DPU Exhibit 3.3

Artie Powell

Docket No. 07-057-13

Select Pages From The
Direct Testimony of
Mr. Robert B. Hevert
Arkansas Public Service Commission
Docket No. 06-161-U

BEFORE THE
ARKANSAS PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF CENTERPOINT ENERGY RESOURCES CORP., D/B/A CENTERPOINT ENERGY ARKANSAS GAS, FOR A GENERAL CHANGE OR MODIFICATION IN ITS RATES, CHARGES AND TARIFFS	))))))	DOCKET NO. 06-161-U

DIRECT TESTIMONY

OF

ROBERT B. HEVERT

PRESIDENT,

CONCENTRIC ENERGY ADVISORS, INC.

ON BEHALF OF

CENTERPOINT ENERGY RESOURCES CORP.
D/B/A CENTERPOINT ENERGY ARKANSAS GAS

Filed: January 16, 2007

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for BBB to A rated utilities.[45] Assuming the Company's proposed TBDAC is implemented, my recommended 10.90 percent ROE would result in an implied FFO interest coverage ratio of 4.56 times, and an FFO/Total Debt ratio of 23.67 percent. Again, those ratios are generally consistent with benchmarks in the BBB to A range.

VIII. TRIAL BILLING DETERMINANT ADJUSTMENT CLAUSE

Q. PLEASE SUMMARIZE THE COMPANY'S PROPOSED TRIAL BILLING DETERMINANT ADJUSTMENT CLAUSE.

A. As is discussed in the testimony of Mr. Paul Gastineau, the Company is supporting the implementation of a Trial Billing Determinant Adjustment Clause ("TBDAC") that is designed to account for any decline in billing determinants, which may result in the under-recovery of non-gas revenues. The TBDAC would enable a review of billing determinants and base revenues, by class on an annual basis, and would adjust revenue to recover revenue deficiencies by class.

[45] As noted in Exhibit RBH-10, while the FFO Interest Coverage ratio is toward the upper end of the benchmark range as is the ratio of FFO/Total Debt. To the extent that working capital obligations are included in the calculation of "Total Debt", both the Debt Ratio and FFO/Total Debt would be toward the lower end of the benchmark range for the BBB category.

Q. IF THE COMMISSION GRANTS THE COMPANY'S ALTERNATIVE PROPOSAL TO INCLUDE A TRIAL BILLING DETERMINANT ADJUSTMENT CLAUSE IN THE COMPANY'S RATE STRUCTURE, WHAT IS THE APPROPRIATE STANDARD TO CONSIDER IN ESTABLISHING THE COMPANY'S ROE?

A. Under the Commission's comparable earnings standard, the allowed ROE should "represent a return commensurate with the returns on investments of similar risks."[46] In this case, the proxy group companies would constitute the comparable earnings standard for CenterPoint Arkansas. Acceptance by the Commission of the proposed TBDAC Rider would not make the Company less risky than the proxy group companies to the extent that those companies have employed some method to address declining use per customer concerns. In other words, the issue is not whether the Company's revenues would be less volatile with the proposed TBDAC than without it; rather the relevant issue is whether the Company would be more or less risky with its proposed TBDAC as compared to the proxy group. Exhibit RBH-9 provides a summary of the methods used by the proxy group companies to address declining use per customer issues. As shown in that exhibit, the issue of declining use per customer has been addressed by the proxy group companies through the implementation of revenue stabilization adjustment mechanisms and favorable rate structures.

Q. PLEASE DISCUSS THE METHODS USED BY THE PROXY GROUP COMPANIES TO ADDRESS DECLINING USE PER CUSTOMER AND DECLINING CUSTOMER BASE ISSUES.

A. Revenue stabilization adjustment mechanisms have been implemented to mitigate cash flow and earnings volatility due to changes between the billing determinants used to develop the

[46] Docket No. 04-121-U, Order No. 16 at 42.

rates and actual billing determinants experienced through a true-up mechanism. Four of the six proxy group companies have such mechanisms.

In addition to addressing declining use per customer through specific revenue stabilization mechanisms, some of the proxy group companies have addressed the issue through other rate design approaches. For example, to the extent that fixed costs can be recovered through fixed monthly customer charges that do not vary with demand levels, some of the risk associated with declining use per customer can be mitigated. All of the proxy group companies have some level of fixed customer charge and in some cases, the fixed customer charge was increased more than the variable charges specifically to address the recovery of fixed costs. In Atmos-Tennessee's 2006 rate case, for example, a revenue-neutral change was made whereby the customer charges for residential and commercial customers were effectively doubled and a corresponding decrease was made to the volumetric charges in order to more appropriately recover fixed costs.[47]

Also, the volumetric rate structure can be designed to mitigate risk due to declining use per customer. Typical volumetric rate structures involve charging a fixed per unit rate for each unit of gas used. A declining block rate structure, which involves increasing the per unit rate associated with the first volume block of gas used, then decreasing the per unit rate for additional volume blocks. As a result, more fixed costs are recovered in the first block, which is less likely to be affected by a decline in customer use.

[47] TRA Docket No. 05-00258 Direct Testimony of Patricia J. Childers dated July 17, 2006, Director Miller's Motion sent to Chairman Kyle dated October 25, 2006, Transcript October 26, 2006, Tariff filed with TRA on November 28, 2006 and November 29, 2006.

As shown in Exhibit RBH-9, several of the proxy group companies employ declining block rate structures to address the declining use per customer issue. Specifically, in the context of declining use per customer due to warmer weather, Laclede, which does not have a revenue stabilization mechanism, was allowed to shift distribution costs from the second rate block to the first rate block which is less sensitive to customer use. "Faced with 'a persistent and increasingly serious under-recovery… of its actual costs of providing service'", Laclede was allowed a rate design that "was intended to collect sufficient revenue to cover Laclede's fixed costs from the customer charge and block one."[48] As shown in Exhibit RBH-9, each of the proxy group companies has addressed declining use per customer issues through some combination of the methods discussed above.

Q. WHAT CONCLUSION DO YOU DRAW ABOUT CENTERPOINT ARKANSAS'S RELATIVE RISK TO THE PROXY GROUP IF THE PROPOSED TBDAC IS APPROVED?

A. The proposed TBDAC would not make CenterPoint Arkansas any less risky than the proxy group companies; it simply will make the Company more comparable to the proxy group in that the TBDAC provides for the recovery of the revenue requirement irrespective of conservation or demand loss.

[48] Order In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules. Case No. GR-2002-356, Dated November 8, 2002, pages 9-10.

Q. HAS YOUR POSITION THAT THE IMPLEMENTATION OF A REVENUE STABILIZATION MECHANISM DOES NOT REQUIRE AN ADJUSTMENT TO ROE BEEN SUPPORTED IN OTHER JURISDICTIONS OR IN THE INDUSTRY?

A. Yes. In 1998, Baltimore Gas & Electric implemented a revenue stabilization mechanism, "Rider 8", that adjusts for both the effects of weather and changes in the number of customers. In Baltimore Gas & Electric's 2005 rate case, the Maryland Office of People's Council recommended a reduction in ROE of 20 basis points, alleging it was appropriate to compensate for the reduction in risk relative to the program; however, no other parties in the case supported this reduction. In fact, the Commission Staff agreed with the Company that no reduction was required. In his testimony, Staff witness Vander Heyden stated:

> The majority of the companies in the proxy group are now using some form of weather or conservation mitigation to stabilize their revenue. The lower risk of recovery has been incorporated in the observed gas LDC market return as represented by the proxy companies. Consequently, Staff is not recommending that the Commission continue to reduce BGE's ROE for gas service in order to account for the lowered risk from the use of Rider 8.[49]

In its Order, the Maryland Commission noted that, "based on reasons provided by Staff and the Company, the Commission declined to order a specific adjustment for the effects of Rider 8."[50]

Q. HAVE COMPANIES BEEN REQUIRED TO ACCEPT A REDUCTION IN THE ALLOWED ROE IN EXCHANGE FOR APPROVING A REVENUE STABILIZATION MECHANISM?

A. No. Exhibit RBH-11 provides a summary of recently approved revenue stabilization programs. The regulatory commissions that approved these programs have not typically

[49] Direct Testimony of Staff witness Vander Heyden, Docket No. 9036, August 15, 2005, at 22.
[50] Public Service Commission of Maryland Order No. 80460, December 21, 2005, p. 67-68.

required a reduction in the companies' allowed ROEs. To that point, in a recent presentation on "The Changing Regulatory Environment for Natural Gas" the director of Rates and Regulatory for the AGA states: "No company accepted a decrease in ROE in return for decoupling."[51]

Q. HOW DO THE RATING AGENCIES VIEW THE IMPLEMENTATION OF REVENUE STABILIZATION MECHANISMS?

A. Rating agencies have become increasingly focused on the issue of declining use per customer for LDCs and are looking to revenue stabilization mechanisms as a solution. As noted by Moody's:

> While [Revenue Decoupling] may have originally begun as a regional concept in certain jurisdictions, it has quickly become a nationwide phenomenon that will challenge regulators and gas utilities alike, as they seek to correct a structural imbalance in their rate design that has become increasingly difficult to ignore.[52]

Q. IS THERE A MEASURABLE DIFFERENCE IN VALUATION MULTIPLES FOR COMPANIES THAT HAVE RATE STRUCTURES DESIGNED TO MITIGATE THE RISK OF DECLINING USAGE?

A. No. The industry has not reflected the inclusion of revenue stabilization mechanisms in the valuation multiples of gas utility companies. If investors considered such revenue stabilization mechanisms to materially affect cash flow volatility, those expectations presumably would be manifested in trading multiple differences. Exhibit RBH-12 presents the price to book multiples for the proxy group companies from January 2003 through 2006 to date.[53] In

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51 "The Changing Regulatory Environment for Natural Gas" , Cynthia J. Marple, AGA/EEI Advanced Public Utility Accounting Training Course, September 18, 2006, slide 18.

52 Local Gas Distribution Companies: Update on Revenue Decoupling and Implications for Credit Ratings, Moodys, June 2006, p. 6. Clarification added.

53 SNL Energy.

addition, I have noted on this exhibit the implementation dates of each of the revenue stabilization mechanisms for the proxy group companies that have implemented such mechanisms during this time period. As shown in that exhibit, there is no meaningful difference in valuation multiples before and after the implementation dates. Consequently, it is not clear that investors' return requirements are significantly affected by such rate structures.

Q. IS IT YOUR POSITION THAT THE IMPLEMENTATION OF THE TBDAC SHOULD HAVE NO EFFECT ON THE COMPANY ROE?

A. Not necessarily. As noted above, rate structures designed to mitigate the effects of declining use per customer are becoming increasingly common. Moreover, there is no conclusive evidence of which I am aware indicating that companies that have implemented such structures either have lower authorized ROEs or have significantly different market valuations. Nonetheless, given the nature of the TBDAC, it is conceivable that there could be a quantifiable effect on certain volatility and risk measures, thereby affecting the Company's cost of equity.

Q. HAVE YOU ESTIMATED AN APPROPRIATE ADJUSTMENT TO THE COMPANY'S ROE TO REFLECT THE IMPLEMENTATION OF THE TBDAC?

A. Yes, I have. I reviewed the credit spread on the Moody's Utility bond indexes for Aa, A, and Baa rated utilities from January 1, 2001 through November 27, 2006[54]. The premise of this analysis is that to the extent that the TBDAC provides an incremental degree of risk

[54] November 27, 2006 was the most recently available data at the time of the filing. I do not expect that the relying on data through November 30, 2006 would alter the results.

mitigation, the effect on required returns may be estimated by looking at the credit spread associated with one ratings notch difference among those three ratings categories.[55] As shown in Table 6 (below), those spreads have averaged between 18 and 41 basis points over that time. In my view, an adjustment of 35 basis points (which is somewhat above the midpoint of that range) is a conservative and reasonable estimate of the potential effect of the TBDAC on the Company's ROE.

Table 6: Credit Spread Summary

	A/Aa Spread	Aa/Baa Spread	Average
2001-2006	0.18	0.33	0.25
2001	0.19	0.26	0.23
2002	0.18	0.65	0.41
2003	0.19	0.26	0.22
2004	0.12	0.24	0.18
2005	0.21	0.28	0.24
2006 YTD	0.24	0.25	0.24

[55] Please note that I am not suggesting that the TBDAC would necessarily result in a rating change for CERC. In addition, there is not necessarily a one-to-one relationship between changes in the cost of debt and the cost of equity. Nonetheless, this analysis is a reasonable approach to estimating the potential effect of the TBDAC on the Company's ROE.

IX. CONCLUSIONS

Q. WHAT IS YOUR CONCLUSION REGARDING A FAIR ROE FOR CENTERPOINT ARKANSAS?

A. I believe that a rate of return in the range of 10.50 percent to 11.50 percent represents the range of equity investors' required rate of return for investment in gas distribution utilities in today's capital markets. My recommended ROE of 11.25 percent is reasonable taking into consideration the following: (i) increased risk due to the Company's declining customer base; (ii) the low market dividend yield relative to the current 30-year Treasury yield; and, (iii) potentially rising interest rates. In the event the Commission accepts the Company's proposed TBIDAC, I would recommend a downward adjustment of 35 basis points, resulting in an ROE of 10.90 percent.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.