BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

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UNITED CITIES GAS COMPANY, a Division of ATMOS ENERGY CORPORATION INCENTIVE PLAN ACCOUNT (IPA) AUDIT	)	DOCKET NO. 01-00704
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UNITED CITIES GAS COMPANY'S MEMORANDUM IN RESPONSE TO THE MOTIONS FOR SUMMARY JUDGMENT FILED BY THE STAFF OF THE TENNESSEE REGULATORY AUTHORITY AND THE CONSUMER ADVOCATE AND PROTECTION DIVISION OF THE ATTORNEY GENERAL'S OFFICE

United Cities Gas Company ("UCG") files this memorandum in response to the motions for summary judgment filed by the Tennessee Regulatory Authority ("TRA") Staff ("Staff") and the Consumer Advocate and Protection Division of the Office of Attorney General ("CAD"). Submitted with this response are the affidavits of Frank Creamer, Pat Childers, John Hack, and Mark Thessin.[1]

The Directors have convened a contested case in this matter to determine the correct interpretation of UCG's performance based rate making mechanism ("PBR") and the proper application of the PBR to UCG's 2000-2001 Incentive Plan Account. (Transcript of Authority Conference, April 30, 2002, pp. 34-36.) All parties to this contested case agree that there are two issues to be decided:

> 1. Whether UCG's inclusion in the PBR of the savings resulting from negotiated discounted transportation contracts is consistent with the Authority's Final Order on Phase Two in Docket 97-01364 (the "Phase Two Order").

[1] Because Patricia Childer's affidavit contains confidential and proprietary information belonging to UCG, it has been filed under seal.

2. How should the savings associated with avoided costs resulting from a negotiated gas supply agreement for requirements from the East Tennessee-NORA Gas Pipeline (the "NORA Contract") be accounted for in the PBR under the terms of the Phase Two Order and the Order in Docket No. 00-00844 authorizing inclusion of the NORA contract in the PBR.

The Staff has moved for summary judgment on both issues.[2] Because the motions for summary judgment filed by the Staff and by CAD do not comply with the requirements of Tenn. R. Civ. P. 56.03 and because the motions do not demonstrate that the Staff's and CAD's interpretation of the PBR is correct as a matter of law, the motions should be denied.

I. THE MOTIONS FILED BY THE STAFF AND THE CAD DO NOT COMPLY WITH THE MANDATORY REQUIREMENTS OF TENN. R. CIV. P. 56.03, AND THEREFORE MUST BE DENIED.

Tenn. R. Civ. P. 56.03 requires that parties moving for summary judgment submit a numbered list of the material facts as to which the moving party contends there is no genuine issue for trial. Rule 56.03 also provides that "[e]ach fact shall be supported by a specific citation to the record."

Contrary to Rule 56.03, the Staff did not submit a statement of the material facts it contends are undisputed. The CAD's memorandum in support of its motion for partial summary judgment does contain a list of the material facts the CAD claims are undisputed. The CAD did not, however, support its factual statements with any citations to the record, as required by Rule 56.03.

Because the Staff's and the CAD's motions failed to comply with the specific requirements of Rule 56.03, their motions must be denied. Tenn. R. Civ. P. 56.04 provides that summary judgment shall be rendered "[s]ubject to moving party's compliance with Rule 56.03." Therefore, the Authority must refuse to even consider a motion for summary judgment if the moving party

[2] The CAD has moved for summary judgment only as to the first issue. The CAD's brief did not discuss the proper treatment of the NORA contract. (CAD Memo. p. 3.)

has not complied with Rule 56.03. Seals v. Tri-State Defender, Inc., 1999 WL 628074 at *3 (Tenn. Ct. App. Aug. 16, 1999) (reversing trial court's grant of summary judgment because moving party failed to submit a statement of undisputed material facts); see also Banks, Entman on Tennessee Civil Procedure (1999) (interpreting Rule 56.04 to require the court to refuse to grant or even consider a motion for summary judgment if the moving party has not complied with Rule 56.03). There is no question but that the motions filed by the CAD and the Staff do not comply with the requirements of Rule 56.03. As such, the motions must be denied.

II. THE RECORD REVEALS THAT THE MATERIAL FACTS ALLEGED BY THE CAD ARE IN DISPUTE.

The CAD submitted three separate material facts it contends are undisputed. None of those facts included any citations to the record whatsoever, as required by Tenn. R. Civ. P. 56.03. As discussed above, Tennessee law requires that the Authority deny the motions for summary judgment filed by the CAD and the Staff because the motions do not comply with Rule 56.03. In the alternative, the CAD's motion should be denied because the record clearly demonstrates that all of the facts alleged by the CAD are disputed.

The Tennessee Supreme Court has cautioned that summary judgment is not to be used as a "substitute for the trial of genuine and material factual matters," and has specifically held that "if there is a dispute as to any material fact or any doubt as to the conclusions to be drawn from that fact, the motion ***must*** be denied." Byrd v. Hall, 847 S.W.2d 208, 210-11 (Tenn. 1993).

The CAD has alleged that the following material facts are undisputed:

> 1. UCG's inclusion in its PBR of the savings resulting from the negotiated transportation discounted contracts is not consistent with the Final Order. The additional calculations supplementing the current formulas do not conform to the Final Order.
>
> 2. The PBR mechanism approved by the TRA for UCG accounts for all transportation costs. Any alleged savings from discounts

specified within negotiated transportation contracts are not permitted under UCG's approved PBR.

3. The calculations made by UCG are not consistent with the terms of UCG's incentive plan.

(CAD Memo. pp. 3-4.) As demonstrated by the Response to Statement of Material Facts filed by UCG in this matter, the record in this case clearly demonstrates, repeatedly, that all of these facts are disputed. In fact, the statements listed by the CAD as undisputed are the very same findings which UCG disputed in its response to the Staff's audit of its Incentive Plan Account and are the very same issues that the parties have agreed must be submitted to the Authority for determination. (See April 10, 2002 Notice of Filing by Energy and Water Division of The Tennessee Regulatory Authority, at Exhibit A, *Compliance Audit Report of United Cities Gas Company's Incentive Plan Account,* pp. 11-16; May 7, 2002 Issues List for Authority Staff Participating as a Party at ¶ 1; June 5, 2002 Issues List Submitted by United Cities Gas Company at ¶ 1; September 24, 2002 United Cities Gas Company's Response to Attorney General's First Set of Interrogatories, Requests for Production of Documents and Things, and Requests for Admissions at ¶¶ 1-4).

Because the material facts alleged by the CAD are disputed, and because the Staff failed to allege any undisputed material facts, the CAD and Staff cannot meet the standard for summary judgment under Tennessee law, and both motions for summary judgment must be denied.

III. TRA STAFF HAS ALREADY ACCEPTED UCG'S PROPOSED INCLUSION OF THE SAVINGS FROM NEGOTIATED DISCOUNT TRANSPORTATION CONTRACTS IN THE PBR AND HAS APPROVED OF UCG'S METHOD OF CALCULATING THOSE SAVINGS.

The Staff alleged in its brief that the current PBR filing is the only filing in which UCG identified a separate figure for transportation savings, and the CAD in its brief accuses UCG of "reformulating" the PBR in the annual report, and attempting to "slip it under the radar" in hopes that the TRA would not notice. (Staff Memo. p. 26; CAD Memo. p. 19.) The Staff and the

CAD's interpretation of events is entirely incorrect. UCG began aggressively pursuing discount transportation contracts in 1999, but was not successful in obtaining a significant amount of discounted contracts until November of 2000. (Hack Aff. ¶¶ 6-7.) Shortly after completing those negotiations, UCG specifically requested a meeting with the Staff to notify the Staff of the newly negotiated discounts and discuss the treatment of the savings under the PBR tariff. (Childers Aff. ¶ 3; Thessin Aff. ¶ 4; Hack Aff. ¶ 9.) The meeting was held on January 31, 2001. (Childers Aff. ¶ 4; Thessin Aff. ¶ 5; Hack ¶ 10.) Present at the meeting were Mike Horne, the Chief of the TRA Energy and Water Division, and TRA Staff members Dave McClanahan and Pat Murphy, and 6 representatives of UCG's gas supply and rates departments, including 2 individuals that flew in from the Atmos Energy home office in Dallas for the meeting. (Childers Aff. ¶¶ 6-7; Thessin Aff. ¶¶ 7-8; Hack Aff. ¶ 12.) At that meeting, UCG stated its position that the transportation costs savings were included in the PBR as "avoided costs," under the Gas Procurement Incentive Mechanism of the tariff and provided the Staff with a written packet of materials demonstrating how UCG proposed to calculate and report the savings in its quarterly and annual reports. (Childers Aff. ¶¶ 11-13;Thessin Aff. ¶¶ 13-14; Hack Aff. ¶¶ 16-17.) The written packet UCG provided to the attendees at the meeting clearly shows that the discounts are calculated by comparing the negotiated rates with the maximum rate permitted by the Federal Energy Regulatory Commission (the "maximum FERC rate"). (Id.) The Staff's response was positive. (Childers Aff. ¶ 14; Thessin Aff. ¶ 16; Hack Aff. ¶ 18.) The Staff indicated that it agreed with UCG's interpretation that the PBR included the transportation savings as avoided costs, and that it accepted UCG's proposed methods of calculating and reporting the savings. (Childers Aff. ¶ 14; Thessin Aff. ¶ 16; Hack Aff. ¶ 18.)

On March 1, 2001, just one month after the meeting with the Staff, UCG filed its quarterly report for the period of time from October through December 2000. (Childers Aff. ¶ 15.) As promised in the January 1 meeting, UCG reported the savings resulting from the negotiated discounted contracts, and calculated that savings as the difference between the negotiated rate and the maximum FERC rate. (Id.) Contrary to the CAD's unsupported allegations, UCG did not attempt to mislead the Staff. In fact, UCG took pains to bring the newly reported savings to the Staff's attention and calculate them in the simplest, most straightforward manner possible. Therefore, UCG did not try to hide the transportation cost savings, but instead separated the transportation costs in a separate column in the quarterly report so there could be no confusion as to how the savings were calculated. (Childers Aff. ¶ 15.) At the time, UCG thought that the end mathematical result would be the same regardless of whether the transportation costs were calculated as part of the total gas commodity costs or included in their own separate column. (Id.) Since UCG thought the end results would be identical, it chose to highlight the additional savings for the TRA staff by including a separate column for the transportation savings. (Id.)

UCG relied on the provision in the tariff requiring the TRA staff to object to the quarterly reports within 180 days, and assumed that the TRA staff would notify UCG if it had any objection to the calculation method used in the quarterly report. (Id.) When no objection, either written or oral, was forthcoming, UCG again used the same method of calculation in its May 31, 2001 quarterly report, again, without objection of any sort whatsoever from the Staff. (Id.) Accordingly, pursuant to the tariff (Sheet No. 45.6), UCG's incentive plan account is deemed in compliance with the provisions of the PBR for the periods represented by the quarterly reports (October – December 2000 and January - March 2001).

The Staff and the CAD have argued that the tariff only requires the Authority to notify UCG of exceptions to annual reports, and that the Staff has no duty to notify UCG of exceptions to the quarterly reports. (CAD Memo. p. 15; Staff Memo. pp. 29-30.) This is contrary to the plain meaning of the specific language in the tariff. The tariff specifically provides:

> The Company will file calculations of shared savings and shared costs quarterly with the Authority not later than 60 days after the end of the quarter and will file an annual report not later than 60 days following the end of the plan year. Unless the Authority provides written notification to the Company within 180 days of ***such reports***, the Incentive Plan Account shall be deemed in compliance with the provision of this Rider.

(Tariff Sheet 45.6) (emphasis added.) This language requires UCG to file annual ***and*** quarterly reports, and then states that the Incentive Plan Account will be deemed in compliance unless the Authority objects to ***such reports*** within 180 days. If the Authority's obligation to object only applied to the annual report, the plural would not have been used.

The Staff and the CAD argue in their briefs that legal obligations cannot be imposed upon government agencies through estoppel where there is no affirmative act to induce reliance. (Staff Memo. at pp. 30-31; CAD Memo. at pp. 18-19.) This argument misses the point in two respects: First, it is not the doctrine of estoppel which imposes a legal obligation on the Staff, it is the binding regulation contained within the tariff, which has been approved and accepted by the Authority. Second, the Staff did not merely acquiesce to UCG's filings – it met with UCG representatives, actively participated in that meeting, and indicated to UCG that it agreed and approved of UCG's position and proposed reporting and calculation methods. These actions indicate much more than passive acquiescence – the Staff took affirmative action that clearly induced UCG to act to its detriment. As such, the Staff is now barred from taking an inconsistent position and contesting both the inclusion of the transportation savings as avoided costs under the PBR and the method UCG used in its quarterly and annual reports to calculate the shared savings.

See Bledsoe County v. McReynolds, 703 S.W.2d 123, 125 (Tenn. 1985) (holding that government may be estopped where "public body took affirmative action that clearly induced a private party to act to his or her detriment").

IV. UCG'S INCLUSION IN THE PBR OF SAVINGS FROM NEGOTIATED DISCOUNTED TRANSPORTATION CONTRACTS IS CONSISTENT WITH THE PHASE TWO ORDER AND UCG'S TARIFF.

Both the Staff and the CAD concede in their briefs that UCG's PBR program was intended to span the entire spectrum of all gas procurement, storage, and capacity activities. (Staff Memo. p. 5; CAD Memo. p. 3.) The testimony of the Authority consultant, Frank Creamer, at the 1998 hearing for approval of a permanent PBR plan confirmed that the PBR was intended to cover all costs of purchasing, delivering, and storing gas to the end consumer, including transportation costs. (Trans. of March 26, 1998 Hearing, vol. 1 p. 61, lines 6-9); see also, Creamer Affidavit ¶ 10.)) The Authority's definition of total gas cost in the Phase Two Order specifically recognizes that gas cost includes a transportation cost component. The Authority stated that

> The total cost of the gas includes the commodity cost ***and the transportation cost to move the gas from its source to the city gate.*** In general the closer the gas source is to the city gate, the higher the commodity cost, but, since the distance to be moved is less, the transportation cost is less. In contrast, the farther the gas is from the city gate, the cheaper the commodity cost, but the transportation cost to move it a greater distance is more. It is, therefore, possible that the total of commodity and transportation costs for the higher cost gas could be lower than the ***total costs (commodity plus transportation)*** for the cheaper gas.

(Phase Two Order p. 18 fn. 46) (emphasis added.) As noted in the Phase Two Order, CAD witness Dan McCormac conceded that gas cost consists of both the commodity price of the gas, plus the transportation cost of moving the gas from the pipeline receipt point to the delivery point. (Phase Two Order p. 18.) UCG's witness, Ron McDowell, testified that UCG's operational plan was to consider all components of gas cost, including transportation and storage costs, to obtain the least total cost possible. (Phase Two Order p. 18.)

The PBR was designed to create an incentive for UCG to out-perform the market in its acquisition of gas supplies by allowing UCG to share in savings obtained and help absorb excess costs. (Phase Two Order p. 2.) A fundamental requirement of the PBR is that UCG is not to be rewarded at the expense of the ratepayer. In order to satisfy the incentive principle behind the PBR, as recognized in the Phase Two Order, the program must be all-inclusive, e.g. it must include all aspects of gas purchasing activities. If transportation costs had been excluded from the PBR program and simply passed on in full to the consumers, the PBR plan would have a material defect. UCG could increase its savings on the commodity portion, which it would share in, by entering into relatively high transportation cost arrangements (which would be passed on to the ratepayer) in order to lower commodity costs. Under this scenario, UCG could earn benefits at the ratepayers' expense. This is completely inconsistent with the goals of the PBR program, and explains why transportation costs were included in the program from its inception.

As outlined in the Staff's brief, an important feature of the PBR program in addition to the incentive component was the elimination of the need for the Authority to hire a consultant each year to review UCG's gas costs for the past year to determine if they were prudent. (TRA Memo. p. 10; Phase Two Order p. 1.) If transportation costs are now excluded from the PBR, as recommended by the Staff and the CAD, UCG would have no incentive to beat the market, and there would be no process in place for the Authority to verify market transportation costs, short of ordering a prudency audit – the very type of regulatory activity the PBR was designed to avoid.

The PBR program provides for consideration of transportation costs through the Gas Procurement Incentive Mechanism of the tariff. (UCG Tariff Sheet 45.2).[3] The Gas Procurement Incentive Mechanism of the tariff measures UCG's performance against a benchmark that consists of three published market indexes ***and a transportation cost adjustor.*** (UCG Tariff Original Sheet 45.2; Creamer Aff. ¶¶ 20, 22.) (emphasis added.) Specifically, UCG's tariff provides that "[f]or city gate purchases, these indexes will be adjusted for the avoided transportation costs that would have been paid if the upstream capacity were purchased versus the demand charges actually paid to the supplier." (UCG Tariff Sheet 45.2). Authority consultant Frank Creamer, in his report reviewing the second year of UCG's experimental PBR period, specifically outlined the avoided transportation cost adjustment that should be applied to city gate purchases to account for transportation costs. (Creamer Aff. ¶ 20). Mr. Creamer stated that the benchmark average index for long-term city gate purchases should be adjusted by adding the appropriate avoided pipeline transportation cost to the average index price of gas. (Id.)

The Staff has argued in its brief that the transportation cost adjustor should only be applied to situations in which the gas is purchased right at the city gate and all transportation costs are avoided. (Staff Memo pp. 25-26.) The Staff's argument is based on the staff's definition of "city gate purchase" as a purchase which consists exclusively of commodity cost, and involves no transportation costs whatsoever. (Id. at p. 23.) "City gate purchases," as that term is used in the PBR tariff, includes both raw commodity costs and transportation costs necessarily incurred for the delivery of the commodity to the city gate. The invoices UCG receives from Woodward

[3] Although it is not clear from the CAD's brief, it appears that the CAD may be arguing that the transportation costs were originally captured in the transportation capacity cost mechanism, which was eventually collapsed into the Capacity Release Sales Mechanism. (CAD Memo. p. 9.) Both UCG and the Staff agree that "[t]he negotiated discount transportation contracts are distinct from United Cities' release of transportation capacity under the Capacity Release Mechanism of the PBR Tariff." (TRA Memo. p. 25 fn. 74; Murphy Aff. p. 3.) The Capacity Release Mechanism refers to UCG's release of unused capacity through marketing to third parties, and has no relevance whatsoever to transportation costs. (Creamer Aff. ¶ 12.)

Marketing, LLC illustrate that UCG is charged for both transportation and commodity costs for "city gate purchases." (Woodward Invoice, attached as Exhibit 4 to the Affdavit of Patricia Childers.) Thus, as used in the tariff, "city gate purchase" refers to the commodity cost of gas plus the necessary transportation cost, if any, to get the gas to the city gate.

The Staff's position that the transportation cost adjustor should be applied only where delivery is taken right at the city gate, and thus where 100% of the transportation costs are avoided, is inconsistent with the Phase Two Order and the testimony of both UCG and CAD witnesses at the Authority's hearing on Phase Two. The Phase Two Order recognizes that, as conceded by both UCG and CAD witnesses, it is meaningless to consider only the commodity component of the total gas cost, without also considering the transportation costs. (Phase Two Order p. 18.) Transportation costs increase the further away the delivery point is, and decrease the closer the delivery point is to the city gate. (Id.) The Staff is arguing that the benchmark should be adjusted when 100% of the transportation costs are avoided, but not when some lower percentage of transportation costs are avoided.

For the 2000-2001 plan year, UCG calculated its avoided transportation costs for the discounted transportation contracts it negotiated as the difference between the maximum approved FERC rate for firm, long-term transportation contracts and the discounted rate UCG negotiated. (*Compliance Audit Report of United Cities Gas Company's Incentive Plan Account,* pp. 11-16.) This was the same method used to calculate avoided transportation costs under the NORA contract during the experimental PBR period. (Creamer Aff. ¶ 21.) For the NORA contract, the avoided transportation costs (i.e., the difference between the maximum FERC rate and the rate UCG paid) were added to the average of the three commodity price indexes to arrive at the benchmark price that was used to determine whether UCG's performance qualified for savings or penalties. (Id.)

In its brief, the Staff acknowledged that the comparison between the benchmark price and UCG's price must be an "apples to apples" comparison. (Staff Memo. p. 24.) UCG agrees. The Phase Two Order specifically recognizes that UCG's total cost of gas includes both commodity costs and transportation costs, and that the two components are inextricable intertwined. (Phase Two Order p. 18.) The CAD's witness, Dan McCormac, testified at the Phase Two hearing that evaluating costs based on commodity alone does not give a true picture of whether UCG has obtained the best deal for the consumers, because sometimes it is cheaper to pay a higher commodity price for closer gas and avoid the transportation costs. (Id.) Unless the benchmark commodity market indexes are adjusted to account for transportation costs, the comparison between the benchmark and UCG's actual total cost, which all parties agree include transportation costs, is not an "apples to apples" comparison. This is because the four indexes used to compute the benchmark average price (Inside FERC, NYMEX, Natural Gas Intelligence, and Gas Daily) do not include the transportation cost UCG incurs to transport the gas from the pipeline receipt point to the city gate, i.e., the delivery point. (Creamer Aff. ¶ 14.) The CAD argues in its brief that "the indices already included the effect of transportation prices." (CAD Memo. p. 13.) The only support CAD cites for this conclusion is two testimony excerpts from the Phase Two hearing. The first excerpt is from the testimony of Dr. Stephen N. Brown, the CAD's expert:

> Q (Mr. Flaherty). Would you agree that the Inside FERC index and the NGI index that United Cities proposes to use in this case are tied to pipelines that are used to transport gas from the gas fields to Tennessee?
>
> A (Dr. Brown). Yes, and not only Tennessee but throughout various other parts of the country.
>
> Q (Mr. Flaherty). And would you agree that those two indexes don't separate out or have a separate index for electric generators, LDCs, industrial customers; there's just one index?
>
> A (Dr. Brown). Yes.

(Transcript Vol. 2, pp. 426-27, lines 97-97; CAD Memo. p. 14.)

UCG is at a loss as to how this testimony supports the CAD's conclusion that the indexes include transportation prices. Dr. Brown is simply admitting that the indexes consist of pipelines used to transport gas to Tennessee and other parts of the country, and that the indexes do not include a separate index for electric generators, LDCs or industrial customers. The cited testimony does not even mention transportation costs, and has no relevance whatsoever with regard to the issue of whether the indexes contain a transportation cost component.

The second testimony excerpt the CAD relies upon in support of its contention that the indexes include a transportation cost component is a statement made by Frank Creamer that "[t]he mechanism has three baskets of indices, are widely followed by the industry. And to the extent of transportation prices, those are included within the program itself." (Trans. Vol. 1 pp. 97-98; CAD Memo. p. 14.) The CAD has mischaracterized Mr. Creamer's testimony. (Creamer Aff. ¶ 13.) Mr. Creamer did not state that ***all*** transportation prices were included in the indices. (Id.) To the contrary, Mr. Creamer's testimony was that the indexes represent only the upstream transportation costs the pipeline incurs to get the gas from the well head to the pipeline receipt point. (Id.) The indexes ***do not include*** the downstream cost of transporting the gas from the pipeline receipt point to the city gate, i.e., the delivery point. (Id.) For example, Inside FERC reports the price range for gas delivered to specific pipeline receipt points, not to customer delivery points. (Id.) Contrary to the CAD's argument, the indexes do not include the downstream transportation costs incurred to get the gas to the city gate. Therefore, because UCG's total cost includes downstream transportation costs, in order to compare "apples to apples," the indexes must likewise be adjusted to include a transportation cost component. (Creamer Aff. ¶ 14.) UCG's cost is a bundled price which includes both commodity and transportation costs – the benchmark index by which UCG's performance is measured must likewise be a bundled price which includes both commodity and transportation costs.

In its brief, the Staff does not dispute that the benchmark indexes in the PBR are commodity only indexes which do not include downstream transportation costs. Instead, the Staff argues that it is impossible to include transportation costs in the PBR at all because no objective market indicator exists that can be used as a benchmark for transportation costs. (TRA Memo. pp. 26-27.) Both the CAD and the Staff argue that the maximum FERC rate cannot serve as an indicator of prices achieved in the market. (TRA Memo. pp. 26-27; CAD Memo. p. 12.) Contrary to the arguments of the Staff and CAD, the maximum FERC rate is an appropriate indicator of market transportation prices, and in fact, has been accepted in other states as the benchmark true market indicator of transportation costs. (Creamer Aff. ¶ 15.)

During the experimental PBR period, all of UCG's actual transportation costs were at the undiscounted published maximum FERC rate. (Creamer Aff. ¶ 11.) During the fall of 1999, discounted transportation contracts for the first time became a feature in the marketplace, and UCG, based on the incentives of the PBR, began to aggressively pursue those discounts. (Creamer Aff. ¶ 11, 16.)[4] In January 2001, UCG requested a meeting with Staff to provide notice of the renegotiated discount transportation contracts that went into effect in November of 2000. (Childers Aff. ¶ 3; Thessin Aff. ¶ 4; Hack Aff. ¶ 9.) On January 31, 2001, the Staff met with UCG to discuss the treatment of the avoided costs from those contracts under the PBR. (Childers Aff. ¶ 4; Thessin Aff. ¶ 5; Hack ¶ 10.) UCG discussed in detail with the Staff the reporting methods it

[4] The CAD made the disingenuous argument in its brief that the fact that UCG did not report negotiated discounted transportation contracts during the first PBR plan year is evidence that such discounts are not included within the PBR. (CAD Memo. p. 10.) In fact, the vast majority of the transportation discounts were not available during the first plan year, leaving almost all of UCG's contracts priced at the maximum FERC rate. (Hack Aff. ¶¶ 6-7.) UCG did neglect to include the three small negotiated transportation contracts that were negotiated in October of 1999 in the 1999-2000 plan year. However, UCG's failure to include the contracts was merely an accounting oversight, and is not evidence that UCG did not belief the PBR covered those contracts. (Id.)

intended to follow with regard to the inclusion of these avoided costs in its quarterly reports. (Childers Aff. ¶¶ 11-13;Thessin Aff. ¶¶ 13-14; Hack Aff. ¶¶ 16-17.) The Staff indicated that it agreed with UCG's interpretation of the PBR tariff, and that it accepted UCG's proposed reporting and calculation methods. (Childers Aff. ¶ 14; Thessin Aff. ¶ 16; Hack Aff. ¶ 18.)

Pursuant to the tariff guidelines, UCG filed quarterly reports on March 1 and May 31, 2001 that clearly indicated that the avoided costs from the transportation contracts had been included in UCG's incentive plan account.[5] (Childers Aff. ¶¶ 15, 16, 17.) The Authority failed to provide any notification to UCG, either written or oral, that it had any exceptions to the filing of those reports. (Id.)

The discounts UCG negotiated in its transportation contracts are uncommon, and must be aggressively pursued. (Creamer Aff. ¶ 16; Hack Aff. ¶ 8.) They are not routinely available just for the asking. (Creamer Aff. ¶ 16; Hack Aff. ¶ 8.) UCG devoted a substantial amount of resources to negotiating these discounts, and had to expend considerable effort to be successful. (Hack Aff. ¶ 8.) The discounts were not simply granted as a result of UCG's request. (Id.) For a period of over a year, UCG had multiple meetings with pipeline company representatives, and spent substantial amounts of time negotiating, drafting, exchanging, and revising the terms of transportation contracts. (Id.) One reason UCG invested so much time and effort into negotiating the discounted transportation rates was because of the incentives provided under UCG's PBR tariff. (Id.) If UCG did not think it would be able to share in the savings it obtained through the negotiations, UCG would not have expended so much effort in negotiating the contract, but would have focused its resources in more profitable areas. (Id.)

[5] The Staff incorrectly alleged in its brief that the current PBR filing is the only filing in which UCG identified a separate figure for transportation savings. (Staff Memo. p. 26.) As stated above, the quarterly reports UCG filed in March and May 2001 included separate calculations for transportation savings. (Childers Aff. ¶¶ 15, 16, 17.)

Discount transportation rates are far from standard in the industry. For example, Atmos Energy as a whole has been unsuccessful in obtaining transportation discounts from the majority of the available pipelines. (Creamer Aff. ¶ 16.) Atmos has been able to negotiate discounts on its contracts for only 2 of the 28 pipelines it contracts with. (Id.) Only 3 of the 6 pipelines serving UCG's territory have discounts on their contracts. (Id.) UCG has been successful in negotiating discounts on 5 of the 16 pipeline contracts it holds, while the remaining 11 contracts remain at the maximum FERC rate. (Id.) UCG negotiates these discounts off the maximum FERC rates, not off of commodity-based indexes. (Creamer Aff. ¶ 15.) The fact that the vast majority of contracts are at the maximum FERC rate demonstrates that the maximum FERC rate is the standard in the market, and that UCG had to expend considerable effort to negotiate discounts. (Id. at ¶ 16.)

Contrary to the statements made by CAD expert Dr. Brown, although the maximum FERC rates for short-term interruptible service do vary, the maximum FERC rates for long-term firm service for specific types of contracts (delivery/receipt points, volumes, seasonality, and duration) do not vary widely, and serve as the most objective benchmark of market transportation prices. (Creamer Aff. ¶ 18.) Furthermore, the maximum FERC rate is the only available market index for transportation costs. (Id. at ¶ 19.) If, as the CAD and Staff suggest, downstream transportation costs are excluded from the PBR, the Authority would be forced to conduct a prudency review of UCG's transportation costs, which would necessarily be based on the maximum FERC rates. (Id. at ¶ 15.) Therefore, the maximum FERC rate is the appropriate market indicator to use to adjust the PBR's benchmark indexes to account for transportation costs.

The Staff argued in its brief that "[t]he burden should be on the Company to demonstrate that the savings it achieves through discounted transportation contracts can be measured in a meaningful way so as to make a savings mechanism acceptable." (Staff Memo. p. 33.) Even assuming that the Staff is correct in its construction of UCG's burden of proof, which UCG specifically disputes, the evidentiary proof contained within the affidavit of Frank Creamer submitted with this response meets the standard the Staff would like to impose. The maximum FERC rate is the market standard for transportation costs, and is the appropriate benchmark to provide a meaningful measurement of the transportation cost adjustment that must be applied to the commodity indexes specified by the PBR.

UCG does not have to prove, however, that the avoided costs resulting from the negotiated discounted transportation contracts ***should*** be included within the PBR. The avoided transportation costs ***were*** included in the PBR. Both the Staff and the CAD admit that the PBR was intended to cover the entire cost of purchasing, delivering, transporting, and storing of gas. The Staff argued in its brief that the comparison between UCG's total costs (which the Phase Two Order specifically defines to include transportation costs) and the market benchmark must be an "apples to apples" comparison. Neither the Staff nor the CAD submitted any competent evidence which contradicts the fact that the PBR market indexes are commodity based only and do not contain a component for downstream transportation costs. Because UCG's costs include a transportation component, the index must as well. This is provided for in the city gate transportation costs adjustor within the Gas Procurement Incentive Mechanism of the PBR. Accordingly, the Staff and CAD have failed to demonstrate that UCG's inclusion in the PBR of the avoided costs resulting from the negotiated discounted transportation contracts is inconsistent with the Phase Two Order as a matter of law. As such, the Staff's and CAD's motions for summary judgment must be denied.

V. UCG'S TREATMENT OF THE NORA CONTRACT UNDER THE PBR WAS SPECIFICALLY AUTHORIZED BY ORDER OF THE AUTHORITY AND IS THE APPROPRIATE METHOD UNDER THE PBR.

The Staff and CAD have challenged UCG's calculation in its Incentive Plan Account of transportation cost savings resulting from the NORA contract. The NORA contract was included within the experimental PBR period, but was removed from the PBR program when the plan was made permanent because the contract pre-dated the existence of the PBR program. (Phase Two Order pp. 6-7.) The Phase One Order specifically provided that if the NORA contract was renewed or renegotiated, UCG could petition for inclusion of the contract in the PBR mechanism. (Final Order on Phase One, Docket No. 97-01364, Jan. 14, 1999, at p. 27.)

During the experimental PBR period, avoided transportation costs from the NORA contract were included as a separate calculation. (Creamer Aff. ¶ 21.) On September 26, 2000, UCG filed a petition to re-include the renegotiated NORA contract in its PBR plan. (United Cities Gas Company's Petition in Docket No. 00-00844, Sept. 26, 2000, attached as Exhibit A to this Response.) Submitted with UCG's petition for Authority approval were attachments which clearly illustrated the proposed separate calculation of the NORA avoided transportation costs, which was the same method of calculation used before the NORA contract was removed from the PBR. (Id.)

On November 8, 2001, the Authority entered an order granting UCG's petition. (Order Granting Permission to Include the New Agreement Covering East Tennessee-NORA Delivery Point in Incentive Plan, Docket No. 00-00844, Nov. 8, 2001 at p. 9.) The Authority's Order specifically provided:

> Upon a ***careful review*** of the petition, ***and of the entire record in this matter***, the Authority approved United Cities' request to include transactions under the new NORA contact in its Incentive Plan.

(Id.) (emphasis added). Neither the Staff nor the Directors nor any third party raised any objection whatsoever to UCG's proposed calculations with regard to the avoided costs resulting from the

NORA contact. By the Authority's own language, it carefully reviewed both the petition and the entire record in the matter, which included the proposed calculations. If the Authority did not approve of the calculations, it would have stated so in its Order.

Both the Staff and the CAD go to great lengths in their briefs to point out that government agencies can not be estopped due to mere silence or inaction. (Staff Memo. at pp. 30-31; CAD Memo. at pp. 18-19.) Instead, the Staff and CAD argue that estoppel applies only to situations where "the public body took affirmative action that clearly induced a private party to act to his or her detriment." (Staff Memo. at p. 31) (quoting Bledsoe County v. McReynolds, 703 S.W.2d 123, 125 (Tenn. 1985)). The Authority's November 8, 2001 Order specifically stated that the Authority had reviewed the entire record in the case concerning UCG's petition for inclusion of the NORA contract, and had decided to grant UCG's petition. In reliance on this opinion, UCG included the NORA contract savings in its Incentive Plan Account and booked as income its share of the benefits earned under the PBR program. It was entirely reasonable for UCG to rely on the Authority's Order, which approved the same method of calculation that was used before the NORA contract was removed from the PBR. The Authority's Order was an affirmative act which induced UCG's reasonable reliance to its detriment. The Order constitutes the official legal position of the Authority, which the Staff is estopped to contradict. See Bledsoe County, 703 S.W.2d at 125.

VI. CONCLUSION

The motions for summary judgment filed by the Staff and CAD do not comply with the mandatory requirements of Tenn. R. Civ. P. 56.03, and therefore, must be denied. The Staff failed to file a statement of undisputed material facts, and the allegedly undisputed factual statements contained within the CAD's brief do not contain any citations to the record and are the precise issues which the record clearly reveals ***are*** disputed by the parties to this action. Under Tennessee law, these procedural errors are fatal, and require that the motions for summary judgment filed by the CAD and the Staff be denied.

In the alternative, the Staff is barred from objecting to both the inclusion of the transportation cost savings in the PBR and UCG's proposed method of reporting and calculation because of the Staff's failure to object to the quarterly reports, as required by the tariff, and because of the Staff's affirmative act of meeting with UCG and indicating that it accepted UCG's interpretation and calculations.

Even if the Staff is not barred from contradicting its earlier position and objecting to UCG's method of calculating the shared savings resulting from the negotiated discounts, the Staff and the CAD have failed to demonstrate that UCG's inclusion of transportation discounts in the PBR is inconsistent with the Phase Two Order as a matter of law. The plain language of the Phase Two Order's definition of total gas cost and recitation of relevant CAD and UCG testimony regarding transportation costs clearly indicates that downstream transportation costs were intended to included in the PBR. UCG's tariff provided for inclusion of those transportation costs in the transportation cost adjustor for city gate purchases under the Gas Procurement Incentive Mechanism. The avoided transportation costs are calculated based on the maximum FERC rate, which is the standard market indicator for transportation costs. If the commodity based market indexes used to evaluate UCG's performance are not adjusted by the avoided transportation costs, the PBR would contain a material defect and would not satisfy the core goals of the PBR program. Therefore, the Staff and the CAD cannot show that UCG's interpretation of the PBR is incorrect as a matter of law, and their motions for summary judgment on that issue should be denied.

Finally, the Authority is estopped to contradict the specific holding of its November 2001 Order in which it approved UCG's calculation of the NORA contract savings in its Incentive Plan Account. As such, the Staff motion for summary judgment on that issue must be denied.

Respectfully submitted,

BAKER, DONELSON, BEARMAN
& CALDWELL, P.C.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via facsimile and/or hand delivery on October 21, 2002.

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BEFORE THE TENNESSEE REGULATORY AUTHORITY
AT NASHVILLE, TENNESSEE

In Re: Petition of United Cities Gas Company Regarding Affiliated Transaction and Request for Permission to Include New Agreement Covering East Tennessee-NORA Delivery Point	))))	Docket No. ________

UNITED CITIES GAS COMPANY'S PETITION REGARDING AFFILIATED TRANSACTION AND REQUEST FOR PERMISSION TO INCLUDE NEW AGREEMENT COVERING EAST TENNESSEE-NORA DELIVERY POINT

COMES NOW United Cities Gas Company, a division of Atmos Energy Corporation (United Cities) and in accordance with the provisions contained in the Tennessee Regulatory Authority's (Authority) Final Order Phase One issued on January 14, 1999 and On Phase Two issued on August 16, 1999, in the above captioned matter (hereinafter referred to as the "Authority's Orders"), and in accordance with the Tennessee Guidelines for United Cities Gas Company's Affiliate Transactions, which are attached to the Authority's Orders, and which are attached to an Order issued by the Authority dated December 3, 1999, in this matter, files this Petition with the Authority.

A. COMPLIANCE FILING REGARDING AFFILIATED TRANSACTIONS

1. The Authority's Order issued on August 16, 1999, in this matter contains the following provision:

> Prior to any affiliate transactions being included in the computation of savings or losses from this performance-based ratemaking mechanism,

THIS PETITION CONTAINS CONFIDENTIAL AND COMPETITIVELY SENSITIVE INFORMATION THAT UNITED CITIES GAS COMPANY REQUESTS THAT THE AUTHORITY KEEP CONFIDENTIAL.

> said affiliate transactions must first comply with the Tennessee Guidelines for United Cities Gas Company's Affiliate Transactions. Documentation of compliance is to be presented by the Company to the Authority during the TRA's annual audit of the Incentive Plan Account. The Authority, at the conclusion of each annual audit, will make a determination of the Company's compliance with all of the affiliate guidelines;

Authority's Order, page 27.

2. The Tennessee Guidelines for United Cities Gas Company's Affiliate Transactions include the following guideline:

> 10. When the Company purchases information, assets, goods or services from an affiliated entity, the Company shall either obtain competitive bids for such information, assets, goods or services or demonstrate why competitive bids were neither necessary nor appropriate.

Tennessee Guidelines for United Cities Gas Company's Affiliate Transactions, paragraph 10, page 2.

3. The order issued by the Authority in this matter on December 3, 1999, which made a determination of United Cities' compliance with affiliated guidelines for year one of the Company's permanent PBR plan (April 1, 1999-March 31, 2000), contained the following requirement:

> 4. On a going-forward basis, Standard of Conduct No. 10 will be in effect and United Cities must provide proof of competitive bids before a contract with an affiliate will be included in the PBR computation.

Order Re: Determination Of Compliance With Affiliate Guidelines, Docket No. 97-01364, dated December 3, 1999, page 8.

4. United Cities' current gas supply agreement covering requirements for its NORA/Dickerson #1 Delivery Point on the NORA/East Tennessee Natural Gas Pipeline expires October 31, 2000. In order to replace the gas supplies under the expiring contract, United Cities has

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requested competitive bids from the two suppliers which currently hold capacity on the NORA/East Tennessee Natural Gas Pipeline system. The request for bids was made, in part, so United Cities could comply with the Authorities Guidelines on Affiliate Transactions. One of the two suppliers holding capacity on the NORA/East Tennessee Natural Gas Pipeline is Woodward Marketing L.L.C. (Woodward), an affiliate of United Cities.

5. Beginning in the fall of last year, United Cities made its request for competitive bids to the two companies currently holding pipeline capacity on the NORA/East Tennessee Pipeline: Equitable Energy and Woodward Marketing, LLC.

6. In response to its request for competitive bids, United Cities received responses from both suppliers. A copy of each of the responses is attached to this compliance filing as Exhibit A, and is incorporated herein by reference. The responses are being submitted to the Authority under seal, and United Cities would request that the Authority treat these documents as containing highly confidential and competitively sensitive information.

7. Upon receipt of the two competitive bids, United Cities' Gas Supply Planning employees submitted their evaluation and analysis of the bids to the management of United Cities. A summary of that evaluation is attached to this compliance filing as Exhibit B, and is incorporated herein by reference. Because United Cities' summary of its evaluation of the bids contains the highly confidential and competitively sensitive information contained in the bids received by United Cities, this information is being submitted under seal. United Cities would request that the Authority treat the information contained in Exhibit B as confidential.

8. Based upon its evaluation of the bids received from the two gas suppliers, United Cities' management has determined that the contract price under the proposal submitted by Woodward

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is the most competitive. A copy of the contract with Woodward is attached hereto as Exhibit C. United Cities would request that the Authority treat the information contained in Exhibit C as confidential.

9. United Cities' respectfully submits that the information being provided in this compliance filing clearly demonstrates that the affiliated transaction with Woodward complies with the above mentioned guidelines and requirements established by the Authority in this docket and that the new Woodward contract should be included in the PBR computation for the period.

B. REQUEST FOR PERMISSION TO INCLUDE NEW AGREEMENT COVERING EAST TENNESSEE/NORA DELIVERY POINT

10. The Authority's Order issued on January 14, 1999 in this matter contains the following provision:

> After considering the testimony given during the Phase One hearing, the Authority concludes that (1) NORA contract existed prior to the PBR mechanism, and (2) it required no change in purchasing behavior by the Company. The NORA contract was not negotiated in response to the incentive mechanism, but acted as a catalyst to hasten the benefits derived therefrom. Including it in the incentive mechanism would "guarantee" a bonus to the Company. Thus, the Authority concludes that the NORA contract is to be excluded from United Cities' incentive mechanism after the first year of the plan. **If, upon the expiration of the current contract and if the Company continues to operate under a PBR plan, the contract is renewed or renegotiated, it could be considered for inclusion in the mechanism at the time.**

Order, Re: Final Order on Phase One, Docket No. 97-01364, dated January 14, 1999, page 27. (Emphasis added).

11. The current NORA contract expires on October 31, 2000. United Cities has obtained a new gas supply under a new agreement on the NORA/East Tennessee Gas Pipeline. Pursuant to the language in the Authority's Order, which is cited above, United Cities requests permission to include

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the new contract covering the NORA/East Tennessee Gas Pipeline supplies in its PBR plan.

WHEREFORE, for the reasons set forth herein, United Cities Gas Company respectfully requests that its petition be granted.

Respectfully submitted,

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Attorneys for United Cities Gas Company, a division of Atmos Energy Corporation

CERTIFICATE OF SERVICE

I hereby certify that a copy of the above and foregoing was mailed, postage prepaid, this 21st day of September, 2000, addressed to:

Mr. L. Vincent Williams
Mr. Vance Broemel
Consumer Advocate Division
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Mr. Richard Collier
Tennessee Regulatory Authority
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James G. Flaherty

THIS PETITION CONTAINS CONFIDENTIAL AND COMPETITIVELY SENSITIVE INFORMATION THAT UNITED CITIES GAS COMPANY REQUESTS THAT THE AUTHORITY KEEP CONFIDENTIAL.

VERIFICATION

STATE OF KANSAS)
)ss:
FRANKLIN COUNTY)

James G. Flaherty, of lawful age, being first duly sworn on oath, states:

That he is an attorney for United Cities Gas Company, a division of Atmos Energy Corporation; that he has read the above and foregoing UNITED CITIES GAS COMPANY'S PETITION REGARDING AFFILIATED TRANSACTION AND REQUEST FOR PERMISSION TO INCLUDE NEW AGREEMENT COVERING EAST TENNESSEE-NORA DELIVERY POINT, knows the contents thereof; and that the statements contained therein are true.

James G. Flaherty

SUBSCRIBED AND SWORN to before me this 21st day of September, 2000.

NOTARY PUBLIC – State of Kansas
RONDA BOSSMAN
My Appt. Expires 5/25/2002

Ronda Bossman
Notary Public

My Commission Expires:

THIS PETITION CONTAINS CONFIDENTIAL AND COMPETITIVELY SENSITIVE INFORMATION THAT UNITED CITIES GAS COMPANY REQUESTS THAT THE AUTHORITY KEEP CONFIDENTIAL.