EXHIBIT # B

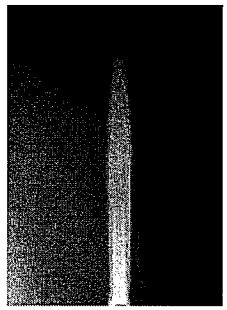
AGA American Gas Association

NATURAL GAS

RATE ROUND-UP

A Periodic Update on Innovative Rate Designs

December 2006



Revenue Stabilization Mechanisms

This issue of the *AGA Rate Round-Up* describes a rate design method that stabilizes customers' bills as well as stabilizes the utility's earnings. The mechanism also reduces the costs of regulatory proceedings to adjust natural gas rates and thereby reduces costs for consumers and the public.

DESCRIPTIONS AND COMPARISONS

Revenue Stabilization Programs

Revenue stabilization, also known as rate stabilization, is a rate design mechanism that decouples a utility's profits from its gas throughput. The mechanism works by adjusting the utility's rates up or down to meet pre-established return and revenue targets. The adjustment amount calculated is added to or subtracted from the commodity charge of the utility in the next period, and the utility files a revised rate schedule with the regulator. Revenue stabilization is not incentive regulation because no reward is granted to the company for hitting performance targets. Instead, revenue stabilization is one of several innovative rate designs that break the link between recovery of a utility's fixed costs and the energy consumption of the utility's customers. Natural gas utilities in five states have received approval for revenue stabilization and the mechanism is pending in a sixth state.

The mechanics and results of revenue stabilization programs are similar to both revenue decoupling mechanisms and weather normalization adjustment (WNA) clauses. As with decoupling, an expedited revenue study is performed in lieu of a general rate case and there are more periodic, yet generally smaller, rate adjustments. The mechanism takes into account normalized customer consumption patterns. Revenue stabilization ensures that the utility does not over-recover or under-recover its authorized distribution charge. However, there are some important differences. The expedited rate study of a revenue stabilization mechanism includes cost elements as well as revenue components. Utility infrastructure investment between rate cases is an important cost item on which many revenue stabilization programs focus. Some revenue stabilization programs benchmark expenses and disallow new expenses greater than the benchmark. Annual adjustment to the utility's rates ensures that the actual return on equity (ROE) falls within a numerical band around the allowed ROE. Revenue stabilization

adjustments may be symmetrical around the ROE band, in that the rate adjustment amount is the same for over-earning the allowed return as it is for under-recovering the allowed return. In some programs, the adjustment is graduated, with some sharing by customers and shareholders of returns above the authorized amount.

Revenue Stabilization and Other Innovative Rate Design Comparisons

More than one rate design method exists that will break the link between volumes of gas consumed and cost recovery for the utility. **Weather normalization adjustment clauses** are rate adjustment mechanisms that neutralize the impact of unusually cold or warm weather on a gas company's revenues and income. Adjustment clauses of all types are actuated without the need for a formal rate hearing.

Another innovative rate technique is **fixed variable rate design**, which places all of the utility's fixed costs, including a regulated profit on the value of the utility's investment in plant and equipment used to provide service to the customer, into a fixed monthly charge called a service charge or a demand charge. This charge is similar to the monthly fee charged by cable TV companies and is unrelated to the amount of gas (or number of TV programs) used by the customer. The basic differences among the various programs include the following:

- With **revenue stabilization,** rates remain volumetric, but if **returns** vary from the level in the rate case, rates are adjusted in the next period.
- With **revenue decoupling mechanisms**, rates remain volumetric, but if **marginal revenues** vary from the level in the rate case, rates are adjusted in the next period.
- Rates remain volumetric with **weather normalization adjustment clauses,** but if **weather-related revenues** vary from the level in the rate case, rates are adjusted either simultaneously or in the next period.
- Rates become **less volumetric and more fixed** with **fixed variable rate design.** Depending on the amount of fixed cost recovered in the service charge or in the first block of the rate design, this can be a purely fixed rate design.

CURRENT AND PROPOSED REVENUE STABILIZATION MECHANISMS

Louisiana

Atmos Energy's two Louisiana natural gas utilities, Louisiana Gas Service and Trans Louisiana Gas, have had a rate stabilization clause (RSC) for several years. On May 25, 2006, the Louisiana Public Service Commission (PSC) extended the RSC for three years through June 1, 2009. The PSC established a 10.4 percent return on equity for both companies through 2009. After 2009, the companies will continue operating under the RSC until the PSC revises the mechanism. The order established a 10.0 to 10.8 percent ROE dead-band for **Trans Louisiana**. If the actual ROE goes above 10.8 percent, rates will be reduced by the amount necessary to reduce the actual ROE to the upper-end of the dead-band. If the actual ROE goes below 10 percent, rates will be increased by the amount necessary to increase earnings to the low-end of the dead-band.

Louisiana Gas is not subject to a dead-band and the company's rates will be adjusted in each of the first three years the RSC is in effect by the amount required to achieve a 10.4 percent ROE. Louisiana Gas is subject to an operations and maintenance (O&M) expense benchmark sharing

mechanism, which is adjusted annually for changes in inflation and customer levels. The 10.4 percent ROE must be calculated using the adjusted O&M benchmark.

CenterPoint Energy operates in Louisiana under a rate stabilization plan that includes a 100-basis-point dead-band around a 10.5 percent ROE and a graduated rate adjustment component. The company's ROE is adjusted annually for certain known and measurable changes (e.g., salary and benefits, revenue taxes), and the change to base rates is made by adjusting the commodity charge. For differences between the actual ROE and the allowed ROE of up to 200 basis points, rates are increased or decreased by 50 percent of the difference necessary to bring the allowed ROE to the end point of the dead-band. For example, if earnings are 200 basis points above the allowed ROE, rates are reduced by the amount necessary to reduce the actual ROE by 75 basis points (or one half the difference between 200 basis points and 50 basis points above the allowed ROE).

For differences of more than 200 basis points above or below the allowed ROE, rates are adjusted by 100 percent of the amount necessary to eliminate the return differential in excess of 200 basis points plus one half of the difference between 200 basis points and the end point of the dead-band. For example, if the earned ROE is 250 basis points below the allowed ROE, rates are increased by an amount equal to that necessary to increase the return by the 50 basis points in excess of the allowed ROE, minus 200 basis points plus 75 basis points for one half of the difference between 200 basis points and 50 basis points below the allowed ROE.

Entergy New Orleans' current rate stabilization plan is similar to the plan for CenterPoint Energy and includes a 100-basis-point dead-band around a 10.5 percent return on equity and a graduated rate adjustment component. The current mechanism, which is in effect until 2008, will continue operating after that until the clause provisions are revised by the Louisiana PSC.

Mississippi

CenterPoint Energy's mechanism in Mississippi features an annual recalculation of the allowed return on equity and a graduated sharing of earnings above the authorized return. The authorized ROE is determined annually by taking the average of three ROE calculation methods: the discounted cash flow method, the capital asset pricing model method, and the regression analysis method. There is a 200-basis-point dead-band around the authorized ROE.

Once the annual authorized ROE has been determined, if the actual ROE is more than 100 basis points below the allowed ROE, then rates are adjusted up to 25 basis points below the allowed ROE. If the actual ROE is greater than 100 basis points but less than or equal to 200 basis points above the authorized ROE, the company returns 25 percent of those earnings to customers. If the actual ROE is greater than 200 basis points but less than or equal to 400 basis points above the authorized ROE, the company refunds 50 percent of those earnings to customers. Under the mechanisms, all earnings greater than 400 basis points above the ROE are returned to customers.

Atmos Energy operates in Mississippi under a rate regulation adjustment clause that is similar to CenterPoint Energy's mechanism.

Oklahoma

CenterPoint Energy's performance based regulation plan, which is in effect until 2009, works in much the same way as a revenue stabilization mechanism. The plan includes a 100-basis-point dead-band around the authorized return of 10.25 percent, and a sharing of earnings above

the authorized ROE. Seventy-five percent of incremental returns above 10.75 percent are returned to customers, while 25 percent of incremental returns above 10.75 percent flow to shareholders. When an increase in revenues is authorized under the plan, the amount is allocated 80 percent to residential customers and 20 percent to general service customers. One half of the revenue increase is added to the monthly customer charge and the other half is added to the commodity rate for the first block of the rate schedule. For returns below the dead-band, the company is allowed to surcharge rates to earn up to 10.25 percent.

Alabama

Mobile Gas Service has had a rate stabilization mechanism since 2002. The company's rates for recovering its total cost of service and allowed return are adjusted annually based on a formulary rate-setting mechanism approved by the Alabama Public Service Commission. All operational costs are included in the annual operations budget and are recovered through current rates established through the rate-setting mechanism. Costs included in the annual rate formula, which are supported by third-party quotes and internal work estimates, are disallowed above a benchmark based on the consumer price index. The plan incorporates a dead-band of 50-basis-points.

Alabama Gas Co.'s current rate stabilization plan is similar to the plan for Mobile Gas Service and was originally implemented in 1983. Since its implementation, Alagasco's plan has been subject to public hearing and comment, and has been modified three times. When an increase in revenues is authorized, the plan caps the amount of increase. Rates can be adjusted upward only once a year, but can be adjusted downward quarterly if year-end net income will exceed the authorized ROE range. The plan has a dead-band of 50 basis points.

South Carolina

South Carolina legislated a Natural Gas Stabilization Act in February 2005 that permits natural gas utilities, upon PSC approval, to adjust rates once per year if their earned ROE is outside a 100-basis-point dead-band around the last authorized ROE. On June 15, 2006, **Piedmont Natural Gas** filed for an increase in rates under the provisions of the legislation. The increase was necessitated due to significant system strengthening investment, residential and commercial customer growth, and continued reduction in normalized use per customer. In September, the company and Office of Regulatory Staff reached a settlement, subsequently approved by the commission, whereby residential rates increased 3.8 percent and commercial rates increased 2.9 percent.

Also on June 15, 2006, **South Carolina Electric and Gas**, which currently is authorized a 10.25 percent ROE, filed to increase its rates under the provisions of the legislation. Residential and commercial customer growth and utility infrastructure investment, specifically liquefied natural gas facilities to help meet peak demand and additional natural gas storage capacity, are the incremental cost elements that led to the requested rate adjustment. The 3.26 percent rate increase would be allocated differentially among customer classes, with residential rates increasing 4.2 percent, small and medium commercial rates rising 2.8 percent, and large commercial and industrial rates increasing 2 percent.

Texas - Pending

Atmos – Mid-Texas Division

In May 2006, Atmos Energy filed a proposal with the Texas Railroad Commission for several rate design changes, including a weather normalization adjustment and a revenue stabilization adjustment. The company's filing, if approved, would authorize an overall ROE of 11.75 percent and would not be subject to a dead-band. The revenue stabilization adjustment would adjust revenues twice a year based on the difference between actual revenues and authorized revenues as adjusted for customer growth. The adjustment periods would be seasonal, with recovery in the following season and reconciliation in the next period. The WNA has already been approved on an interim basis. The new rates would be for the 440 incorporated cities and approximately 1.5 million customers that Atmos Energy serves throughout its Mid-Tex Division service territory, including the Dallas-Fort Worth area.

DENIED MECHANISMS

- **Arkansas Western** in Arkansas – Although the rate stabilization mechanism was denied for Arkansas Western, the Arkansas Public Service Commission recently completed a generic investigation and industry collaborative on energy efficiency mechanisms. A report is expected soon.
- **Atmos Energy** in Georgia – Straight fixed variable, an innovative rate design that decouples the recovery of utility fixed costs from volumetric throughput, is a similar rate design that is accepted in Georgia.
- **CenterPoint Energy Southern Operations** in Arkansas – Arkansas recently completed a generic investigation and industry collaborative on energy efficiency mechanisms. A report is expected soon.

HOW WELL HAVE THEY WORKED?

- **Revenue stabilization mechanisms have reduced the cost of regulation.** In his written opinion, Commissioner Robert Anthony (OK) stated that plans like the one approved for CenterPoint by the Oklahoma Commerce Commission allow for annual streamlined reviews of the company's operations without the expense of a full-blown rate case.
- **Revenue stabilization has reduced regulatory lag** and **has stabilized recovery of utility earnings** while at the same time **has stabilized customer** rates when increased utility earnings have exceed the authorized ROE.
- The volatility of customer rates has been reduced by revenue stabilization mechanisms that allow **more efficient recovery of costs associated with maintaining and expanding natural gas service infrastructure.**

RESOURCES: COMPANIES, RATE ORDERS, WEBSITES, CONTACTS, ETC.

- **Alabama Gas – Alabama** – Approved – www.psc.state.al.us *Amy Stewart @ 205-326-8144*
- **Atmos Energy – Georgia** – Denied – Georgia Order No. 20298-U, February 2, 2006; *Contact Pat Childers @ 615-771-8332*
- **Atmos Energy – Louisiana** – Approved – Louisiana PSC Case No. U-28814, May 18, 2006; *Contact Christine Tabor @ 225-376-4605;* https://p8.lpsc.org/Workplace/WcmJavaViewer.jsp?vsId=%7BF5A00868-D2CD-4729-A5C4-

E8A012B60FFC%7D&objectStoreName=Dockets&objectType=document&id=%7B3100C462-AA37-40B4-9543-06429D7F716A%7D

- **Atmos Energy – Mississippi** – Approved – Mississippi PSC Docket No. 05-UN-0503, October 7, 2005; *Contact Bill Senter @ 601-360-1461*
- **Atmos Energy Mid-Tex – Texas** – Pending – Texas Railroad Commission Docket No. GUD 9670, May 31, 2006; *Contact Charles Yarbrough @ 214-206-2809*
- **CenterPoint Energy Southern Operations– Arkansas** – Denied – Arkansas PSC Docket No. 04-121-U, September 19, 2005; *Contact Chuck Harder @ 713-207-7273*
- **CenterPoint Energy – Louisiana** – Approved – Louisiana PSC Order No. U-26720 Subdocket A, Rider RSP-R3, September 16, 2004; *Contact Chuck Harder @ 713-207-7273*
- **CenterPoint Energy – Mississippi** – Approved – Mississippi PSC Schedule #2, Rider RRA: Feb 1998; *Contact Chuck Harder @ 713-207-7273*
- **CenterPoint Energy – Oklahoma** – Approved – Oklahoma CC Cause No. PUD-200400187, Order No. 499253; December 28, 2004; *Contact Chuck Harder @ 713-207-7273*
- **Entergy New Orleans, Inc. – Louisiana** – Approved – Rider Schedule GFRP-2, August 25, 2005; *Contact Al Eiffert @ 504-670-3673*
- **Mobile Gas Service – Alabama** – Approved –Alabama PSC Docket No. 28101, June 10, 2002, www.psc.state.al.us, *Contact Danny Ford @ 251-450-4637*
- **Piedmont Natural Gas – South Carolina** – Approved – South Carolina PSC Docket No. 2005-113-G; *Contact David Carpenter @ 704-731-4242;* http://dms.psc.state.sc.us/attachments/F736538C-C702-4F87-F8A6D0E7456EF171.pdf
- **South Carolina Electric and Gas – South Carolina** – Approved – South Carolina PSC Docket No. 2005-113-G, October 31, 2005; http://dms.psc.state.sc.us/attachments/F736538C-C702-4F87-F8A6D0E7456EF171.pdf

ADDITIONAL INFORMATION

If you would like more information about a particular program or would like to speak to another AGA member regarding the details of the program, please contact: *Cynthia Marple*, AGA director of rates and regulatory affairs, cmarple@aga.org or 202-824-7228.

Previous Editions:

The June 2006 Rate Round-Up on Innovative Rate Designs for Fixed Cost Recovery can be found at: ***http://www.aga.org/Template.cfm?Section=Rate_Round-Up&Template=/MembersOnly.cfm&ContentID=20563g***

The July 2006 Rate Round-Up was an updated version of the November 2005 article on revenue decoupling. Find this Round-Up at: ***http://www.aga.org/Template.cfm?Section=Rate_Round-Up&template=/ContentManagement/ContentDisplay.cfm&ContentID=20693***