of rates in the Company's tariff book.

Non-firm customers don't deserve to be used; they deserve to be served on a par with every other customer.

They are not "Johnny-come-lately's" looking to take advantage of capacity someone else paid for. They are Rhode Island institutions and companies most of whom have been providing jobs and services to our communities for decades.

They are not a bunch of "thems"; they are part of "us".

We recognize that there are matters to be addressed in order to make the change to a cost based rate for non-firm customers.

A lower rate on average will mean fewer margins to contribute to distribution revenue requirements or share with firm customers.

A lower rate will probably convince some customers who switched from non-firm to firm rates seeking a safe haven to return to the non-firm tariff once it is fixed. This will also reduce revenues available to meet revenue requirements.

But it is the right thing to do. Those foregone revenues are in a certain sense windfalls that were inflated because of the surge in oil prices. They might have been nice while they lasted, but are not rightfully to be counted on.

It is significant in this regard that even in the face of these adjustments to firm revenues and rates, the Division is nonetheless in favor of fixing the non-firm tariff. Undoubtedly it is because they see the basic fairness in doing so.

II. REVENUE DECOUPLING

Q. Please provide an overview of your surrebuttal testimony in the matter of revenue decoupling.

A. Certainly. The majority of my comments are in response to the rebuttal testimony of Mr. James Simpson. I will comment on legal issues, regulatory issues, and policy/economic issues.

Q. Environment Northeast cites cites R.I.G.L § 39-1-27.7(a)(2)(d) in their July 25, 2008 Comments concerning National Grid's Decoupling Proposal. Does Rhode Island state law require the Commission to adopt gas decoupling?

A. No. There is no requirement in the law for full gas revenue decoupling as sought by the Company in this docket.

Here is the text of that section of the law:

> (d) If the commission shall determine that the implementation of system reliability and energy efficiency and conservation procurement has caused or is likely to cause under or over-recovery of overhead and fixed costs of the company implementing said procurement, the commission may establish a mandatory rate adjustment clause for the company so affected in order to provide for full recovery of reasonable and prudent overhead and fixed costs.

R.I. G.L. § 39-1-27.7(a)(2)(d) does not apply for three reasons:

First, this law by its express terms (see R.I.G.L. 39-1-27.7) addresses electrical energy needs not natural gas needs. The law applies only to electric distribution companies, not gas distribution companies.

Second, the law permits, but does not require, adjustments.

Third, the adjustments are permitted only to address under-recovery caused by a very specific factor, namely electric utility procurement of system reliability, energy efficiency and conservation.

The law does not call for general revenue per customer decoupling, where rates are adjusted regardless of the cause of the change in revenues. It allows for a limited mechanism to address revenue shortfalls related solely to the direct impacts of energy efficiency and conservation programs. Plus, it addresses electric energy efficiency programs, not gas energy efficiency programs.

Q. Mr. James D. Simpson, in his Rebuttal Testimony[6], points to the Gas Cost Recovery clause as a parallel example to decoupling of a cost-related modification to traditional ratemaking. Do you agree?

A. No, I do not. The Company's proposed decoupling mechanism is fundamentally different in nature from the Gas Cost Recovery Clause.

The Gas Cost Recovery Clause targets a specific cost category that regularly exhibits a great deal of volatility. However, the Company's proposed revenue per customer mechanism addresses the entire spectrum of revenue, not a particular slice of revenue that exhibits volatility.

A theme of my direct testimony that bears repeating is the fact that the Company's proposed revenue per customer decoupling makes adjustments to rates whenever revenues per customer change <u>regardless of the cause</u>.

Q. On page 12, Mr. Simpson states that decoupling does nothing to address changes in costs, so the Company will still have to file rate cases on a regular basis. Do you agree?

A. Yes, I agree with Mr. Simpson that decoupling does nothing to address changes in costs. Yet that does not mean that the Company will have to file rate

[6] James D. Simpson, Rebuttal Testimony, page 9.

cases on a regular basis. The Company has existing cost-side mechanisms in place to address changes in costs, and they are asking for a few new ones in this docket. In addition to the existing mechanisms in the current Distribution Adjustment Charge (DAC), the Company is proposing a new capital expenditure tracker, a pension and post-retirements other than pensions (P&PBOP) adjustment factor, and an annual uncollectible adjustment.

Q. Mr. Simpson devotes a section of his rebuttal testimony (pages 13-16) to justifying the need for utility-sponsored energy efficiency programs in the face of what he characterizes as TEC-RI's claim that there is no need. What is your response?

A. I must respectfully dispute Mr. Simpson's characterization of TEC-RI's position. He states on page 13 lines17-21 that TEC-RI claims that there is no need or basis for utility-sponsored energy efficiency programs. I made no such claim in my testimony, and that is not TEC-RI's policy. The reference in my Direct Testimony that he cites as proof [7] says no such thing. These statements concern the fact that non-participants typically see their bills go up rather than down as a result of utility energy efficiency programs, and that decoupling exacerbates the problem. This does not mean that we should not have utility energy efficiency programs, and nowhere in my testimony do I ever make such a statement.

[7] Rebuttal testimony of James Simpson, page 15, lines 5 to 18.

The fact is that TEC-RI has been a partner with the Company in the DSM collaborative for many years. When the Company submitted its gas energy efficiency filing last year, I personally testified on behalf of TEC-RI in favor of the programs. TEC-RI has supported each and every Company energy efficiency program filing since I have been the Executive Director.

Believe it or not, it is possible to be a fan of energy efficiency programs – even utility sponsored programs! – and still be opposed to this particular revenue per customer decoupling proposal!

Q. Mr. Simpson takes issue with the statement in your direct testimony that decoupling erodes the incentive for customers to conserve energy. Is he right?

A. No. However, I do agree with his statement that "the savings a customer would experience from conserving energy would not be offset by the decoupling-related rate increases"[8]. He is absolutely right that this decoupling mechanism has no effect on the gas commodity portion of the bill, and I accept for the sake of illustration his claim that the gas commodity represents approximately 70% of the total gas bill.

[8] James Simpson Rebuttal Testimony, page 17.

But he is arguing against a point he constructed, not a point I made. In my direct testimony[9], I said that decoupling erodes the incentive for customers to conserve energy. I did not say that it would eliminate it.

So I heartily endorse his analysis that follows on page 18 and 19 where he shows the impact of conservation and decoupling on customer bills. Make that participating customer bills. Mr. Simpson does not provide an attachment that shows the impact of utility conservation and decoupling on non-participants. Their bills increase. Nor does he show the impact of the energy efficiency surcharge. That is not to say that programs cannot be designed to lower the bill for the customers as a whole, because they can and do. It's just that decoupling erodes the incentive to ratepayers to conserve.

Q. Mr. Simpson in his rebuttal testimony states that decoupling and the Company's future energy efficiency programs are closely linked. [10] How well does the record in this case line up with this principle?

A. Let me start by saying this is the key reason given by the Company why decoupling is good policy and should be approved. The Company's stated purpose for decoupling is to advance the goal of achieving greater energy efficiency in the state of Rhode Island.

[9] Cited in Mr. Simpson's Rebuttal Testimony, page 17 lines7-13.
[10] James Simpson Rebuttal Testimony, page 21 lines 5-6.

The Company has the burden of proof to demonstrate that decoupling will bring additional benefits to ratepayers in the form of additional energy efficiency services over and above what would occur in the absence of decoupling.

This proof has not been provided.

There are no new energy efficiency programs being offered by the Company in their filing.

The Company is not proposing to spend any of its own money to implement the existing energy efficiency programs it currently offers.

It is existing law[11] that requires the Company to implement gas energy efficiency programs. In other words, we will get our gas efficiency programs even without decoupling!

[11] R.I.G.L. § 29-2-1.2(d) (d) Effective January 1, 2007, and for a period of seven (7) years thereafter, each gas distribution company shall include, with the approval of the commission, a charge of up to fifteen cents ($0.15) per deca therm delivered to demand side management programs, including, but not limited to, programs for cost-effective energy efficiency, energy conservation, combined heat and power systems, and weatherization services for low income households.

If this change in ratemaking called decoupling is really for the benefit of the ratepayers, then what exactly are these new benefits that will accrue to the ratepayers?

The Company has come forward with no additional resources of its own, no energy efficiency programs, no new services, other than those that are already required by law and paid for by the ratepayers in the energy efficiency surcharge.

Q. Mr. Simpson next states that decoupling will not provide the Company with excess, unjust levels of revenue. What is your response to that?

A. First of all, he used those words "excess, unjust"; you will not find them in my testimony. I made a factual statement, not a moral evaluation!

I stated that the decoupling method generates revenues higher than needed to meet revenue requirements whenever the customer count increases beyond that established in the latest rate case. I stand by that description of how the Company's proposed decoupling method works.

This decoupling mechanism allows the Company to earn more than its revenue requirement.

If the number of customers in a rate class increases - for example, the residential heating class that is targeted by the Company's proposed gas marketing program – the amount of revenue that the Company is entitled to receive from that class would increase proportionately.

To illustrate: Attachment NG-PCC-7, page 1 shows 179,950 Residential Heating customers, $87,880,968 base revenue, and a target Revenue per customer (RPC) of $486.51.

Now suppose that next year there are 2,000 additional customers in the Residential Heating class. That class would then have 181,950 customers.

The Company under their decoupling proposal would then be entitled to earn $973,020 of additional revenue or a total of $88,853,988.

When combined with the cost side reconciling adjustments in the DAC, decoupling could allow the Company to avoid filing a rate case for a longer period of time.

I agree with Mr. Simpson that the rate year revenue requirement does not allow for inflationary cost increases, infrastructure replacement and improvement investments, and incremental plant to serve new customers.

Yet I do not agree that this means that the LDC – this LDC- could not avoid filing a rate case for very long if full decoupling were adopted.

The fact is that the Company has included other elements in its rate tariff and policies, and indeed some new ones in this case, that are designed specifically to collect additional revenues. Some of these elements are designed to cover precisely these kinds of cost increases. Others represent additional revenue sources to the Company over and above base rates. I would now like to list the ones I am aware of:

The Company has an <u>energy efficiency surcharge</u> to cover all costs associated with its energy efficiency programs.

The Company has the opportunity to earn additional revenues as a result of its energy efficiency programs because it has a <u>performance incentive</u> it can earn each year.

The Company has the opportunity today to earn <u>additional margin from its 25% share of excess non-firm margins</u> over and above the target point of $1.6 million dollars.

The Company is proposing a new Gas Marketing Program that will provide additional revenues.

One element of the Company's energy efficiency program is combined heat and power, which will result in more gas revenues for the Company.

The Company has a Gas Cost Recovery clause to cover all costs including inflation and market price increases associated with its procurement of the gas commodity.

The Company receives payments from new customers in what is called the Contribution in Aid of Construction (CIAC) to cover any customer connection costs that would not be recovered by revenues from that customer.

The Company is this case is proposing a new capital expenditure tracker to cover incremental infrastructure replacement and improvement investments.

The Company in this case is proposing a new pension and post-retirement benefits other than pensions ("P&PBOP") adjustment factor to cover unanticipated costs related to these kinds of human resource costs.

The Company in this case is proposing a new annual uncollectible adjustment as well.

Even without decoupling it is certainly possible that the Company will be well situated to avoid coming in for a new rate case for years to come.

In this case, the Company has also redesigned its rates to receive a higher percentage of its revenues from the customer charge and from the demand charge pieces of the bill. [12]

Even without the new trackers, factors and adjustments the Company did not come in for a rate case for about seven years this time around.

In the final analysis, we agree with the Company that it ought to have a reasonable opportunity to earn a fair rate of return. In my judgment, though, the Company will have this opportunity –even without decoupling.

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[12] For the particulars, see Mr. Simpson's Attachments Rebuttal-NG-JDS-1 and Rebuttal–NG-JDS-2, which show that their proposed rate designs collect 36.7% of distribution revenues from the customer charge, and 45.7% of distribution revenues from the customer and demand charges combined. These are up from 24.3% and 30.6% respectively with the current rates. Combined customer and demand charges under proposed rates would collect fully 77.2% and 75.6% respectively of the total distribution revenues from the Extra Large LLF and Extra Large HLF classes. While it is true that some conservation measures save demand proportionately with therms, others (notably non-heating measures) save proportionately less in demand than they do in therms. Also, keep in mind that the Company's revenue per customer decoupling mechanism would adjust rates upward <u>regardless of the cause</u> for the decline in revenue per customer. Economic recessions may result in lower therm use throughout the year but not reduce peak day heating requirements for a facility.

Q. Mr. Simpson summarizes his case against intervener statements concerning decoupling on page 35. What is your response to his concluding thoughts?

A. He makes the following statement on lines 17-20 of page 35:

> Contrary to the Opposing Parties' claims, the Company's decoupling proposal will not provide the Company with any greater revenues than the Company would reasonably expect to collect under traditional ratemaking, *were it not for the effects of conservation* [emphasis added].

Mr. Simpson in his rebuttal testimony points out places where he believes the interveners made statements that indicate they may not fully understand decoupling or the Company's proposal. See for instance Mr. Simpson's rebuttal testimony beginning on page 33 line 11.

But here it looks like the above statement does not accurately describe the Company's proposal.

The Company's decoupling proposal calls for an upward adjustment in rates to a rate class whenever the actual revenue per customer for that class drops below the target revenue per customer.

This happens <u>no matter what the reason is</u> for the lower revenue per customer figure. It is <u>not</u> limited to the effects of utility energy efficiency. In fact, it is <u>not</u> limited to the effects of conservation generally. It is applied <u>regardless of the cause</u>.

The reason could be an economic recession.

The reason could be higher than average consuming customers leaving the rate class.

The reason could be lower-than-average customers being added to the rate class.

The reason could be a trend toward fewer master meters and more sub-meters.

The Company's proposal is <u>not</u> limited to the effects of conservation!!!

The Company's revenue-per-customer decoupling proposal <u>will</u> provide the Company with greater revenues than the Company would reasonably expect to collect under traditional ratemaking, were it not for the effects of conservation, whenever all or any portion of the adjustment is caused by <u>any factor other than</u> conservation.

Q. Mr. Simpson also makes the case that the Company's decoupling proposal is not radical, risky, or untested. How convincing is that case?

A. A majority (12 out of 21) of the approved gas decoupling mechanisms he cites have been in effect for less than two years. Mr. Simpson states that this is a sufficient body of experience to demonstrate that decoupling does not lead to bad or unintended consequences.

Let me first state that one or two years is scarcely enough time to give such a new and untested approach to allow for the surfacing of bad consequences.

Second, though, Mr. Simpson does not provide any data or reports or even experiences to tell us how decoupling is actually turning out in any of those jurisdictions. So it is simply not possible to evaluate his claim one way or the other.

Q. Mr. Simpson next devotes a section of his rebuttal testimony to addressing certain recommended modifications that interveners including TEC-RI made in their direct testimony. Please comment.

A. TEC-RI appreciates the Company's willingness to consider the modifications that we and other interveners have suggested. We also appreciate Mr, Simpson's fair-mindedness in pointing out that TEC-RI and the Division strongly oppose the Company's revenue decoupling mechanism.

We are encouraged, therefore, that the Company thinks that TEC-RI's recommended modification to exclude the Large and Extra Large rate classes from the revenue per customer decoupling mechanism would result in a "workable decoupling mechanism that would allow the Company to mostly meet its objective of being a forceful advocate for all cost-effective energy efficiency activities"[13]. To adequately represent the Company's position, they do still think that their original proposal represents the best balance of several decoupling design considerations.

Q. Environment Northeast (ENE) made a proposed modification to have reconciliations occur on a company-wide revenue basis[14]. What is TEC-RI's position on ENE proposal?

A. TEC-RI opposes ENE's proposed modification because it would result in cross-subsidies between classes.

Q. Mr. Simpson had one minor concern about the TEC-RI modification to exclude the Large and Extra Large classes from revenue decoupling. What is it, and do you share that concern?

A. Mr. Simpson thinks that excluding the Large and Extra Large classes will not eliminate the Company's disincentive to aggressively offer energy efficiency programs to these classes.

While I understand his concern, I do not share it. First of all, the Company's energy efficiency program for commercial and industrial customers (approved by the Commission last year) includes incentives for combined heat & power (CHP).

[13] James Simpson Rebuttal Testimony, page 43 lines 3-6.
[14] Comments of Environment Northeast concerning the National Grid Decoupling proposal, page 12.

CHP results in increases in natural gas consumption and that means more revenue to the Company, not less.

Second, in my judgment, other factors besides energy efficiency are likely to play a very significant role in determining future growth in gas volumes and revenues in the Large and Extra Large classes. These factors include:

- General economic conditions in Rhode Island
- Large customer loads that exit the system/leave RI
- New large customers that come on the system
- The price differential on a BTU basis between oil and natural gas
- Environmental regulations
- Migration patterns between the firm and non-firm rate classes

Third, the Company has actually experienced very <u>healthy growth in revenues</u> from its Large and Extra Large customers over the last 3 years. Specifically, for the period beginning June 2005 and ending June 2008, distribution revenues from Large, Extra Large and Non-Firm margins have grown at a compound annual growth rate of 6.1%.

This is the same period of time during which, according to Mr. Simpson's testimony, the price spikes of 2005 and 2006 occurred which result in "customer conservation at a rate that was unexpected and unprecedented." [15]

The following table shows the growth in distribution revenues from the Large and Extra Large rate classes over the last three years:

Distribution revenues[16]	12 months ended June: 2005	2006	2007	2008
Large Low	$6,741,416	$6,675,467	$6,875,512	$6,665,103
Large High	$1,867,451	$1,749,210	$1,656,949	$1,786,519
Xlarge Low	$1,063,182	$961,511	$865,581	$981,839
Xlarge High	$2,652,668	$2,908,183	$3,115,079	$3,619,350
Non-Firm Margin[17]	$3,152,849	$3,586,906	$5,214,516	$5,429,797
Total	$15,477,566	$15,881,277	$17,727,637	$18,482,608
Annual Growth rate		3%	12%	4%
3 year compound annual growth rate				6.1%

So the energy efficiency programs include measures such as combined heat and power that increase revenues to the Company. Second, other factors besides energy efficiency are likely to drive revenue growth in these classes. Third, recent history

[15] James Simpson Rebuttal Testimony pages 29-30.
[16] Distribution revenues for the firm rate classes are taken from Company response to TEC-RI data request 1-7 in this docket.
[17] Non-firm margins are taken from the testimony of Peter Czekanski in the following DAC dockets before the PUC: 3690 (2005); 3760 (2006); 3859(2007); 3977(2008).

shows that the Large and Extra Large classes did not exhibit the same trends in declining revenues that the residential space heating class did.

Therefore, if decoupling is adopted, it makes good sense to exclude the Large and Extra Large classes.

Q. Mr. Simpson, on page 45 of his rebuttal testimony, takes issue with your recommendation that non-firm margins be included as revenue for purposes of decoupling. What is your response to his remarks?

A. Mr. Simpson correctly points out that revenues from non-firm customers are currently treated very differently from firm revenues. The Company receives an incentive of 25% of non-firm margins over $1.6 million. The remaining funds, or 75% of non-firm margins over $1.6 million, are returned to firm customers through a credit in the Distribution Adjustment factor.

I agree with him that given the fact that 75% of the non-firm revenues are already returned to firm customers, including these non-firm revenues in the RPC, calculations would result in these revenues being returned to customers twice. TEC-RI therefore withdraws that recommendation.

Q. Concerning the Large and Extra Large rate class RPC targets, Mr. Simpson on page 46 of his testimony addresses the TEC-RI recommendation to

remove the impact of customers that switched from non-firm to firm service after the test year. Do you agree with his assessment?

A. Mr. Simpson correctly points out the inconsistency of removing those customers from the RPC targets but not from rate year billing determinants.

It was certainly my intention that the impacts of these customers be removed from both the revenue side and the billing determinants side. However, I should have made that explicit in my testimony, and I thank Mr. Simpson for clarifying that.

Q. After consideration of the rebuttal and surrebuttal testimony, what is TEC-RI's position concerning decoupling?

A. TEC-RI remains fundamentally opposed to the Company's decoupling proposal, and asks the Commission to reject it.

The threshold question is whether instituting this particular form of revenue decoupling by this utility in our state now will produce substantial new benefits to Rhode Island ratepayers, such that these substantial new benefits outweigh the new costs and risks that will be imposed on Rhode Island ratepayers.

If the answer to that question is no, as we believe it is, then this decoupling proposal is not in the public interest and it should be rejected.

However, if the Commission decides to grant the Company's request to institute this decoupling proposal despite the sound reasons not to do so, TEC-RI suggests the following modifications:

1. The Company's return on equity should be adjusted to reflect the lower risk to stockholders. The Division has sponsored a witness to address the particulars here, and TEC-RI defers to the Division witness on this point. He has recommended a 75 basis point downward adjustment[18].
2. The Large and Extra Large Rate Classes should be exempted entirely from the Revenue per Customer mechanism. It is notable that the Company's decoupling witness, in rebuttal, stated that this TEC-RI modification would result in a "workable decoupling mechanism that would allow the Company to mostly meet its objective of being a forceful advocate for all cost effective efficiency activities." [19]
3. The adjustment mechanism should be reworked to limit adjustments to the direct impacts of Company energy efficiency programs.
4. Should the Commission decide to grant the Company's request and include Large and Extra Large rate classes (despite sound reasons for not doing so), the Large and Extra Large rate class Revenue per Customer targets (RPCs) and billing determinants should be

[18] James A Rothschild Direct Testimony on Behalf of the Division of Public Utilities and Carriers, page 5 lines 5-8.
[19] James Simpson Rebuttal Testimony page 43 lines 3-6.

adjusted to remove the impact of customers that switched from non-firm to firm service after the test year (i.e., from October 2007 through January 2008).

IV. LOW INCOME DISCOUNT

Q. What is TEC-RI's position on the Low Income Discount?

A. TEC-RI is asking that the stockholders of the Company contribute 50% of the cost of the low income discount, especially given the fact that the program will lower the uncollectibles and thereby contribute funds to the Company's earnings.

Q. Have you reviewed Mr. LaFlamme's rebuttal testimony on this matter?

A. Yes I have. Mr. LaFlamme disputes the premise that the low income discount will have an impact on uncollectibles expense. His argument hinges on an exhibit he prepared identified as Attachment NG-MDL Rebuttal-3.

Q. What does Attachment NG-MDL Rebuttal-3 show?

A. That exhibit shows uncollectible expense for the electricity A-60 rate as a percent of A-60 billed revenues over four years: 12 months ended July 31, 2005 through 2008. In the first year of that period, the Company increased the discount that was given on its distribution rates to the A-60 customers.

His exhibit shows that in fact the uncollectibles went up, both in dollars and as a percentage of billed revenue after the larger discount was given.

Q. Does this settle the matter?

A. Not exactly. On the surface, this would appear to show that providing a discount to low income customers increases uncollectibles. I don't think that the Company or anyone else really believes that though. It is extremely unlikely that the discount caused the increase in uncollectibles.

If the discount did not cause uncollectibles to increase, then it follows that <u>something else did</u>.

There are other factors besides the discount on the distribution portion of the bill that drive the uncollectibles.

The distribution rate is not the complete picture of the price that low income customers face. The price of the electricity supply is in fact the larger portion of the price.

At the same time that the distribution component of price went down, it turns out that the price for the supply portion of the bill went up. And the supply portion went up more than the distribution portion went down. According to documents in docket 3710, the A-60 discount represented a price decrease of 1.24 cents per kWh.

However, in July of 2004 the Standard Offer price was 5.9 cents. By July of 2005 it stood at 6.7 cents, and at the time the higher low income discount was applied, the Standard Offer was increased to 10 cents. Since then, the positive difference between the actual Standard Offer price and the 6.7 cents has always been bigger than the 1.24 cent discount.

What Attachment NG-MDL Rebuttal-3 really shows then is the impact of all factors on the uncollectibles level and rate. Of these it is reasonable to assert that the total price of electricity is the most significant.

What this attachment really shows is that the increase in electricity prices seems to have driven uncollectibles significantly higher.

Therefore, it is reasonable to conclude that in the absence of the 1.24 cent discount, uncollectibles would have been even higher! Given that fact, the discount had the effect of lowering uncollectibles from what they otherwise would have been.

So, given the evidence provided by the Company in this exhibit, it is reasonable to conclude that the low income discount reduces uncollectible expense.

SUMMARY

Q. Please briefly summarize the your surrebuttal testimony.

A. Certainly.

(1) With respect to the Non-firm Tariff, I have made the point that this is primarily a rate design issue rather than a policy issue. I have identified several areas where I believe the Company's characterization of the non-firm customer is not accurate. Acknowledging the implications of doing so, I have reaffirmed the need to change the non-firm tariff to a cost based rate at a discount to firm service.

(2) With respect to Revenue Decoupling, I have clarified aspects of rebuttal testimony from the Company where either I have a different view from the Company's witness or I think there are factual misstatements. I have also acknowledged items in my direct testimony that were not accurate. Finally, I have restated the TEC-RI positions in light of these clarifications and corrections.

(3) With respect to the proposed Low Income Discount, I have explained why in my view the Company's rebuttal witness did not disprove TEC-RI's basis for asking the Commission to require the Company stockholders to contribute 50% of the costs of the discount.

Q. Does this conclude your surrebuttal testimony?

A. Yes it does in the formal matters of surrebuttal. There is an addendum to this testimony that complies with the First Data Request from the Commission directed to all intervenors and the Division of Public Utilities and Carriers.

Addendum to Farley Surrebuttal Testimony
Docket 3943

The Commission, in its First Data Request directed to all interveners, directed each intervener to include a list of each item where the party disagrees with the positions of the Company or other parties to the docket. We are to include the financial impact of each item in dispute.

The following are the list of items where TEC-RI disagrees with the positions of the Company or other parties to the docket. An X means that the TEC-RI position differs from the party's position.

Issue	Company	ENE	CLF	Division
1. Non-firm Tariff	X			
2. Decoupling	X	X	X	
3. DAC	X			
4. Low Income Discount	X			
5. GCR classes	X			X

What follows is TEC-RI's best estimate of the financial impact of each of the above items that are in dispute.

1. **Non-firm tariff.** TEC-RI's recommendation is to establish a cost based rate for non-firm service. This rate has not been designed as of yet. The actual revenue implications also depend on future price differentials between natural gas and oil, which of course are not known.

To give some idea of what the revenue implications might be, we can examine recent history as well as information that the Company provided in a data request concerning a cost-based rate. The Company's response to data request DIV 5-53 will be used as a proxy for that rate. Using that number here in no way implies that TEC-RI supports that number!

Revenue impact of cost of service based rate

Current Distribution rate for non-firm		$ 1.91	per dekatherm	source: Attachment PCC-5 in docket 3977 p: 12
Cost of service Distribution rate		$ 0.81	per dekatherm	see Company response DIV 5-53
Total Non-firm Volumes		2,840,352		
Current Distribution revenues		$ 5,429,798		
COS Rate Distribution revenues		$ 2,300,685		
Difference		$ 3,129,113		
Base Rate threshold		$ 1,600,000		
Excess margin		$ 3,829,798		
Company share	25%	$ 957,449		
Firm Ratepayer share of Current Rev		$ 4,472,348		
Firm Ratepayer share of COS Rev		$ 2,300,685		
Difference		$ 2,171,663		
Add'l contribution to Base Rates		**$ 700,685**		
Current Contribution to DAC		$ 2,872,348		
COS Contribution to DAC		$ -		
DAC Revenues lost		**$ 2,872,348**		
Net impact		**$ (2,171,663)**		

2. **Decoupling.** TEC-RI's position is not to approve the Company's decoupling mechanism. The actual financial impact cannot be determined with certainty. It depends on several factors, including:

- Frequency of future rate cases
- Future trends in revenue per customer by rate class
- Customer additions and removals from rate classes

Here again, history can be used as a starting point . We will use the Company response to TEC-RI data request TECRI-1-7 as the basis.

Here is a summary of what the Company response shows would have been the impact of decoupling had it been in effect over the past four years, expressed in terms of additional payments that ratepayers would have made to the Company:

Total additional amounts that ratepayers would have paid the Company
if the decoupling mechanism had been in effect during these years:
Based on Company response to Data Request TECRI-1-7

12 months ending June:	Decoupling Payments to Company	Weather Normalization Charge	Net effect of Decoupling
2005	$ 2,490,599	$ (1,602,000)	$ 4,092,599
2006	$ 9,785,500	$ 927,000	$ 8,858,500
2007	$ 10,505,110	$ 882,000	$ 9,623,110
2008	$ 11,618,128	$ -	$ 11,618,128
Total	$ 34,399,337	$ 207,000	$ 34,192,337

If revenue per customer trends were to continue in the future as they have been over the past 4 years, then a figure somewhere in the range of $4 to $10 million is not a bad estimate.

On the other hand, there is no guarantee that the use per customer reductions in the past few years will continue in future years.

Also, the Company's proposed new rates collect a greater share of revenue from customer charges and demand charges. This will likely mitigate the impact to ratepayers, but TEC-RI does not have the wherewithal to calculate that effect.

Finally, the early years are likely to be more modest than later years between rate cases if revenue per customer trends continue.

Given all of these considerations, in our judgment the first year impact to ratepayers is likely to be under $ 4 million.

3. **Distribution Adjustment Charge**. TEC-RI is proposing to change the way DAC credits and debits are allocated to rate classes. Actual future financial impacts depend on reconciliation values for each account in the DAC. However, the direction of the change will be to allocate more dollars to classes with higher average price per dekatherm and fewer dollars to classes with lower average price per dekatherm. Here is the table showing these average revenues per dekatherm in the test year:

Firm Classes

from attachment NG-PCC-2

Annual Therms	Class	Oct 06 - Sep 07 Throughput Dt	Firm Base Revenue	Revenue per Dt
	Sales service			
<5,000	Small C&I	2,250,237	$ 10,029,893	$ 4.46
<35,000	Medium C&I	3,903,210	$ 11,070,708	$ 2.84
<150,000	Large LLF	1,314,703	$ 3,362,780	$ 2.56
	Large HLF	415,493	$ 752,438	$ 1.81
150,000+	Extra Large LLF	100,295	$ 140,111	$ 1.40
	Extra Large HLF	406,673	$ 399,744	$ 0.98
	Transportation service			
<35,000	Medium C&I	1,137,579	$ 3,028,730	$ 2.66
<150,000	Large LLF	1,356,943	$ 3,373,357	$ 2.49
	Large HLF	549,081	$ 959,292	$ 1.75
150,000+	Extra Large LLF	622,893	$ 710,274	$ 1.14
	Extra Large HLF	3,587,934	$ 2,503,732	$ 0.70

In years where the DAC is a positive balance, classes with higher than average revenue per dekatherm will receive more of the refund under TEC-RI's proposal than they would under the Company's proposal.

In years where the DAC has a negative balance, classes with higher than average revenue per dekatherm will pay more of the under-collection under TEC-RI's proposal than they would under the Company's proposal.

4. Low income discount. TEC-RI's proposal is for the Company to pay for 50% of the costs of this discount. According to the direct testimony of Division witness Oliver (page 72, line 4), that represents a reduction to revenue requirements of $415,169.

TEC-RI also proposes to allocate the cost burden of the program to rate classes according to class revenues. By our calculations, that would change the revenue responsibility in the following manner:

Under TEC-RI's proposal, the residential classes would pay $578,446, which is 0.57% of residential class revenue before applying the burden of the program.

The non-residential classes would pay $250,892, which is 0.57% of non-residential class revenue before applying the burden of the program.

5. **GCR classes:** TEC-RI's proposal is to keep the number of classes at the current 6, and not reduce them to 2. It is not possible to determine the financial impact of that request. The required data includes cost of service data that have not been provided in recent GCR filings. The financial impact can only be determined after discovery in the next GCR docket.