STATE OF TENNESSEE

Office of the Attorney General

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PAUL G SUMMERS
ATTORNEY GENERAL AND REPORTER

ANDY D BENNETT
CHIEF DEPUTY ATTORNEY GENERAL

LUCY HONEY HAYNES
ASSOCIATE CHIEF DEPUTY
ATTORNEY GENERAL

MAILING ADDRESS

P O BOX 20207
NASHVILLE, TN 37202

MICHAEL E. MOORE
SOLICITOR GENERAL

CORDELL HULL AND JOHN SEVIER
STATE OFFICE BUILDINGS

TELEPHONE 615-741-3491
FACSIMILE 615-741-2009

Reply to:
Consumer Advocate and Protection Division
Post Office Box 20207
Nashville, TN 37202

May 17, 2004

Honorable Deborah Taylor Tate
Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243

**IN RE: United Cities Gas Company, a Division of Atmos Energy Corporation
Incentive Plan Account (IPA) Audit**

Docket No: 01-00704

Dear Chairman Tate:

Enclosed is an original and thirteen copies of the Consumer Advocate and Protection Division's Objections To The Motion For Approval Of Settlement Agreement Filed By Atmos Energy Corporation And The Staff Of The Tennessee Regulatory Authority. Please file same in this docket. Copies are being sent to all parties of record.

Should you have any questions, please contact me at 615-741-3533. Thank you.

Sincerely,

Timothy C. Phillips
Assistant Attorney General

CC: All Parties of Record.

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BEFORE THE TENNESSEE REGULATORY AUTHORITY
AT NASHVILLE, TENNESSEE

IN RE:	)	
	)	
UNITED CITIES GAS COMPANY, a Division of	)	**DOCKET NO.**
ATMOS ENERGY CORPORATION,	)	**01-00704**
INCENTIVE PLAN ACCOUNT (IPA) AUDIT	)	

CONSUMER ADVOCATE'S OBJECTIONS TO THE MOTION FOR APPROVAL OF SETTLEMENT AGREEMENT FILED BY ATMOS ENERGY CORPORATION AND THE STAFF OF THE TENNESSEE REGULATORY AUTHORITY

Comes now Paul G. Summers, the Tennessee Attorney General and Reporter, through the Consumer Advocate and Protection Division ("Consumer Advocate"), and respectfully objects to the approval of the proposed settlement agreement between Atmos Energy Corporation ("Atmos") and the Staff of the Tennessee Regulatory Authority ("Staff") filed on March 8, 2004. The Consumer Advocate did not object to consolidation of these matters.

PRELIMINARY STATEMENT

In support of its opposition to approval of the proposed settlement agreement, the Consumer Advocate requests that the Tennessee Regulatory Authority ("Authority") take note that the motion seeking approval of the settlement is devoid of citation to the record in this matter in support of the effort by Staff and Atmos to drastically change the mode and manner of the operation of Atmos' Performance Based Ratemaking ("PBR") Plan. Further, the motion does not contain any substantive discussion of why the Authority should approve these changes to the PBR Plan. The motion appears to be loosely predicated on the assertions that: Staff "agrees with, supports and recommends the Transportation Index Factor ("TIF"); the TIF "will provide a more detailed and specific method for calculations of savings from discounted transportation contracts under the PBR Plan mechanism"; "the TIF tariff is consistent with the intent and scope of the PBR Plan"; and the tariff is "beneficial to consumers."

The Staff and Atmos are apparently relying on the bare refrain that the proposed settlement agreement "is necessary and proper for the public convenience and properly serves the public interest." The standard for approval of the motion is not whether Staff and Atmos are convinced that this proposed settlement serves the public interest, but have Staff and Atmos made the requisite demonstration to the Authority that the proposed settlement serves the public interest. In short, Atmos and Staff appear to be relying on some sort of unarticulated presumption in favor of their proposed settlement.

Staff and Atmos do not present supporting argument, marshaling the necessary material facts, applicable law and pertinent policy concerns, demonstrating why the Authority should stray so significantly from the PBR Plan approved for Atmos in TRA Docket No. 97-01364. The record makes the position of the Staff and Atmos clear. As such, the filing does not demonstrate at least some underlying support for the assertions made in the motion for approval filed by Staff and Atmos. In accord with TRA Rule 1220-1-2-.06, Atmos and the TRA Staff are required to state the ground(s) for granting of their motion. Staff and Atmos rest on the record and their motion as filed, as such the motion should be denied and the petition in 02-00850 dismissed as lacking factual support, since no testimony has been submitted demonstrating that the TIF is an appropriate change in the PBR.

Atmos and the Staff are taking the remarkable position that they can settle this matter without the consent (and over the objection) of one of the parties and that the non-consenting party has the burden of proving that the settlement is <u>not</u> in the public interest.[1] Also, Atmos is apparently taking the position that under this burden of proof formulation and after the proponents' unwillingness to more definitely state their reasons for believing that the proposed settlement should be approved, that the Consumer Advocate's request to be allowed to file a reply is "frivolous."[2]

In support of its objection to the proposed settlement, the Consumer Advocate has attached and incorporated fully herein by reference the affidavits of Dan McCormac and Dr. Steve Brown as Exhibits 1 and 2, respectively.

SUMMARY OF THRESHOLD OBJECTIONS

In summary terms, the Consumer Advocate objects to the proposed settlement on the following grounds:

1. The Consumer Advocate is a party and it is not joining the settlement; therefore, the settlement should be summarily denied;

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[1]There has been a well-documented recent dispute about the applicable standard which the Consumer Advocate Division will not address directly here. Although the Consumer Advocate articulates what it believes the standard should be later in these objections, "public interest" is used here in a generic sense for whatever standard the TRA believes governs review of the proposed settlement.

[2]*See* Response Of Atmos Energy Corporation To The Consumer Advocate's Motion For Relief Under Rule 37.02. The Consumer Advocate is requesting that it be allowed to file a reply if it has the burden of proof, particularly given the disputes between the parties about the applicable standard.

2. The Consumer Advocate is improperly being put in a worse position than it was in before it agreed to attempt to settle this matter through mediation;

3. As a corollary to objection number 2, the mediation was tantamount to a judicial settlement conference because Chairman Tate served as the mediator and, accordingly, the impropriety of punishing the Consumer Advocate for negotiating in good faith[3] and declining to settle is exacerbated;

4. Contrary to notions of fundamental fairness, the TRA is requiring the opponent of the proposition that the proposed settlement is in the public interest to bear the burden of *disproving* that the proposed settlement is in the public interest; and

5. If the settlement is allowed under the circumstances of this case (regardless of whether retroactive ratemaking is indicated), it will put the TRA's imprimatur on Atmos' effort to amend its tariff and the TRA's orders through after the fact conversations with the Staff.

I. <u>THRESHOLD OBJECTIONS</u>

A. <u>A Settlement Requires the Consent of All the Parties.</u>

"Settlement" may be defined in several ways:

> In legal parlance, implies meeting of minds of parties to transaction or controversy; an adjustment of differences or accounts; a coming to an agreement.
>
> To fix or resolve conclusively; to make or arrange for final disposition.

Black's Law Dictionary (6th ed. 1990). Also, "compromise and settlement" is similarly defined:

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[3]In a recent status conference, Atmos and the Staff conceded that the Consumer Advocate had negotiated in good faith. Transcript of Proceedings, Thursday, April 22, 2004, page 11, lines 11-12; page 12, lines 4-7.

> An arrangement arrived at, either in court or out of court, for settling a dispute upon what appears to the parties to be equitable terms, having regard to the uncertainty they are in regarding the facts or the law and the facts.
>
> An agreement or arrangement by which, in consideration of mutual concessions, a controversy is terminated.

Black's Law Dictionary (6th ed. 1990). The golden thread running through these definitions, therefore, appears to be a requirement that all the parties reach an agreement to compromise through a meeting of the minds designed to conclude a controversy.

Similarly, Black's Law Dictionary (6th ed. 1990) succcinctly defines "mediation" as follows:

> Private, informal dispute resolution process in which a neutral third person, the mediator, helps disputing parties to reach an agreement. <u>The mediator has no power to impose a decision on the parties. (Emphasis added).</u>

The point here is <u>not</u> that the mediator is seeking to impose a decision on the Consumer Advocate, but that the other parties to the controversy are seeking to have this Tribunal impose a "settlement" on the Consumer Advocate and against the interests the Consumer Advocate represents.

The only examples presented in response to discovery by Atmos and the Staff citing a standard for approval of proposed settlements have only two (2) things in common: all parties in the contested case agreed to settle and no objection was lodged. In this matter, the representative of the consumers involved objects to the giveaway envisioned in the agreement struck behind the closed doors of the TRA. It would appear that there have been no instances at the TRA, nor its predecessor the Tennessee Public Service Commission in which a proposed settlement has been accepted where all the parties have not joined the settlement agreement. Instead, the TRA rightfully rejects efforts to settle matters where all parties are not represented in the settlement. Squarely addressing the issue in 2000, the TRA stated:

> During the July 11, 2000 Conference, the Authority found that the terms of the *Proposed Settlement Agreement* ultimately affected the rights and liabilities of competing local exchange carriers who were not a part of the settlement negotiations between the Staff Investigative Team and BellSouth. Having determined that all affected parties had not been extended the opportunity to participate in the negotiations leading up to the *Proposed Settlement Agreement*, the Authority concluded that the *Proposed Settlement Agreement* would not be enforceable as to those parties.

Order Rejecting Proposed Settlement Agreement And Dismissing Show Cause Petition, Docket No. 00-00170, pages 4-5. (Attached as Exhibit 3).

The effort on the part of Staff and Atmos violates Tennessee Code Annotated §4-5-105, which allows an agency to set up informal proceedings for settlement, but the legislature was clear to specify that this informal process could not be used to require any party to settle.

The proposed settlement is fatally flawed because all of the parties do not agree to it. *See Harbour v. Brown For Ulrich*, 732 S.W.2d 598, 599 (Tenn. 1987). Under the Tennessee Rules of Civil Procedure, it is contemplated that all the parties to a case must agree to a proposed settlement before the case can be settled.[4] *See, e g*, Rule 68 (offer of judgment).

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[4]In this case, counsel for Atmos, moreover, could conceivably have a glaring conflict of interest if they propose to represent the interest of Atmos' shareholders <u>and</u> the interests of Tennessee consumers in promoting this settlement proposal. *See* Rule 8, RPC 1.7, Rules of the Supreme Court of the State of Tennessee. The only Office statutorily empowered to serve as advocates for the interests of Tennessee consumers, moreover, is the Consumer Advocate Division.

B. A Party Should Not Be Punished For Agreeing To Participate In A Mediation

The Honorable Deborah Tate, Chairman of the TRA, served admirably and patiently as the mediator in this case. Chairman Tate is a Rule 31[5] mediator. The Consumer Advocate's contention that approving the proposed settlement without the Consumer Advocate's consent violates the spirit of Rule 31 and the well-settled principle that settlement discussions should be encouraged is not in any way based on Chairman Tate's handling of the mediation. The Consumer Advocate's point is simply this: before agreeing to and participating in good faith in the mediation request by Atmos, the Consumer Advocate had the opportunity for discovery and hearing on the merits[6] and now after the mediation that opportunity could be taken away over the Consumer Advocate's objection. This result would violate the spirit of Rule 31[7] and the notion that settlement discussions are in the public interest. *See Team Design v Gottlieb*, 104 S.W.3d 512 (Tenn.App. 2002).

C. A Party Should Not Be Punished For Participating In A Judicial Settlement Conference

Similarly, the mediation may have also been a "judicial settlement conference" because the mediator (Chairman Tate) was also a "judicial officer." Rule 31, Section 2(e), Rules of the Supreme Court of the State of Tennessee. The harm flowing from the Consumer Advocate being put in a worse position for having participated in a mediation which was also a judicial

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[5]*See* Rule 31, Rules of the Supreme Court of the State of Tennessee.

[6]In fact, the Hearing Officer's ruling on the summary judgment motions was essentially a determination that there were issues to try. *See* Orders On Motion For Summary Judgment, Docket No. 01-00704.

[7]The Consumer Advocate is <u>not</u> asserting that Rule 31 was violated in the course of the mediation.

settlement conference, therefore, is arguably exacerbated. *See Environmental Abatement, Inc. v. Astrum R.E. Corp.*, 27 S.W.3d 530 (Tenn.App. 2000).

D. <u>The Consumer Advocate Should Not Be Required To Disprove That The Proposed Settlement Is In The Public Interest.</u>

Tennessee law embraces traditional formulations of the burden of persuasion which, put simply, require parties seeking relief (such as approval of a settlement to which all the parties do not agree) to bear the burden of establishing entitlement to the relief. *See Northland Insurance Co. v. State of Tennessee*, 33 S.W.2d 727, 729 (Tenn. 2000). Similarly, affording parties who are opposing relief an opportunity to review, analyze and respond to the other side's theories is a basic tenet of fundamental law and of Tennessee law. A party seeking relief or who is the proponent of a proposition cannot simply make conclusory allegations in the papers seeking relief and then expect the other party to bear the burden of disproving the claims. *See Ballard v Herzke*, 924 S.W.2d 652 (Tenn. 1996); *Cleveland Bd. of Education v. Loudermill*, 470 U.S. 532, 105 S.Ct. 1487 (1985).

The motion does not meet the rigors of process and standards set out in Tennessee Code Annotated §§, 65-4-117, 65-5-201 and 65-5-203. It is clear that Staff and Atmos present this motion only to gain an advantage by improperly shifting the burden of proof clearly outlined in Tennessee Code Annotated §§ 65-4-117, 65-5-201 and 65-5-203.[8] This is very obvious given the fact that Atmos and Staff were unable to present any standard of review for their motion.

[8] These statutes and TRA Rule 1220-1-2-.16 are clearly inconsistent with the representations of Atmos at the April 22, 2004 pre-hearing conference regarding the burden of proof in this matter.

E. Approving The Settlement Gives Credence To Atmos' Strategy Of Attempting To Modify Tariffs AND TRA ORDERS THROUGH AFTER THE FACT CONVERSATIONS WITH THE TRA STAFF.

The Consumer Advocate believes that this settlement allows retroactive ratemaking. The Staff and Atmos seek approval of a tariff filed in August, 2002, but agree between themselves to an effective date of April 1, 2001, which clearly violates the prohibition against retroactive ratemaking. *See* Memorandum In Support Of Motion For Partial Summary Judgment, pps. 19-22. The point here, however, is that even if retroactive ratemaking is not implicated here, it is contrary to the public interest to reward Atmos for its brazen effort to modify its tariff and TRA Order through after the fact conversations with the Staff.

II. SPECIFIC OBJECTIONS RELATED TO ATMOS' ATTEMPTED MODIFICATION OF THE PBR

1. The Staff and Atmos seek approval of a tariff filed in August, 2002, but agree between themselves to an effective date of April 1, 2001, which clearly violates the prohibition against retroactive ratemaking.

2. The Staff and Atmos ignore the difficult, actually impossible, task of demonstrating at what point the Authority approved the use of negotiated transportation "savings" in administering the PBR Plan, which is the heart of the issue in TRA Docket No. 01-00704.

3. It is of significant importance that Staff and Atmos be required to explain why it would be appropriate that the State of Tennessee pursue a path regarding transportation contracts which is clearly incongruent with the approach of the Federal Energy Regulatory Commission ("FERC") described in its July 25, 2003 Order.[9] Review of the FERC ruling makes it clear that

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[9] *Modification of Negotiated Rate Policy*, *Natural Gas Pipeline Negotiated Rate Polices and Practices*, 104 FERC ¶ 61,134 (2003).

the mixing of "savings" from transportation contracts and the "savings" from gas purchases to form an incentive based ratemaking plan is inherently flawed.

4. The Staff and Atmos suggest that consumers will some how benefit from the proposed settlement agreement. The problem is that only Atmos and the Staff actually benefit. Atmos gets roughly $750,000 annually in additional revenue taken directly from the pockets of its customers. Staff settles TRA Docket No. 01-00704, which Atmos has somehow convince Staff that it should be embarrassed by its action or inaction with respect to meetings held between Staff and Atmos representatives in January, 2001. It is now apparent that the only reason Staff intervened in TRA Docket No. 02-00850 was to gain a seat at Atmos' negotiating table. Staff also appears to have negotiated a provision regarding an audit of Atmos' practices.

5. In return, Consumers receive nothing of value. Atmos is under an obligation now to meet the needs of consumers at the lowest possible gas cost. Further, it is a difficult to conceive of why Staff shies away from its duty. Even if there may be some embarrassment on the part of Staff regarding its conduct in TRA Docket No. 01-00704, the solution is not covering up the problem but meeting Atmos' allegations head on in the open and not withing the closed doors of the TRA. Even more difficult to conceive is the idea that Staff is too busy to audit Atmos itself. Giving up $750,000 in consumer funds on an annual basis leads to a very expensive audit.

6. The idea that the TIF offers a better way to calculate the "savings" is not persuasive. Why do consumers need to pay $750,000 per year more on their gas bills in order that Atmos and the Staff might take credit for a better math formula. The truth is that this better way of calculating the "savings" simply means improperly raising the price of gas for consumers.

7. Before the first Purchased Gas Adjustment ("PGA") rule was approved in Tennessee by order on June 5, 1970 in Docket G-4557-70-1, the gas companies had a powerful incentive to control gas costs, demand costs, and storage costs. All of those costs were included in the base rates of the local distribution company (LDC) and the LDC's earnings were at risk for all price changes.

8. In 1970 the Federal Power Commission set the rates for gas costs and transportation charges so the local utilities had no control over those costs. In effect, the PGA mechanism adopted in 1970 shifted substantially all risks associated with gas costs to consumers and left the LDC with almost no incentive to control those costs.

9. In 1995, United Cities Gas Company proposed the first "incentive plan" to shift some of the risks, and some of the incentive to control costs, back to the LDC (Docket 95-01134). In theory, the proposed change was supposed to benefit consumers and LDCs by encouraging more efficient management of gas costs which were being charged directly to consumers. In practice, there are several factors that are critical to an incentive mechanism's success in reaching the goal of reducing costs to consumers. These factors include:

A. Any measurement of "savings" must be accurate or real.

B. Any measurement of "savings" must include the effects of changes in other costs that may be paid by consumers outside the incentive plan formula. Incentives should be designed to assure that rewards for "savings" in one area do not encourage cost increases in another area.

C. There should be a reasonable balance of the risks and rewards of changes in management and operating practices.

10. Atmos' proposed change to tariff sheet 45.1 adds a Transportation Index Factor Incentive Mechanism (TIF) to the previously existing Performance Based Ratemaking ("PBR") Mechanism Rider. The tariff states: "The TIF establishes a **predefined standard of performance** to which the Company's actual discounted transportation costs from the discounted contracts are compared." [Emphasis added]

11. This "**predefined standard of performance**" is a counterfeit. [Emphasis added] Consumer Advocate and Protection Division interrogatory item 9 in this docket asked Atmos to "List and describe all credible market benchmarks or industry **standards** you are relying on in formulating the proposed settlement and in claiming that the proposed settlement is in the public interest." Atmos replied that "The Company is **not relying on any market benchmarks or industry standards** in formulating the proposed settlement or submitting the settlement for approval. The TIF factor proposed by the petition in Docket No. 02-00850 utilizes the published **maximum FERC rate** in its formula. [Emphasis added] Atmos admits that the "predefined standard of performance" is nothing more than a "maximum FERC rate" and is "not relying on any market benchmarks or industry standards."

12. The failure to establish a "standard of performance" is a critical flaw in the proposal. Since there is no established benchmark, standard of performance, or "market" price for transportation services, "real" savings cannot be accurately measured.

13. The measurement of "savings" does not take into account the possible effects of other cost increases that may be incurred to obtain those "savings." For example, the LDC may manage to reduce transportation costs, but may increase the cost of gas, reservation fees, storage costs, or other costs in the process. If consumers are paying the increased costs, these costs

should certainly be accounted for in the measurement of "savings." It is patently unfair for consumers to pay 100% of the costs of certain expenses through the Purchased Gas Adjustment Mechanism while the company keeps part of the "savings" gained from some other related transactions. See **Attachment A to the Affidavit of Dan McCormac** for an illustrative example of how a reduction in transportation costs could actually cause the total cost of gas to increase, thus rewarding Atmos for raising prices to consumers. This example shows that using a "standard of performance" that is not based on "market benchmarks" or "industry standards" will only reward Atmos for buying gas so that rewards can be maximized without regard for the ultimate cost to consumers. Atmos would be rewarded for buying gas at the Henry Hub (Option 1) for $5.50 delivered cost since it would get a $0.25 bonus for "TIF savings" even though gas could be purchased in Murfreesboro, Tennessee at the same delivered cost of $5.50. However, consumers would have to pay Atmos a $0.25 bonus for the "TIF savings" causing consumers to pay $5.75 instead of $5.50. Atmos would be rewarded for a behavior that would actually harm consumers.

14. The proposed TIF formula does not include a reasonable balance of the risks and rewards of changes in management and operating practices. If there is no risk associated with a contract revision to reduce transportation costs, there should be no reward. There certainly is no risk for Atmos since it admits that the "standard of performance" is based on the "**maximum FERC rate**." Since the "standard" is the same as the "maximum," there is NO RISK of transportation costs exceeding the "standard" price. There is NO RISK that Atmos would have to share in a "loss." By Atmos' definition, there can only be rewards for Atmos and higher expenses for ratepayers being forced to pay the rewards..

15. If the proposed incentive or reward will not change future costs and produce savings, the reward is unearned and only serves to increase costs to consumers. There is no indication that the proposal will alter future behavior in a way that will reduce the total delivered cost of gas.

16. Even if the "savings" were real, the proposal to move some of the "savings" from the ratepayers to the company contradicts a recent change in ratemaking policy established on February 9, 2004 in the Uncollectible Accounts expense docket 03-00209. The Tennessee Regulatory Authority adopted Atmos' arguments and modified the refund formula in the PGA rule (1220-4-7-.03) to **force consumers to bear 100% of the risk** of **cost increases** associated with gas costs that are billed to consumers but never collected by the company. Atmos argued successfully in that docket to transfer the risk of **cost increases** to consumers. Atmos now claims to have produced **cost decreases**, but does not want to assign 100% of the "risk" and 100% of the supposed benefits to consumers. As shown in the example on **Attachment A**, these "cost decreases" may not be real. This certainly is not a reasonable balancing of the risks and rewards of changes in management and operating practices. Atmos wants no risks, just rewards.

17. In light of recent events in the natural gas business, such as allegations of price manipulation, erroneous price reports, and unreliability of "market price" indicators, a detailed audit and review of the current facts should be required to provide reasonable assurance that regulatory practices are appropriate before any additional rate increases are charged to consumers.

CONCLUSION

The TRA, therefore, should summarily deny the proposed settlement and set a schedule for this matter to proceed to a hearing on the merits. In the alternative, the TRA should deny the proposed settlement at the conclusion of the June 8, 2004 hearing.

Respectfully submitted,

TIMOTHY C. PHILLIPS, B.P.R. #12751
Assistant Attorney General
Office of the Attorney General
Consumer Advocate and Protection Division
(615) 741-3533

CERTIFICATE OF SERVICE

I hereby certify that on May 17, 2004, a true and exact copy of the foregoing document has been mailed, first class U.S. postage prepaid, and faxed to the following:

Joe A. Conner
Baker, Donelson, Bearman & Caldwell, P.C.
1800 Republic Centre
633 Chestnut Street
Chattanooga, Tennessee 37450-1800

Randal Gilliam
Office of Legal Counsel
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505

Timothy C. Phillips
Assistant Attorney General

ODMA\GRPWISE\sd05 IC01S01.JSB1.75297 1

Exhibit
1

IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
UNITED CITIES GAS COMPANY, a	)	**CONSOLIDATED DOCKET NOS.**
Division of ATMOS ENERGY	)	**01-00704 and 02-00850**
CORPORATION INCENTIVE PLAN	)	
ACCOUNT (IPA) AUDIT	)	

AFFIDAVIT OF DANIEL W. MCCORMAC

I, Daniel W. McCormac, being duly sworn, depose and say:

1. I am the Coordinator of Analysts for the Consumer Advocate and Protection Division.

2. I have a Bachelor of Science Degree in Accounting from David Lipscomb College and I am a licensed Certified Public Accountant in the State of Tennessee.

3. Since 1976 I have been employed in various positions dealing with increasing complexity and difficulty in the field of public utility regulation, regulatory accounting, and ratemaking. I have been involved in auditing gas companies, reviewing testimony, tariffs and exhibits, negotiating rates, and preparing testimony and exhibits relating to various revenue, expense, and rate base issues of all major Tennessee gas distribution companies. I have prepared testimony in every major case involving a gas utility since my employment with the Attorney General's office in 1994.

4. I am providing this affidavit in regard to the Tennessee Regulatory Authority's Consolidated Dockets 01-00704 and 02-00850 - UNITED CITIES GAS COMPANY, a Division

of ATMOS ENERGY CORPORATION INCENTIVE PLAN ACCOUNT (IPA) AUDIT.

5. In particular, I am giving my opinion on the importance of avoiding the problems associated with some forms of incentive based regulation.

6. Before the first Purchased Gas Adjustment ("PGA") rule was approved in Tennessee by order on June 5, 1970 in Docket G-4557-70-1, the gas companies had a powerful incentive to control gas costs, demand costs, and storage costs. All of those costs were included in the base rates of the local distribution company ("LDC") and the LDC's earnings were at risk for all price changes.

7. In 1970 the Federal Power Commission set the rates for gas costs and transportation charges so the local utilities had no control over those costs. In effect, the PGA mechanism adopted in 1970 shifted substantially all risks associated with gas costs to consumers and left the LDC with almost no incentive to control those costs.

8. In 1995, United Cities Gas Company proposed the first "incentive plan" to shift some of the risks, and some of the incentive to control costs, back to the LDC (Docket 95-01134). In theory, the proposed change was supposed to benefit consumers and LDCs by encouraging more efficient management of gas costs which were being charged directly to consumers. In practice, there are several factors that are critical to an incentive mechanism's success in reaching the goal of reducing costs to consumers. These factors include:

A. Any measurement of "savings" must be accurate or real.

B. Any measurement of "savings" must include the effects of changes in other costs that may be paid by consumers outside the incentive plan formula. Incentives should be designed to assure that rewards for "savings" in one area do not encourage cost increases in another area.

C. There should be a reasonable balance of the risks and rewards of changes in management and operating practices.

9. Atmos' proposed change to tariff sheet 45.1 adds a Transportation Index Factor Incentive Mechanism ("TIF") to the previously existing Performance Based Ratemaking ("PBR") Mechanism Rider. The tariff states: "The TIF establishes a **predefined standard of performance** to which the Company's actual discounted transportation costs from the discounted contracts are compared." [Emphasis added]

10. This "**predefined standard of performance**" is a counterfeit. [Emphasis added] Consumer Advocate and Protection Division interrogatory item 9 in this docket asked Atmos to "List and describe all credible market benchmarks or industry **standards** you are relying on in formulating the proposed settlement and in claiming that the proposed settlement is in the public interest." Atmos replied that "The Company is **not relying on any market benchmarks or industry standards** in formulating the proposed settlement or submitting the settlement for approval. The TIF factor proposed by the petition in Docket No. 02-00850 utilizes the published **maximum FERC rate** in its formula. [Emphasis added] Atmos admits that the "predefined standard of performance" is nothing more than a "maximum FERC rate" and is "not relying on any market benchmarks or industry standards."

11. The failure to establish a "standard of performance" is a critical flaw in the proposal. Since there is no established benchmark, standard of performance, or "market" price for transportation services, "real" savings cannot be accurately measured.

12. The measurement of "savings" does not take into account the possible effects of other cost increases that may be incurred to obtain those "savings." For example, the LDC may manage to reduce transportation costs, but may increase the cost of gas, reservation fees, storage costs, or other costs in the process. If consumers are paying the increased costs, these costs should certainly be accounted for in the measurement of "savings." It is patently unfair for consumers to pay 100% of the costs of certain expenses through the Purchased Gas Adjustment Mechanism while the company keeps part of the "savings" gained from some other related transactions. See **Attachment A** for an illustrative example of how a reduction in transportation costs could actually cause the total cost of gas to increase, thus rewarding Atmos for raising prices to consumers. This example shows that using a "standard of performance" that is not based on "market benchmarks" or "industry standards" will only reward Atmos for buying gas so that rewards can be maximized without regard for the ultimate cost to consumers. Atmos would be rewarded for buying gas at the Henry Hub (Option 1) for $5.50 delivered cost since it would get a $0.25 bonus for "TIF savings" even though gas could be purchased in Murfreesboro, Tennessee at the same delivered cost of $5.50. However, consumers would have to pay Atmos a $0.25 bonus for the "TIF savings" causing consumers to pay $5.75 instead of $5.50. Atmos would be rewarded for a behavior that would actually harm consumers.

13. The proposed TIF formula does not include a reasonable balance of the risks and rewards of changes in management and operating practices. If there is no risk associated with a contract revision to reduce transportation costs, there should be no reward. There certainly is no risk for Atmos since it admits that the "standard of performance" is based on the "**maximum FERC rate**." Since the "standard" is the same as the "maximum," there is NO RISK of

transportation costs exceeding the "standard" price. There is NO RISK that Atmos would have to share in a "loss." By Atmos' definition, there can only be rewards for Atmos and higher expenses for ratepayers being forced to pay the rewards.

14. If the proposed incentive or reward will not change future costs and produce savings, the reward is unearned and only serves to increase costs to consumers. There is no indication that the proposal will alter future behavior in a way that will reduce the total delivered cost of gas.

15. Even if the "savings" were real, the proposal to move some of the "savings" from the ratepayers to the company contradicts a recent change in ratemaking policy established on February 9, 2004 in the Uncollectible Accounts expense docket 03-00209. The Tennessee Regulatory Authority adopted Atmos' arguments and modified the refund formula in the PGA rule (1220-4-7-.03) to **force consumers to bear 100% of the risk** of **cost increases** associated with gas costs that are billed to consumers but never collected by the company. Atmos argued successfully in that docket to transfer the risk of **cost increases** to consumers. Atmos now claims to have produced **cost decreases**, but does not want to assign 100% of the "risk" and 100% of the supposed benefits to consumers. As shown in the example on **Attachment A**, these "cost decreases" may not be real. This certainly is not a reasonable balancing of the risks and rewards of changes in management and operating practices. Atmos wants no risks, just rewards.

16. The TIF formula is not a reasonable measure of performance or a reasonable basis for incentives.

17. In light of recent events in the natural gas business, such as allegations of price manipulation, erroneous price reports, and unreliability of "market price" indicators, a detailed

audit and review of the current facts should be required to provide reasonable assurance that regulatory practices are appropriate before any additional rate increases are charged to consumers.

Further Affiant saith not.

Daniel W. McCormac

Daniel W. McCormac
Coordinator of Analysts
Office of the Attorney General
Consumer Advocate and Protection Division
P.O. Box 20207
Nashville, Tennessee 37202
(615) 741-2935

Dated: May 17, 2004

Sworn and subscribed before
me this 17th day of May, 2004

Emily Knight
NOTARY PUBLIC

My commission expires: 9-22-07

EMILY KNIGHT NOTARY PUBLIC AT LARGE DAVIDSON COUNTY, TENN.
My Commission Expires SEPT. 22, 2007

CERTIFICATE OF SERVICE

The undersigned hereby certifies that true and exact copies of the forgoing documents were delivered via facsimile to the parties of record in this action on this 17th day of May, 2004.

Timothy C. Phillips

75241

Transportation Charges "Below Maximum FERC Rate" Does Not Mean Lower Total Cost To Consumers

Option 1
Purchase point: Henry Hub

	Costs for Atmos	Standard of Performance	Shared Savings	**Total Cost to Consumers**
Gas cost	$ 5.00	$ 5.00	$ -	**$ 5.00**
Transportation cost	$ 0.50	$ 1.00	$ 0.25	**$ 0.75**
Total delivered cost	$ 5 50	$ 6.00	$ 0.25	**$ 5.75**

Option 2
Purchase point: Murfreesboro, TN

	Costs for Atmos	Standard of Performance	Shared Savings	**Total Cost to Consumers**
Gas cost	$ 5 50	$ 5.50	$ -	**$ 5.50**
Transportation cost	$ -	$ -	$ -	**$ -**
Total delivered cost	$ 5.50	$ 5.50	$ -	**$ 5.50**

Exhibit
2

IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
UNITED CITIES GAS COMPANY, a Division of ATMOS ENERGY CORPORATION INCENTIVE PLAN ACCOUNT (IPA) AUDIT	))))	CONSOLIDATED DOCKET NOS. 01-00704 and 02-00850

AFFIDAVIT OF STEPHEN N. BROWN

I, Stephen N. Brown, being duly sworn, depose and say:

1. I am an economist in the Consumer Advocate and Protection Division, Office of the Attorney General and have held this position since 1995. In that capacity, I review utility filings and information relating to rates and rate changes and follow the economic conditions that affect the companies. Also, I assess and evaluate facts for the Consumer Advocate and Protection Division and other entities within the Office of the Attorney General.

2. From 1986 to 1995 I was employed by the Iowa Utilities Board as Chief of the Bureau of Energy Efficiency, Auditing and Research, and Utility Specialist and State Liaison Officer to the U.S. Nuclear Regulatory Commission. From 1984 to 1986, I worked for Houston Lighting & Power as Supervisor of Rate Design. From 1982 to 1984, I worked for Arizona Electric Power Cooperative as a Rate Analyst. From 1979 to 1982, I worked for Tri-State Generation and Transmission Association as Power Requirements Supervisor and Rate Specialist. From 1979 through 2004, my work spanned many issues including cost of service studies, rate design issues, telecommunications issues and matters related to the disposal of nuclear waste.

3. I have an M.S. in Regulatory Economics from the University of Wyoming, an M.S.

and Ph.D. from the University of Denver, and a B. A. from Colorado State University.

4. I am providing this affidavit in regard to the Tennessee Regulatory Authority's Consolidated Dockets 01-00704 and 02-00850 - UNITED CITIES GAS COMPANY, a Division of ATMOS ENERGY CORPORATION INCENTIVE PLAN ACCOUNT (IPA) AUDIT

5. In particular, I am giving my opinion on the relevance of the FERC's order in 104 FERC 61,134, Natural Gas Pipeline Docket No. PL02-6-000 Negotiated Rate Policies and Practices MODIFICATION OF NEGOTIATED RATE POLICY (Issued July 25, 2003), as that order relates to this Docket.

6. In 1996, FERC adopted a national policy allowing pipelines to determine their transportation rates on the basis of negotiations rather than following the cost-of-service prices for transportation, which are stated in the pipeline's tariffs approved by FERC. The policy is generally referred to as the Commission's Negotiated Rate Policy.

7. Subsequent to FERC establishing its policy, several pipelines implemented the policy. On August 31, 1996 FERC approved Tennessee Pipeline's petition to implement FERC's policy. A copy of this order is attached to my affidavit. On October 31, 1996 FERC approved East Tennessee Pipeline's petition to implement FERC's policy. A copy of this order is attached to my affidavit. On August 23, 1999 Texas Eastern Pipeline filed a petition with FERC to implement FERC's policy. On September 23, 1999, United Cities, a division of Atmos Gas, filed an intervention in the Texas Eastern docket, where the intervention claimed "United Cities has a valid and substantial interest in this proceeding." All pages from that intervention are attached to my affidavit. According to United Cities and Atmos, they became a party to contracts with East Tennessee Pipeline in late 1999 and with Tennessee Pipeline in late 2000, where the

transportation rates in each contract were determined by negotiation.

8. In FERC's order of July 25, 2003 regarding negotiated transportation rates, at paragraph 22 FERC determined that negotiated rates were not in the public interest:

> "...where the negotiated transportation rate is tied to the commodity price of gas[,]...a negotiated rate may render the shipper indifferent to the actual costs of transportation. For example, a shipper may agree to an index differential-based, negotiated transportation rate with a pipeline. The shipper may then enter into gas sales agreements with its customers based upon the downstream price index that, in effect, lock in this transportation rate and/or a profit on the transaction. As a result, the shipper is indifferent to the price of gas at the downstream point and the pipeline's withholding of capacity to manipulate the downstream commodity gas price (and the effect of such manipulation on the negotiated transportation rate). It has, in effect, shifted the possible risks of the pipeline's abuse of its market power to the gas commodity market as a whole. In other words, negotiated transportation rates that use basis differentials to price transportation give the pipeline an incentive to withhold capacity so as to widen the basis differentials. In addition, the shipper may have little incentive not to agree since it is either held harmless or may, in fact, share in the profits from the increased price differential."

In TRA Docket No. 97-01364, "Application of United Cities Gas to Establish an Experimental Performance-based Ratemaking" Mr. J.D. Woodward, a marketer whose business acted on behalf of United Cities and whose business has since been purchased by Atmos, stated: "So the transportation charge that we refer to as a commodity charge, is the rate that's actually charged for the movement of the gas. So I control that now." [Transcript Vol. III, March 31, 1998 Page 692, lines 19-22].

9. There is a clear and strong relationship between the FERC's Negotiated Rate Policy established in 1996, and its later order of July 25, 2004. In between those two orders there is a pattern of activity set in motion by FERC itself: the subsequent actions by East Tennessee and Tennessee pipeline to implement the policy; Atmos and United Cities actions four years later to act on FERC's policy; and United Cities' intervention in the Texas Eastern docket before FERC. In addition, there is Mr. Woodward's statements under cross-examination that the transportation

charge "is a commodity rate" and that "I control that now." His statement supports FERC's finding that shippers such as Atmos "may have little incentive not to agree [to negotiated transportation rates] since it is either held harmless or may, in fact, share in the profits from the increased price differential." This establishes a clear and strong economic motive for Atmos and United Cities to pursue negotiated rates despite FERC's finding that the pipeline and the shipper have "in effect, shifted the possible risks of the pipeline's abuse of its market power to the gas commodity market as a whole."

10. Therefore, FERC's July 25, 2003 order moderating and generally reversing FERC's policy on negotiated rates is directly relevant to this proceeding.

Stephen N. Brown

STEPHEN N. BROWN
Economist
Office of the Attorney General
Consumer Advocate and Protection Division
P.O. Box 20207
Nashville, Tennessee 37202
(615) 741-3132

Dated: May 11, 2004

Sworn and subscribed before
me this 11th day of May, 2004

Janice J. Tomlinson
NOTARY PUBLIC

My commission expires: 7/21/2007

CERTIFICATE OF SERVICE

The undersigned hereby certifies that true and exact copies of the forgoing documents were delivered via facsimile to the parties of record in this action on this 17th day of May, 2004.

Timothy C. Phillips

75178 1

ORIGINAL

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C.

In the Matter of:)
)
Texas Eastern Transmission Corporation) Docket No. RP99-480-000

MOTION TO INTERVENE OF UNITED CITIES GAS COMPANY, A DIVISION OF ATMOS ENERGY CORPORATION

Pursuant to Rule 214 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission, United Cities Gas Company, a division of Atmos Energy Corporation (United Cities) through counsel, respectfully requests the Commission to grant it leave to intervene in the above-captioned proceeding. In support of this Motion, United Cities respectfully shows the following:

1. The names, titles, and addresses of the persons to whom correspondence in regard to this Motion should be directed are:

Douglas C. Walther
Legal Department
Atmos Energy Corporation
Post Office Box 650205
Dallas, Texas 75265-0205

James H. Jeffries IV, Esquire
Jerry W. Amos, Esquire
Amos, Jeffries & Robinson, L.L.P.
Post Office Box 787
Greensboro, North Carolina 27402

2. Atmos Energy Corporation (Atmos) is a corporation organized under the laws of the state of Texas, is engaged in the natural gas distribution business in the states of Colorado, Georgia, Illinois, Iowa, Kansas, Kentucky, Louisiana, Missouri, South Carolina, Tennessee, Texas and Virginia, and has its principal place of business in Dallas, Texas. United Cities is an operating division of Atmos engaged in the natural gas distribution business in the states of Georgia, Illinois, Iowa, Kansas, Missouri, South Carolina, Tennessee and Virginia.

3. On August 23, 1999, Texas Eastern Transmission Corporation (Texas Eastern) filed certain revised tariffs to Sixth Revised Volume No. 1 of its FERC Gas Tariff. Texas Eastern states that the purpose of this filing is to set forth in its tariff a negotiated rates provision pursuant to the Alternative Rates Policy Statement, 74 FERC ¶ 61,076 (1996).

4. United Cities is a customer of Texas Eastern and will be directly affected by the outcome of this proceeding; therefore, United Cities has a valid and substantial interest in this proceeding. This interest cannot be adequately represented by other parties to this proceeding, and the participation in this proceeding by United Cities will not prejudice the rights of any party. United Cities is an interested party within the meaning of Section 15(a) of the Natural Gas Act, 15 U.S.C. Section 717(n)(a), and its intervention and participation in this proceeding will be in the public interest.

WHEREFORE, United Cities hereby respectfully requests the Commission, pursuant to the authority contained in its General Rules and Regulations, for good cause shown, to issue an order permitting United Cities to intervene in this proceeding and become a party thereto, with rights afforded to parties thereto including the right to notice of, and to participate in, all hearings and other proceedings.

Respectfully submitted, this the 3d day of September, 1999.

United Cities Gas Company, a Division of Atmos Energy Corporation

By:______________________

James H. Jeffries IV
Jerry W. Amos
Its Attorneys

OF COUNSEL:

Amos, Jeffries & Robinson, L.L.P.
Post Office Box 787
Greensboro, North Carolina 27402
Telephone: 336-273-5569

<u>CERTIFICATE OF SERVICE</u>

The undersigned hereby certifies that a copy of the foregoing document was served upon each person designated on the official service list compiled by the Secretary in this proceeding by depositing a copy of the same in the United States Mail, First Class Postage Prepaid, to their last known address.

Dated at Greensboro, North Carolina, this the 3d day of September, 1999.

Sonya R. Lowe

Sonya R. Lowe

77 FERC ¶ 61,095

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Elizabeth Anne Moler, Chair;
Vicky A. Bailey, James J. Hoecker,
William L. Massey, and Donald F. Santa, Jr.

East Tennessee Natural Gas Company) Docket No. RP97-13-000

ORDER ACCEPTING TARIFF SHEETS

(Issued October 31, 1996)

On October 1, 1996, East Tennessee Natural Gas Company (East Tennessee) filed tariff sheets 1/ to permit East Tennessee to charge negotiated rates pursuant to the Commission's Alternative Rates Policy Statement 2/ for all of its Part 284 firm and interruptible transportation and storage services. East Tennessee filed to motion the tariff sheets into effect November 1, 1996, in the event of a minimal suspension. For the following reasons, the Commission accepts the tariff sheets, effective November 1, 1996, subject to the conditions discussed below.

Background

In Docket No. RM95-6-000, Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, 3/ the Commission stated that it would permit pipelines to negotiate rates with their customers provided that the customers would have the option of taking service under the recourse rates contained in the pipeline's tariff rather than enter into a Negotiated Rate agreement. The Policy Statement envisioned benefits to customers from enabling customers to maximize competitive opportunities while providing recourse to a Commission-approved tariff rate. Consistent with Commission policy, a customer may seek recourse to the pipeline's tariff rates only at the time the shipper is deciding whether to negotiate with the pipeline or simply to choose the recourse rate for its service. Pursuant to the policy statement, the customer may not enter into a Negotiated Rate agreement and later seek recourse to the tariff rate during the term of the Negotiated Rate agreement. 4/

The Policy Statement's approval of negotiated rate authority is pending before the Commission in Docket No. RM96-7-000,

1/ See Appendix A for a list of proposed tariff sheets.

2/ Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, 74 FERC ¶ 61,076 (1996).

3/ 74 FERC ¶61,076 (1996) (Policy Statement).

4/ 76 FERC ¶61,223 (1996).

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DC-B-37

Regulation of Negotiated Transportation Services of Natural Gas Pipelines (1996). The Policy Statement authorizing negotiation of rate terms is pending on appeal in the United States Court of Appeals for the District of Columbia circuit in Meridian Oil Inc. v. FERC (1996). 5/

East Tennessee's Filing

East Tennessee proposes to modify each of its Part 284 open access rate schedules to permit East Tennessee and shippers to agree to rates that are not necessarily limited to the maximum and minimum rates stated on the rate sheets. 6/ East Tennessee proposes that shippers retain the right to obtain the recourse rate until they agree to a negotiated rate and that, at the conclusion of the negotiated rate period, the rate will revert to the pipeline's applicable maximum rate.

East Tennessee also proposes to revise the scheduling and curtailment provision to state that for capacity allocation purposes, a shipper paying a rate above the maximum rate shall be deemed to be paying the maximum rate. 7/ East Tennessee states that this revision is required by the Policy Statement

The right-of-first refusal is revised to provide that a shipper with an expiring contract is not required to pay a rate higher than the maximum rate in order to retain its capacity rights. 8/

East Tennessee also proposes to modify the capacity release provision. 9/ East Tennessee contends that with the introduction of negotiated/recourse rates, it is possible that East Tennessee and a firm shipper may agree to non-standard rate forms, including, for example, rates that are partially or wholly volumetric. East Tennessee states that it may be agreeable to such a rate form if East Tennessee has a reasonable assurance of sufficient revenues, either as a result of an historically high load factor or a minimum bill. East Tennessee contends that such a revenue expectation could be frustrated by a capacity release. Therefore, East Tennessee states that it is modifying its capacity release provisions to recognize that a Negotiated Rate shipper's payment responsibility in the event of a capacity

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5/ Docketed as Case No. 96-1160 (1996).

6/ See revised tariff sheet nos. 10, 21, 30, and 42.

7/ See revised tariff sheet no. 130.

8/ See revised tariff sheet no. 116.

9/ see revised tariff sheet nos. 145 and 154.

release may extend beyond just the reservation charge. 10/ East Tennessee also states that its negotiated rate program does not extend to rates for released service and that the rates for released service are capped by East Tennessee's maximum tariff rates.

East Tennessee proposes to comply with the accounting requirements enumerated by the Commission in NorAm Gas Transmission Co.. 11/ East Tennessee asserts that it will establish a new subaccount for the revenues received from any negotiated rate revenues and will keep separate and identifiable each volume transported, billing determinant, rate component, surcharge, and revenue, associated with the negotiated rate to permit filing in the format required by Statements G, I, and J in future rate case filings.

East Tennessee further states that it is not seeking, at this time, to implement any particular negotiated rates; the instant filing is solely to provide East Tennessee with the flexibility to submit negotiated rate filings.

Interventions and Protests

Notice of the filing was issued with comments due by October 15, 1996. Timely notices or motions to intervene were filed by the parties listed in the Appendix to this order. Pursuant to Rule 214, 12/ any timely filed motions to intervene are granted unless an answer in opposition is filed within 15 days of the date such motion is filed. Any timely filed motions not listed in the Appendix are also granted with the conditions of Rule 214.

Atlanta Gas Light Company and Chattanooga Gas Company (Atlanta) and Natural Gas Clearinghouse (NGC) filed protests to East Tennessee's filing. East Tennessee filed an answer to NGC's protest. Protests and interventions are listed in Appendix B. The issues raised in the protests and comments are discussed below.

10/ For example, East Tennessee and a Negotiated rate shipper could agree to a minimum bill and could then credit Replacement Shipper revenues to the Releasing Shipper's minimum bill responsibility, rather than limiting the Negotiated Rate Releasing Shipper's payment responsibility (and any associated credits) to only the reservation charge.

11/ NorAm Gas Transmission Co., 75 FERC ¶ 61,091 at 61,312 (1996).

12/ 18 C.F.R. § 385.214 (1993).

Discussion

The Commission, in its Policy Statement, stated that it would consider proposals to implement negotiated rates where customers retain the ability to choose a cost-of-service based tariff rate. East Tennessee's proposal generally conforms to the Policy Statement and other Commission policies and precedents. 13/ However, there are issues raised by the filing that warrant additional consideration.

Liability of Releasing Customer

NGC asserts that the Commission has recently allowed pipelines to implement negotiated rates, and has decided to only further consider whether it should allow pipelines to negotiate terms and conditions of service. NGC argues that East Tennessee's proposed tariff language in sections 17.13(h) and 18.13(e) of East Tennessee's GT&C gives the pipeline the ability to negotiate terms and conditions of a capacity release. Sections 17.13(h) and 18.13(e) of East Tennessee's proposed GT&C provide that: "Transporter and Shipper Customer may, in connection with their agreement to a Negotiated Rate under a firm transportation rate schedule, agree upon [Releasing Shipper] payment obligation and crediting mechanisms in the event of a capacity release that vary from or are in addition to those set forth herein..."

NGC maintains that, under these provisions, East Tennessee could require that a shipper agree to allow East Tennessee to keep some or all of the capacity-release revenues that East Tennessee would otherwise have to credit against the releasing shipper's demand obligation. NGC contends that, in recent years, many pipelines have turned to extracting agreements, in exchange for transportation rate discounts, that require the firm shipper to give up any rights it has to release in return for any discount.

Furthermore, NGC contends that the proposed conditions look like the negotiated terms and conditions that the Commission is now considering in Docket No. RM96-7. NGC asserts that the

13/ See NorAm Gas Transmission Co., 75 FERC ¶ 61,091 (1996); Colorado Interstate Gas Co., 75 FERC ¶ 61,090 (1996); NorAm Gas Transmission Co., 75 FERC ¶ 61,322 (1996); Northern Natural Gas Co., 76 FERC ¶ 61,026 (1996); National Fuel Gas Supply Corporation, 76 FERC ¶ 61,223 (1996); Tennessee Gas Pipeline Company, 76 FERC ¶ 61,224 (1996); Florida Gas Transmission Company, 76 FERC ¶ 61,226 (1996); Koch Gateway Pipeline Company, 76 FERC ¶ 61,227 (1996); and Transcontinental Gas Pipeline Corporation, 76 FERC ¶ 61,318 (1996).

crediting mechanism proposed by East Tennessee would extend beyond what appears to be the intent of allowing negotiated rates: allowing a customized, perhaps stripped-down, service for lesser or on different terms. NGC requests that the Commission require East Tennessee to provide a clarification of the intent of the language cited from Sections 17.13(h) and 18.13(e) of the GT&C.

East Tennessee's proposed revisions to Sections 17.13(h) and 18.13(e) are broad in character and would appear to permit East Tennessee to negotiate terms and conditions of service, in violation of Commission policy. In its answer to NGC's protest, however, East Tennessee has clarified the intent of its filing. It states specifically that it is not seeking any authority at this time to negotiate terms and conditions of service. Rather, it states, its only purpose is to include revisions that would allow it and a negotiated rate shipper to agree to a nonstandard rate design and to payment responsibility and revenue credits, in the event of capacity release, that would extend beyond just the reservation charge. In light of this explanation, we will accept the proposed revisions to Sections 17.13(h) and 18.13(e), subject to East Tennessee filing revised tariff sheets, within 15 days of the issuance of this order, that clearly do not permit East Tennessee to negotiate terms and conditions of service.

Transition Costs and Surcharges

Atlanta protested East Tennessee's filing, asserting that East Tennessee's application does not indicate whether or not it intends to follow the Commission's existing policies on discounting of surcharges, both for transition costs and others (such as ACA, GRI, and take-or-pay), or being at risk for the recovery of those surcharges. Atlanta contends that East Tennessee should be required to state its intentions on the discounting of surcharges and, if it does not plan to follow the Commission's policies, it should be placed at risk for recovery of any surcharges that it does not recover from shippers taking service at negotiated rates. Atlanta requests that the Commission address the transition cost issue now or state that parties can raise issues with respect to East Tennessee's discounting of transition costs and other surcharges in East Tennessee's next general section 4 rate proceeding.

In the order on rehearing in NorAm, the Commission did not permit NorAm to make any discount-type of adjustments to its recourse rates at the time of its next general rate case. Accordingly, East Tennessee is on notice that the same principle for discounting of recourse rates also applies to surcharges. East Tennessee is not permitted to make any discount-type adjustment for its surcharges, both for transition costs and others (such as ACA, GRI, and take-or-pay). The Commission can, in this manner, ensure that the costs associated with negotiated rate shippers are not shifted to East Tennessee's recourse rate shippers.

Policy on rate cap for release capacity

Atlanta requests that the Commission revise its secondary market policy to state that a shipper paying a negotiated rate above the pipeline's maximum rate may release the capacity subject to the negotiated rate for a price up to the negotiated rate. Atlanta contends that if there is no cap on the rate a pipeline can charge a customer, then that customer should be able to resell capacity purchased at a negotiated rate for anything up to the actual rate paid to the pipeline. Thus, Atlanta requests that the Commission revise its policy to state that when negotiated rates go into effect, the same rate should apply as the cap in the secondary, released capacity market.

Atlanta's request that the Commission revise its policy on the secondary released capacity market is better suited for consideration in the current proceeding in Docket No. RM96-14-000, where the Commission is reviewing the price cap on released capacity.

Compliance with NorAm rehearing order and RM96-6-000

Both Atlanta and NGC request that East Tennessee be required to comply with the recent order on rehearing in NorAm. 14/ NGC alleges that, consistent with the NorAm order, East Tennessee must file either its negotiated rate contracts or tariff sheets reflecting the essential elements of its negotiated rate agreements. Atlanta requests that East Tennessee be required to comply with the NorAm condition on the discount-type adjustment; which requires that pipelines with negotiated rates may not employ a discount-type adjustment in their next rate case to recover from recourse rate customers "shortfalls" associated with negotiated rate transactions. Atlanta acknowledges that East Tennessee has not sought discount-type authority but, nevertheless, wants the NorAm policy applied to East Tennessee.

Atlanta references the Commission's current rulemaking proceeding in Docket No. RM96-7 on negotiated rates and terms and conditions and requests that the instant filing be made subject to the outcome of that proceeding and that East Tennessee be required to make any conforming changes to its tariff.

The Commission finds that East Tennessee should be required to comply with the Commission's decisions in NorAm. Accordingly, East Tennessee is advised that, consistent with the order on rehearing in NorAm, the treatment of costs normally recovered

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14/ 77 FERC ¶ 61,011 (1996).

through surcharges will not change for shippers under negotiated rate contracts. Further, East Tennessee is on notice that it must file either its negotiated rate contracts or tariff sheets reflecting the essential elements of its negotiated rate agreements necessary to permit shippers that believe that they are similarly situated with respect to a particular negotiated rate customer to make such a determination. Finally, in accordance with the order on rehearing in NorAm, the Commission hereby advises East Tennessee that it will not be permitted to make discount-type adjustments to its recourse rates or its surcharges, both for transition costs and others at the time of its next rate case. However, Atlanta's request that the Commission condition this proceeding to outcome of Docket No. RM96-7 is unnecessary inasmuch as East Tennessee will be required to make any conforming changes to its tariff when a final rule is issued.

Except as discussed earlier, East Tennessee's proposal generally conforms to the Commission's Alternative Rates Policy Statement and other policies, and is generally consistent with applicable precedent. Therefore, the Commission conditionally accepts East Tennessee's filing, effective November 1, 1996, subject to the foregoing conditions.

The Commission orders:

(A) East Tennessee's tariff sheets, First Revised Sheet No. 10, First Revised Sheet No. 11, First Revised Sheet No. 21, Original Sheet No. 21A, Second Revised Sheet No. 30, Original Sheet No. 30A, First Revised Sheet No. 42, First Revised Sheet No. 116, First Revised Sheet No. 130, First Revised Sheet No. 155, to Second Revised Volume No. 1 of its FERC gas Tariff, are accepted, effective November 1, 1996, subject to conditions set forth in the body of this order.

(B) East Tennessee's First Revised Sheet Nos. 145 and 154 are accepted, effective November 1, 1996, subject to East Tennessee filing revised tariff sheets within 15 days of the issuance of this order, as discussed in the body of this order.

By the Commission. Commissioner Hoecker dissented in part with a separate statement attached. Commissioner Santa concurred with a separate statement attached.

(S E A L)

Lois D. Cashell

Lois D. Cashell,
Secretary.

through surcharges will not change for shippers under negotiated rate contracts. Further, East Tennessee is on notice that it must file either its negotiated rate contracts or tariff sheets reflecting the essential elements of its negotiated rate agreements necessary to permit shippers that believe that they are similarly situated with respect to a particular negotiated rate customer to make such a determination. Finally, in accordance with the order on rehearing in NorAm, the Commission hereby advises East Tennessee that it will not be permitted to make discount-type adjustments to its recourse rates or its surcharges, both for transition costs and others at the time of its next rate case. However, Atlanta's request that the Commission condition this proceeding to outcome of Docket No. RM96-7 is unnecessary inasmuch as East Tennessee will be required to make any conforming changes to its tariff when a final rule is issued.

Except as discussed earlier, East Tennessee's proposal generally conforms to the Commission's Alternative Rates Policy Statement and other policies, and is generally consistent with applicable precedent. Therefore, the Commission conditionally accepts East Tennessee's filing, effective November 1, 1996, subject to the foregoing conditions.

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(B) East Tennessee's First Revised Sheet Nos. 145 and 154 are accepted, effective November 1, 1996, subject to East Tennessee filing revised tariff sheets within 15 days of the issuance of this order, as discussed in the body of this order.

By the Commission. Commissioner Hoecker dissented in part with a separate statement attached. Commissioner Santa concurred with a separate statement attached.

(S E A L)

Lois D. Cashell

Lois D. Cashell,
Secretary.

APPENDIX A

EAST TENNESSEE NATURAL GAS COMPANY
Docket No. RP97-13-000

FERC GAS TARIFF - Second Revised Volume No. 1

Tariff Sheets Accepted November 1, 1996

First Revised Sheet No. 10
First Revised Sheet No. 11
First Revised Sheet No. 21
Original Sheet No. 21A
Second Revised Sheet No. 30
Original Sheet No. 30A
First Revised Sheet No. 42
First Revised Sheet No. 116
First Revised Sheet No. 130
First Revised Sheet No. 145
First Revised Sheet No. 154
First Revised Sheet No. 155

APPENDIX B

EAST TENNESSEE NATURAL GAS COMPANY
Docket No. RP97-13-000

Interventions

Atlanta Gas Light Company and Chattanooga Gas Company *
Columbia Gas Transmission Corporation
East Tennessee Group
Enron Capital & Trade Resources Corp.
Natural Gas Clearinghouse *
NorAm Gas Transmission Company
Producer-Marketer Transportation Group

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* Protest

East Tennessee Natural Gas Comapny)   Docket No. RP97-13-000

(Issued October 31, 1996)

HOECKER, Commissioner, dissenting in part:

Atlanta Gas Light Company and Chattanooga Gas Company (Atlanta) request the Commission to allow negotiated rates above the pipeline's maximum rate to serve as the price cap for capacity release transactions. The order rejects this request. For the reasons expressed in my partial dissents in Trunkline Gas Company, Docket No. RP96-181-000, 75 FERC ¶ 61,064 (1996), and in Texas Eastern Transmission Corporation, Docket No. RP96-218-000, 75 FERC ¶ 61,218 (1996), I would grant Atlanta's request. I therefore respectfully dissent in part from today's order.

James J. Hoecker /pm

James J. Hoecker
Commissioner

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

East Tennessee Natural Gas Company) Docket No. RP97-13-000

(Issued October 31, 1996)

SANTA, Commissioner, concurring:

For the reasons stated in my concurrences to the Commission's orders in NorAm Gas Transmission Company, 77 FERC ¶ 61,011 (October 2, 1996), and in Northern Natural Gas Company, 77 FERC ¶ 61,035 (October 17, 1996), I concur in part with the order. The application to East Tennessee Natural Gas Company of the NorAm prohibition of discount-type adjustments in future rate cases highlights my concern that we not let the NorAm facts drive the Commission into adoption of a per se rule that may work to the detriment of both recourse shippers and the pipeline.

In NorAm the Commission was faced with a pipeline claiming the right in a future rate case to seek a discount-type of adjustment to its recourse rates. Similarly, in Northern, where the pipeline remained silent as to its intended treatment of negotiated rate volumes in future rate cases, prophylactic application of the NorAm policy may have been warranted.

Still, if a pipeline files a request for authority to negotiate rates with individual shippers and makes a specific proposal to hold recourse ratepayers harmless in future rate proceedings, I would give such a proposal serious consideration before deciding whether the NorAm policy should apply there as well. I urge my colleagues to keep an open mind on this issue in the event that a future applicant presents the Commission with a proposal for a discount-type adjustment that holds ratepayers harmless in future rate proceedings.

Donald F. Santa, ~~Jr.~~
Commissioner

UNITED STATES OF AMERICA76 FERC ¶61,224
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Elizabeth Anne Moler, Chair;
Vicky A. Bailey, James J. Hoecker,
William L. Massey, and Donald F. Santa, Jr.

Tennessee Gas Pipeline Company	))	Docket Nos. RP96-312-000 and RP96-312-001

ORDER ACCEPTING TARIFF FILING
SUBJECT TO CONDITIONS

(Issued August 30, 1996)

On July 16, 1996, Tennessee Gas Pipeline Company (Tennessee) filed tariff sheets, 1/ to be effective September 1, 1996, which permit Tennessee to charge negotiated rates for its transportation and storage services in accordance with the Commission's Statement of Policy issued on January 31, 1996. 2/ Numerous parties have filed protests and/or comments on Tennessee's filing. As discussed below, the Commission accepts the tariff filing effective September 1, 1996, subject to the conditions discussed in this order.

The Instant Filing

Tennessee states that the proposed revisions to its tariff are submitted only to provide it with the flexibility to submit negotiated rate filings as contemplated by the Alternative Rate Policy Statement. Tennessee proposes to modify the "Rates and Charges" sections of each of its Part 284 rate schedules to reflect that Tennessee and a shipper under such rate schedule may mutually agree in writing to rates or charges that differ from the rates and charges otherwise imposed under such rate schedule. 3/ Tennessee proposes that its negotiated rates will be effective for the period agreed to by the parties and that during this period, the recourse rate will not be available to the shipper that agreed to a negotiated rate. Tennessee also proposes that at the conclusion of the negotiated rate period, the rate will revert to the pipeline's applicable maximum rate.

1/ See Appendix A.

2/ Alternatives to Traditional Cost-of-Service Ratemaking for Natural Gas Pipelines, 74 FERC ¶ 61,076 (1996) (Alternative

Rate Policy Statement).

3/ See revised tariff sheet nos. 98, 109, 128, 154, 155E, 162, 167, 173, and 226.

Tennessee's proposed tariff sheets also revise the scheduling and curtailment provisions of Article III of its General Terms and Conditions to state that, for capacity allocation purposes, a shipper paying a rate above the maximum rate shall be deemed to be paying the maximum rate. 4/ Tennessee states that these revisions do not change the manner in which Tennessee currently schedules and curtails firm service, which is generally on a pro rata basis with other firm shippers that are in the same (e.g., primary, secondary, or tertiary) priority class.

Tennessee further proposes to revise the right-of-first refusal provision of Section 10, Article III of the General Terms and Conditions 5/ to provide that a shipper with an expiring contract is not required to pay a rate higher than the maximum rate in order to retain its capacity rights.

Tennessee proposes to modify the capacity release provisions in its tariff 6/ to recognize that a Negotiated Rate Shipper's payment responsibility, in the event of a capacity release, may extend beyond just the reservation charge. Tennessee states as an example, that the negotiated rate shipper could agree to some form of assured revenue responsibility and could then credit Replacement Shipper Revenues to match the Releasing Shipper's responsibility, rather than limiting the Negotiated Rate Releasing Shipper's payment (and any associated credits) to only the reservation charge. Tennessee states that its proposed negotiated rate program does not extend to rates for released service and that the rates for released service are capped by Tennessee's maximum tariff rates.

Tennessee states that it will establish a new subaccount for the revenues received from any negotiated rate services and shall maintain supporting information at a level of detail that would be sufficient for NGA Section 4 rate change filing purposes. Thus, Tennessee states that it will keep separate and identifiable, each volume transported, billing determinant, rate component, surcharge, and revenue associated with a negotiated rate, to permit filing in the format of Statements G, I and J in future rate case filings.

4/ See Fourth Revised Sheet Nos. 317 and 318.

5/ See Second Revised Sheet No. 324.

6/ See First Revised Sheet Nos. 337A and 348.

Interventions and Protests

Interventions and protests were due as provided in Section 154.210 of the Commission's regulations. Timely notices or motions to intervene were filed by the parties listed in Appendix B to this order. Pursuant to Rule 214 of the Commission's regulations, 7/ any timely filed motions to intervene are granted unless an answer in opposition is filed within 15 days of the date such motion is filed. Any timely filed motions or notices not listed are also granted in accordance with the conditions of Rule 214.

Motions to intervene-out-of-time were filed by the parties so designated in Appendix B. Pursuant to 18 C.F.R. □ 385.214(d) (1995), the Commission finds that, at this stage of the proceeding, late intervention will not unduly disrupt the proceeding or place undue additional burdens on existing parties. Consequently, the late filed motions to intervene are granted.

A number of intervenors filed protests to or comments on Tennessee's filing. Those parties are also identified in Appendix B. The issues raised in the protests and comments are addressed below. In addition, on August 20, 1996, Tennessee filed an answer to the protests and comments filed in this proceeding. 8/

Discussion

The Commission finds that Tennessee's proposal to revise its tariff sheets to provide for the negotiation of rates for its firm and interruptible transportation services generally conforms with other such filings that the Commission has previously approved, 9/ as well as with the criteria for such filings articulated in the Alternative Rate Policy Statement. Therefore, the Commission accepts the proposed revised tariff sheets list in Appendix A to this order, subject to the conditions discussed below.

7/ 18 C.F.R. □ 385.214 (1995).

8/ For good cause shown, the Commission waives the requirements of its regulations to permit Tennessee's answer.

9/ Colorado Interstate Gas Co., 75 FERC □ 61,090 (1996); NorAm Gas Transmission Corp., 75 FERC □ 61,322 (1996); and Northern Natural Gas Company, 76 FERC □ 61,026 (1996).

General Arguments for Rejecting Tennessee's Filing

The Pennsylvania Office of Consumer Advocate (Pennsylvania OCA) protests Tennessee's filing on the grounds that (a) the Alternative Rate Policy Statement's approval of negotiated rate authority is currently pending before the Commission in a generic proceeding in Docket No. RM96-7-000; and (b) the Policy Statement authorizing negotiation of rate terms is pending on appeal before the D.C. Circuit Court of Appeals. 10/

Indicated Shippers and Exxon contend that Tennessee's proposal is premature. Petitioners argue that the Alternative Rate Policy Statement contemplates the filing of negotiated rate proposals on a "shipper-by-shipper" basis, rather than sweeping proposals to amend every open-access rate schedule to provide for the negotiation of rates. Indicated Shippers and Exxon assert that, because Tennessee acknowledges that it does not propose to implement any specific rates with this filing, the Commission should reject Tennessee's filing as inconsistent with the Policy Statement. Alternatively, Indicated Shippers and Exxon request that the Commission clarify that acceptance of this language does not constitute pre-approval of any negotiated rate and require Tennessee to file the actual negotiated rates upon effectiveness.

The Commission's actions here do not affect the appeal of the Alternative Rate Policy Statement. Rather, the Commission's action is consistent with the Policy Statement. There, the Commission stated it would consider requests to implement negotiated rates where customers retain the ability to choose a cost-of-service based tariff rate, on a shipper-by-shipper basis. Thus, case-by-case implementation of the Commission's policy was contemplated from the beginning. A pending appeal of that policy to the Court of Appeals does not preclude the contemplated case-by-case implementation of the policy. In general, judicial review of a policy statement is appropriate only when the policy statement has been applied in a particular case.

Nor is Tennessee's filing premature. In establishing the guidelines to be used in implementing negotiated rates, the Commission indicated that pipelines could file revised tariff sheets that generally permit negotiated rates, so long as shippers had the ability to either negotiate a rate or elect a cost-of-service based recourse rate. The Commission indicated that such filings could be made in advance of, or contemporaneously with, a filing to implement actual negotiated rates. Thus, Tennessee's filing general tariff provisions that

10/ Meridian Oil Inc. v. FERC, Case No. 96-1160 (1996).

contemplate future negotiated rates was contemplated by the Policy Statement and is fully consistent with the Policy Statement.

Phillips Petroleum Company and Phillips Gas Marketing Company (Phillips) assert that Tennessee's filing must be rejected because it does not contain sufficient record evidence to prove that negotiated rates will be just and reasonable under NGA Section 4. Phillips further contends that the filing should be rejected because it does not contain any credible record evidence demonstrating that the requisite logical basis for negotiated rates, i.e., the need to address the issue of excess capacity, exists on Tennessee's system.

Aside from their argument that Tennessee's proposal is inconsistent with the Policy Statement, Indicated Shippers and Exxon maintain that the proposal violates the Natural Gas Act (NGA) and Commission precedent. Indicated Shippers and Exxon oppose the Commission's new negotiated rate policy for pipelines with undisputed market power because, they allege, it permits pipelines to bestow competitive advantages to their marketing affiliates and favored customers, and to discriminate against their captive customers.

As was the case when the Commission considered NorAm's proposal for negotiated rates, the Commission here finds that Tennessee's proposal is a variation of the authority to discount rates for services that the Commission has repeatedly granted to pipelines. Pipelines are required to offer discounts on a non-discriminatory basis. In the same manner, pipelines are prohibited from negotiating rates in an unduly discriminatory manner. In this case, none of the parties has provided any evidence that Tennessee will negotiate rates in an unduly discriminatory manner. Accordingly, Commission action at this time is not warranted. The Commission will continue to stand ready to address any evidence that Tennessee has negotiated in an unduly discriminatory manner if and when such evidence is presented to the Commission.

Indicated Shippers and Exxon also assert that the Commission may not deviate from SFV rate design without satisfying a heavy burden of persuasion. However, the Commission has recognized that in certain circumstances, such as when pipelines have excess capacity, additional flexibility in rate design may be necessary. If rate design flexibility can result in increased overall throughput, the industry is well served by that additional flexibility. Similarly, rate design flexibility in the context of negotiated rates can increase efficiency and better meet the needs of both the pipeline and shipper.

Indicated Shippers and Exxon contend that permitting Tennessee to negotiate rates for its services, as proposed, contravenes the cornerstone requirements of NGA Section 4 that rates for jurisdictional services must be just and reasonable and that such rates must be filed with the Commission. The Cities of Clarksville, Springfield, and Portland, Tennessee, the Northwest Alabama Gas District, the West Tennessee Public Utility District, the Humphreys County Utility District, and the Greater Dickson Gas Authority (collectively the Tennessee Municipal Group) contend that there is no evidence to support the assumption that negotiated rates and services will solve the unsubscribed capacity problem. Moreover, the Tennessee Municipal Group contends that the Commission has not examined the extent to which movement away from straight fixed-variable rate design, alone, could contribute to curing the perceived problems of capacity turnback and unsubscribed capacity, without the additional input and potential downside of allowing pipelines to negotiate rates with certain customers. The Municipal Group asserts that the Commission should allow the new flexibility in alternatives to SFV cost allocation and rate design, such as those proposed in Tennessee's pending settlement, to be tested. The Municipal Group argues that the Commission should evaluate the impact upon the unsubscribed capacity problem of alternative rate designs within a cost-based rate structure.

Indicated Shippers and Exxon assert that the Commission should require Tennessee to show that its pending settlement in Docket No. RP95-112-000 will not provide it with sufficient flexibility to negotiate rates with its shippers, without the authority sought here. Indicated Shippers and Exxon contend that the settlement provides that Tennessee will reclassify certain of its fixed costs from its reservation to its usage charges, thereby departing from straight fixed-variable cost classification and rate design. Indicated Shippers and Exxon argue that Tennessee justifies this element of the settlement based on its purported need for greater rate flexibility to address capacity turn-back on its system.

In its Answer, Tennessee argues that the agreement of the parties to the settlement in Docket No. RP95-112-000 to shift a portion of Tennessee's fixed costs to the usage rate will, in addition to its other benefits, help make Tennessee's recourse rate more competitive. However, Tennessee asserts that, contrary to Indicated Shippers' characterization, the rate design element of the settlement does not provide Tennessee with flexibility to negotiate rates. Rather, Tennessee argues that, if approved by the Commission, the settlement will establish Tennessee's new recourse rates. Tennessee asserts that the settlement rates were neither designed nor intended to be an exclusive substitute for negotiated/recourse rate flexibility.

The Commission will not address the settlement in Docket No. RP95-112-000 at this time. However, to the extent that the settlement establishes new system-wide rates for Tennessee's transportation services, such rates will become Tennessee's new recourse rates if the settlement is approved. As for proposals to establish flexibility to negotiate rates, the Commission intends that such proposals be the subject of a separate proceeding, not tied to other proceedings. Tennessee has appropriately filed to obtain negotiated rate authority in this proceeding and the Commission finds its filing acceptable, subject to the conditions set forth herein.

The Tennessee Municipal Group, Indicated Shippers and Exxon contend that, if the Commission does not reject the instant filing, the filing should be suspended for the full five months permitted under the NGA and the Commission should institute hearing procedures with full evidentiary rights for all parties. Tennessee opposes this request stating that suspension and a hearing are unnecessary and would be unduly burdensome.

Tennessee seeks general authority to negotiate rates for services at some future date. Tennessee does not propose to implement any specific negotiated rates at this time. Thus, suspension of the filing and a hearing are unwarranted and unnecessary.

As discussed above, the settlement in Docket No. RP95-112-000 is currently pending before the Commission and the Commission will take action on that agreement at a later date.

Determination of Net Present Value and Capacity Allocation for Negotiated Rate Services

Consolidated Edison Company of New York and the Southern Connecticut Gas Company (ConEd and Southern Connecticut), National Fuel Distribution Corporation (National Fuel), Northern Illinois Gas Company and Northern Indiana Public Service Company (NI-Gas and NIPSCO), and the New England Customer Group argue that, in contrast to the roll-over and capacity release sections of Tennessee's current tariff, which set out an explicit numerical formula used to determine the bid having the highest net present value (NPV), the NPV proposal contained in Docket No. RP96-275-000 11/ provides Tennessee a significant amount of discretion to determine what bid has the highest NPV. 12/

11/ Tennessee Gas Pipeline Company, 76 FERC ¶ 61,101 (1996).

12/ ConEd and Southern Connecticut cite language in Section 5.2 of Tennessee's General Terms and Conditions which would (continued...)

ConEd and Southern Connecticut contend that there is nothing in Tennessee's proposal which would preclude Tennessee from exercising its discretion to treat negotiated rate proposals as having the highest NPV, when compared to a recourse rate bid for capacity. ConEd and Southern Connecticut assert that, in order for the recourse rate provision to provide customers meaningful protection as required by the Alternative Rate Policy Statement, the NPV proposal must be amended to ensure that where negotiated bids exceed the recourse rate, recourse rate bids will be deemed to have the same NPV as such negotiated bids of the same quantity, duration and length of haul. ConEd and Southern Connecticut further contend that it is not clear whether Tennessee will apply the maximum recourse rate limitation on a period-by-period basis or an average rate basis. ConEd and Southern Connecticut assert that Tennessee has also failed to specify how it will analyze non-traditional rate forms to determine whether a negotiated rate is above the maximum applicable recourse rate and how an accepted "highest bid" with a negotiated rate shipper will be translated into a recourse rate, which may need to be discounted, for the original shipper with right of first refusal rights.

In response to these concerns, Tennessee suggested certain changes it is willing to make to clarify how capacity will be awarded on its system. Tennessee states that, for the awarding of capacity, there should be some recognition of the possibility of negotiated rate agreements that include volumetric rates. Tennessee asserts that this can be done in a manner that satisfies concerns expressed by the Commission in Tennessee Gas Pipeline Company, Docket No. RP96-275-000, 13/ by clarifying that the NPV calculation can be based on both the reservation rates and on any mechanism that guarantees the pipeline a certain level of revenue agreed to by a negotiated rate shipper that is paying a volumetric rate. In this regard, Tennessee acknowledges that the Commission's regulations generally prohibit revenue guarantees. However, Tennessee contends that such rate forms should be acceptable in the negotiated/recourse rate context, just as payment of a rate above the maximum cost-based rate is acceptable in that context. Tennessee argues that given that both the reservation rate for firm service and a negotiated revenue guarantee are forms of assured recovery of costs, both should be included in the NPV calculation.

12/(...continued)
permit Tennessee to take into account "other factors determined to be relevant by the Transporter" in deducing the highest NPV.

13/ 76 FERC ¶ 61,101 (1996).

With respect to scheduling and curtailment of service, Tennessee asserts that the rate paid is a relevant factor only in connection with interruptible services. Tennessee states that once it enters into a firm service agreement, the shipper is scheduled and curtailed in the same manner as all firm shippers, i.e., based on its primary and secondary rights and without regard to the level of its rate. Therefore, Tennessee contends, a firm shipper's negotiated rate will not affect its scheduling or curtailment priority.

Regarding interruptible services, Tennessee states scheduling and curtailment are based on the shipper's agreed rate. In that regard, Tennessee has submitted pro forma tariff changes designed to ensure that an interruptible customer does not obtain a higher scheduling or curtailment priority by paying above the maximum rate. Tennessee states it is willing to submit its pro forma sheets as part of a compliance filing.

The Alternative Rates Policy Statement states that:

> For purposes of allocating capacity, shippers willing to pay more than the maximum recourse rate would be considered to have paid the maximum recourse rate. Therefore, a shipper willing to pay only the recourse rate cannot lose access to capacity merely because someone else is willing to pay a negotiated rate. 14/

Tennessee's proposed NPV tariff language in Docket No. RP96-275-000 at Article 28, section 5.2 of its General Terms and Conditions does not contain a limitation on the maximum rate that may be reflected in the NPV formula. 15/ Therefore, Tennessee's proposal to include rates that use different rate forms is acceptable and Tennessee should file as revised tariff sheets, the relevant pro forma tariff sheets.

In addition, Tennessee did not propose to change its proposed NPV method of allocating capacity. 16/ Therefore, under Tennessee's conditionally accepted NPV tariff language,

14/ 74 FERC at 61,241. At footnote 78, a numerical example is provided demonstrating the same.

15/ Pro Forma Sheet No. 405A.

16/ Tennessee did propose to modify its tariff with regard to scheduling and right of first refusal to consider negotiated rates in excess of the maximum recourse rate equal to the maximum recourse rate.

negotiated rates in excess of the maximum recourse rate will be reflected in the NPV formula allocating capacity. Consistent with the Alternative Rates Policy Statement, Tennessee's proposed revision to its NPV formula filing provides the negotiated rate reflected in the NPV formula cannot exceed the maximum recourse rate. In addition, Tennessee proposes tariff changes designed to ensure that an interruptible customer does not obtain a higher scheduling or curtailment priority by paying above the maximum rate. However, the Commission will require Tennessee to provide an explanation of how it will evaluate right of first refusal bids that are less than the maximum rate and scheduling under different rate forms, and propose tariff language if necessary.

Cost Shifting and Discounts

The New England Customer Group and the Pennsylvania OCA contend that specific measures must be taken to ensure that Tennessee's negotiated rate proposal does not result in cost-shifting to Tennessee's recourse rate customers. The Pennsylvania OCA contends that the Commission should authorize Tennessee to place its revised tariff sheets into effect only if the pipeline is willing to hold its non-negotiated rate customers harmless from any revenue shortfall resulting from negotiated rate discounts by agreeing in its future general rate filings under NGA Section 4 to reflect negotiated rate volumes at maximum tariff rates.

The Small Customers submit that protective safeguards are required on Tennessee to assure that cost allocation decisions arising out of the establishment of negotiated rates or negotiated terms and conditions of service do not unfairly shift costs to small customers. The Small Customers argue that the Commission must make clear to Tennessee that receiving authority to implement negotiated rates does not remove the burden of proof from Tennessee in future NGA Section 4 rate cases in which

Tennessee seeks to allocate additional costs to recourse services generally. Tennessee responds that such issues should be addressed in its next Section 4 rate case.

The Commission has required pipelines to maintain certain very specific information regarding negotiated rate revenues and costs and to maintain that information in a format suitable for review and analysis in Section 4 rate cases. To date, the Commission has not mandated any specific treatment for costs or revenues associated with negotiated rates and declines to do so here.

Atlanta and Chattanooga, the New England Customer Group, and Texaco contend that the Commission should clarify that negotiated rates and discounting are separate and distinct mechanisms and that the Commission should make clear that Tennessee may not

manipulate its rates by claiming that when a negotiated rate is below the cost-based rate, it is actually a discounted rate and should be subject to a discount adjustment in Tennessee's next section 4 rate case.

In its Policy Statement, the Commission stated that issues regarding the appropriate allocation of costs between recourse rate shippers and negotiated rate shippers will be addressed fully in the pipeline's section 4 rate case. At that time, the Commission will consider issues relating to cross-subsidization and interested parties will be able to raise any concerns they may have regarding the proper allocation of costs. These issues are being considered by the Commission on rehearing of an order involving a negotiated rate provision in NorAm Gas Transmission Company (NorAm). 17/ If the Commission further clarifies or changes its position in NorAm, that ruling will apply here.

Degradation of Services and the Role of Recourse Rates

ConEd and Southern Connecticut assert that Tennessee's filing does not provide recourse rate customers with tariff safeguards. Therefore, petitioners request that the Commission clarify that negotiated rate authority does not absolve Tennessee from meeting its obligation to ensure that customers taking service under recourse rates are insulated from any adverse effects which might result from Tennessee agreeing to provide service under negotiated rates.

Indicated Shippers and Exxon assert that Tennessee is currently under no obligation to file a general NGA Section 4 rate case. In addition, Indicated Shippers and Exxon contend that Commission action under NGA Section 5 to remedy instances where negotiated rates are found to be unjust and unreasonable and/or unduly discriminatory is too limited. Indicated Shippers and Exxon assert that such a remedy would be prospective only, which, given the time normally involved to complete an on-the-record adjudication, could render any ultimate remedy largely academic. Thus, Indicated Shippers and Exxon suggest that the Commission should consider requiring Tennessee to file its next rate case by a date certain to ensure that an examination of Tennessee's rates takes place. Indicated Shippers and Exxon state, however, that they are not making such a request at this time, but rather reserve the right to make this request in the future.

The Small Customers assert that a policy of allowing negotiated rates must not result in the degradation of a pipeline's other tariff rates or tariff services and that care

17/ 75 FERC ¶ 61,322 (1996).

must be exercised so that the overall system operations of the pipeline are not adversely affected to the extent that customers are allowed to negotiate superior rates for superior terms of service.

Pursuant to Sections 284.8(b) and 284.9(b) of the Commission's regulations, 18/ pipelines are expected to negotiate rates with their customers on a non-discriminatory basis. Customers electing recourse rates should be no worse off than they would be absent negotiated rates. 19/ The Commission's complaint procedures remain for those recourse customers who believe their service has been degraded as the result of a negotiated service.

With respect to Indicated Shippers' request that Tennessee be required to file its next Section 4 rate case by a date certain, Tennessee responds that any such filing requirement would be inconsistent with the settlement pending in Docket No. RP95-112-000 in which the settling parties elected not to include any filing deadline. Moreover, Tennessee contends that approval of negotiated rates does not necessitate imposition of a rate filing deadline.

The Commission agrees with Tennessee's latter argument. The Commission stated repeatedly that it will exercise its authority under NGA Section 5 to remedy instances where negotiated rates are found to be unjust and unreasonable or where such rates are applied in an unduly discriminatory manner. Because the Commission's authority can be exercised at any time, it is unnecessary to impose a filing requirement at this time.

National Fuel contends that Tennessee's proposed tariff language does not expressly provide for the customer's opportunity to fall back to recourse rates should Tennessee exercise market power. 20/ Thus, National Fuel requests that Tennessee be required to include tariff language which protects

18/ 18 C.F.R. §§ 284.8(b) and 284.9(b).

19/ Alternative Rate Policy Statement, 74 FERC at 61,242.

20/ National Fuel cites the Alternative Rate Policy Statement, 74 FERC at 61,240:

> Recourse rates "prevent pipelines from exercising market power by assuring that the customer can fall back to cost-based, traditional service if the pipeline unilaterally demands excessive prices or withholds service."

the negotiated rate shipper from a pipeline's exercise of market power, as contemplated by the Policy Statement. Tennessee opposes National Fuel's request.

In stating that it would consider proposals for negotiated rates with a cost-based recourse rate as a backstop, the Commission stated that the availability of the recourse rate itself would prevent pipelines from exercising market power. The prevention comes, however, at the time the shipper is deciding whether to negotiate with the pipeline or simply to choose the recourse rate for its service. Because the shipper can always elect the recourse rate and receive service, pipelines cannot exact monopoly rents and are precluded from exercising their market power. It is at this time that the shipper can "fall back" to the recourse rate. Once the shipper has decided to negotiate with the pipeline and a deal is struck, the shipper must comply with the terms of its negotiated contract and the rules of contract law would apply.

Tennessee's Accounting for Negotiated Rates

Indicated Shippers and Exxon contend that Tennessee's filing does not contain any provision for accounting for costs and revenues attributable to negotiated rates and services. Thus, Indicated Shippers and Exxon assert that the Commission should require Tennessee to account separately for the costs and revenues attributable to negotiated rate services, to allow parties to examine these issues in Tennessee's next rate case. Phillips contends that Tennessee's filing is deficient because it does not provide that Tennessee will make negotiated rate accounting data and information public on a real-time basis. Phillips argues that the accounting data is legitimately required to enable parties to monitor whether or not Tennessee is over-collecting its cost of service through its negotiated rates. Phillips believes this is significant because if Tennessee is able to make a windfall profit through negotiated rates, it will have no incentive, and no legal obligation, to file future Section 4 rate cases.

In addition, Indicated Shippers and Exxon contend that Tennessee's ability to retain 10 percent of its interruptible transportation revenues 21/ would provide Tennessee with an incentive to drive up the rates for its interruptible service.

21/ Tennessee's currently effective interruptible rate schedules provide for the crediting of 90 percent of net revenues from Tennessee's various interruptible services to Tennessee's firm customers and retention of 10 percent of those revenues by Tennessee. See, e.g., Third Revised Sheet No. 154, Rate Schedule IT, Section 6.

Therefore, Indicated Shippers and Exxon assert that the Commission should condition its acceptance of Tennessee's filing on a requirement that revenues attributable to negotiated interruptible services should be credited in full to Tennessee's firm customers.

The Commission has required pipelines to maintain certain very specific information regarding negotiated rate revenues and costs and to maintain that information in a format suitable for review and analysis in Section 4 rate cases. Pipelines providing service under negotiated rates must record each volume transported, billing determinant, rate component, surcharge, and the revenue associated with the negotiated rates so that this information can be filed, separately identified, and separately totalled, in particular, as part of and in the format of Statements G, I and J in the pipeline's next Section 4 rate case. 22/ Tennessee also is required to maintain this information and acceptance of Tennessee's filing is subject to any future decisions the Commission may reach with respect to the implementation of negotiated rates in this regard.

With respect to Indicated Shippers' request that Tennessee be required to credit all revenue derived from negotiated rate interruptible service, Tennessee responds that the request is unprecedented, unwarranted, and at odds with the pending settlement in Docket No. RP95-112-000.

The Commission does not believe that Tennessee's ability to retain 10 percent of its interruptible revenues provides the pipeline with an inappropriate incentive to drive up the rates for its interruptible service. Rather, the Commission believes that Indicated Shippers' negotiated IT rate revenue crediting proposal confuses a record keeping requirement with a requirement to credit revenues. There is no nexus. Tennessee's proposal simply modifies its Part 284 interruptible service rate schedules; it does not change the nature of the services or establish new services. These revenues should be treated as any other IT revenue under these rate schedules. For currently effective rates, that would mean these revenues would be subject to the 90/10 interruptible revenue credit mechanism. If the proposed settlement in Docket No. RP95-112-000 is approved, then there would be no revenue credit after November 1, 1996. The Commission rejects Indicated Shippers' proposal.

22/ NorAm Gas Transmission Company, 75 FERC 61,322 slip op. at

14 (1996).

Treatment of Transition Costs and Other Surcharges

Atlanta Gas Light Company and Chattanooga Gas Company (Atlanta and Chattanooga), Ni-Gas and NIPSCO, National Fuel, Central Hudson Gas & Electric Corporation (Central Hudson), the Tennessee Municipal Group, ConEd and Southern Connecticut, the New England Customer group, and Texaco assert that Tennessee's filing does not address the treatment of transition cost recovery or other surcharges. Petitioners urge that Commission approval of Tennessee's proposal be made subject to the condition that Tennessee's negotiation of individual rates with shippers should not affect the way the pipeline accounts for the recovery of transition costs and surcharges. Specifically, petitioners assert that if Tennessee negotiates a rate with a customer that does not include transition costs or surcharges, Tennessee should be at risk for the collection of those costs and cannot reallocate them to its recourse rate shippers.

The Commission has already established its expectation that pipelines' recovery and treatment of such costs will not change for shippers under negotiated rate contracts. Pipelines who negotiate to provide services at less than the maximum tariff rate will be subject to the same Commission policies, such as the Natural policy on the attribution of discounting, and that the Commission expects that, to the extent pipelines wish to deviate from these existing policies, they will be willing to accept the risk of under-recovery of these costs. The Commission remains committed to ensuring that recourse rate shippers are not affected by the rates charged to other customers that were achieved through negotiation. Thus, the petitioners' concerns have already been addressed.

Penalties

Atlanta and Chattanooga, Central Hudson, the Public Service Commission of New York (NYPSC), National Fuel, Ni-Gas and NIPSCO, the Tennessee Municipal Group, ConEd and Southern Connecticut, the Process Gas Consumers Group, Connecticut Natural Gas Corporation, Phillips, and the New England Customer Group protest Tennessee's filing to the extent it includes the authority to negotiate the penalty provisions of its tariff. Petitioners assert that penalties are generally imposed to maintain the operational integrity of the system, and that parties should not be afforded the opportunity to shift costs associated with such penalties or responsibilities for system balancing to the remainder of the system by negotiating around such provisions.

In addition, petitioners argue that penalty provisions are terms and conditions of services, not rates, and therefore are not

eligible for negotiation. 23/ Central Hudson contends that Tennessee's proposal is contrary to Commission policy requiring non-discriminatory waiver of penalties, which is reflected in Article XXXI of Tennessee's tariff. Petitioners assert that the Commission should require Tennessee to remove language permitting the negotiation of penalties from its proposal.

In its answer, Tennessee revised the negotiated rate provisions in its proposed tariff to remove all references to negotiation of penalties. This revision was appropriate. In Northern Natural Gas Company, 24/ the Commission stated that it considers penalties part of the General Terms and Conditions which, under current Commission policy, cannot be negotiated as part of the negotiated/recourse rate program. Tennessee's revision to its proposed tariff sheets removes any reference to penalties from the list of rate components which can be negotiated and, thus, complies with the Commission's policy. As such, petitioners concerns in this regard are rendered moot. Tennessee should file as revised tariff sheets, the relevant pro forma tariff sheets proposed in its Answer.

Negotiated Rates and Capacity Release

NYPSC protests Tennessee's failure to include a provision that would provide customers with a negotiated rate an opportunity to recover the full fixed portion of their rate in the capacity release market. NYPSC contends that unlike other pipelines' customized reservation proposals, Tennessee is not proposing to amend its tariff sheets to provide that the negotiated rate will be the cap on the rate for capacity release. 25/ The New England Customer Group and NYPSC argue that it is inconsistent to find the negotiated rate just and reasonable when charged by the pipeline, but not just and reasonable when applied to released capacity and that any authorization by the Commission which allows Tennessee to charge negotiated rates, while denying customers the right to charge such rate to the release capacity, would be unduly discriminatory. Thus, NYPSC requests that the Commission direct Tennessee to include in its tariff sheets revised language providing that when the negotiated rates go in to effect, the same rates should apply as the cap in the secondary, released capacity market.

23/ Citing, Northern Natural Gas Company, 76 FERC ☐ 61,026, slip op. at 8 (1996).

24/ 76 FERC ¶ 61,026 (1996).

25/ Citing, Texas Eastern Transmission Corporation, 75 FERC ¶ 61,218 (1996).

Tennessee has made no proposal to lift capacity release rates to the negotiated levels. As such, the Commission believes that the concerns expressed by the New England Customer Group and the NYPSC are better suited to the proceeding in Docket No. RM96-14-000, where the Commission is reviewing the price cap for released capacity.

Treatment of Affiliate Transactions

Texaco Natural Gas Inc. (Texaco) asserts that rates negotiated between an interstate pipeline and its marketing affiliate should be subject to greater scrutiny than the transactions between a pipeline and its unaffiliated customers. Thus, Texaco contends that full disclosure of the affiliate agreement should be made prior to the effective date, with an adequate opportunity for others to request and utilize the applicable service at the negotiated rate.

The Commission's regulations currently require pipelines to report transactions with their affiliated marketers. 26/ In addition, Tennessee is required to maintain specific data regarding each individual negotiated rate transaction. Should the need arise, this information, in conjunction with that filed pursuant to Section 161.3 of the regulations, can provide the basis for determining whether allegations of undue discrimination and affiliate preference warrant further investigation by the Commission.

Concerns Expressed by Small, Captive Customers

The Small General Service Customer Group (Small Customers) assert that Tennessee's proposal is likely to have a significant impact on its small captive customers. Therefore, the Small Customers recommend that the Commission adopt certain suggestions to protect small customers on Tennessee's system. Specifically, the Small Customers recommend that future filings by Tennessee to implement specific negotiated rates take the form of "prior notice" filings similar to those used by the Commission for construction activities undertaken under a Part 157 blanket certificate. The Small Customers assert that "prior notice" type filings would give affected parties the opportunity to file protests to a Tennessee negotiated rate proposal and to present a prima facia showing that the proposal is inconsistent with Commission policies, is unduly discriminatory, or would result in rates that are unjust and unreasonable.

26/ 18 C.F.R. □ 161.3.

The Small Customers also assert that the prime beneficiaries of Tennessee's negotiated rate proposal likely will be shippers with large load requirements and multiple pipeline transportation options. The Small Customers contend that the Commission should adopt specific guidelines to ensure that larger customers do not receive a competitive advantage in markets in which small and large customers are both providing services.

The Commission believes that the current guidelines regarding pipeline authority to negotiate rates, including the requirement to maintain specific information regarding negotiated rate transactions, are sufficient to protect both large and small customers on Tennessee's system. For example, pipelines are already required to provide service in a non-discriminatory manner. Therefore, if a small customer is similarly situated with a large customer serving the same market, then the two customers should pay the same rate for transportation service. Because these requirements already exist, the Commission declines to require that Tennessee make the "prior notice" type of filing requested by the Small Customers.

Filing Requirement for Negotiated Rate Transactions

The majority of the petitioners request that the Commission require Tennessee to revise its tariff to state specifically the information it will file in conjunction with any filing to place into effect actual negotiated rates. Specifically, petitioners request that Tennessee state in its tariff that it will file the information the Commission has required of other pipelines seeking to place negotiated rates into effect, including: the exact legal name of the customer, the negotiated rate for the service, other applicable charges for the service, and the applicable rate schedule.

In its Answer, Tennessee asserts that because it is already subject to and will comply with the Commission's filing and reporting requirements, the requested tariff changes are unnecessary. Moreover, Tennessee states that because the details of the filing and reporting requirements are subject to change from time to time, it can lessen the need to make future tariff changes by simply cross-referencing in its tariff the obligation to make any filings required by the Commission with respect to negotiated rates. However, to eliminate any possible ambiguity on this point, Tennessee states that it will file a numbered tariff sheet stating the exact legal name of the customer, the negotiated rate for the service, other applicable charges for the service, and the applicable rate schedule, on or before the proposed effective date of each individual negotiated rate agreement, in accordance with the Commission's policies concerning negotiated rates.

The Commission agrees with Tennessee. Section 4 of the NGA authorizes the Commission to designate the form of rate filings necessary to carry out the intent of the statute and pipelines are obligated to meet any such filing requirements imposed by the Commission. A statement in the pipeline's tariff is not necessary to ensure compliance with such requirements. With respect to Tennessee's filing future negotiated rates, thus far the Commission has only required pipelines seeking to charge negotiated rates for transportation services to file tariff sheets reflecting the exact legal name of the customer, the negotiated rate for the service, other applicable charges for the service, and the applicable rate schedule. 27/ The Commission declines to impose other filing requirements on Tennessee at this time.

The Commission orders:

(A) The tariff sheets listed in Appendix A are accepted, to be effective September 1, 1996, subject to the conditions of this order.

(B) Before implementing any specific negotiated rate, Tennessee must file numbered tariff sheets stating the name of the shipper and the negotiated rate, for each rate negotiated for its transportation service, as further explained in NorAm Gas Transmission Company,75 FERC 61,091 (1996), subject to the outcome of that proceeding.

(C) Within 15 days of the date of this order: (1) Tennessee must file as revised tariff sheets, the pro forma tariff sheets submitted with its August 20, 1996 Answer in this proceeding; and (2) Tennessee must explain how it will evaluate right-of-first-refusal bids that are less than the maximum rate and scheduling under different rate forms, and propose tariff language if necessary, consistent with the discussion in this order.

By the Commission.

(S E A L)

Lois D. Cashell,
Secretary.

27/ Northern Natural Gas Company, 76 FERC slip op. at 3.

APPENDIX A
List of Proposed Tariff Sheets
Docket No. RP96-312-000

Tennessee's FERC Gas Tariff

Fifth Revised Volume No. 1
Third Revised Sheet No. 98
First Revised Sheet No. 109
Original Sheet No. 109A
Fourth Revised Sheet No. 128
Original Sheet No. 128A
Third Revised Sheet No. 154
Original Sheet No. 154A
Second Revised Sheet No. 155E
Third Revised Sheet No. 162
Fourth Revised Sheet No. 167
Third Revised Sheet No. 168
Third Revised Sheet No. 173
Original Sheet No. 173A
First Revised Sheet No. 219
Original Sheet No. 219A
Second Revised Sheet No. 226
Original Sheet No. 226A
Fourth Revised Sheet No. 317 (withdrawn as mispaginated) *
Fifth Revised Sheet No. 317
Fourth Revised Sheet No. 318
Second Revised Sheet No. 324
First Revised Sheet No. 337A
First Revised Sheet No. 348

* On July 18, 1996, Tennessee filed a substitute tariff sheet in Docket No. RP96-312-001, to correct a pagination on one of the tariff sheets in its July 16 filing. This revised tariff sheet renders Fourth Revised Sheet No. 317 moot.

APPENDIX B

List of Intervenors and Abbreviations

Party	Protest/Comments
Air Products and Chemicals, Inc.	
ANR Pipeline Co.	
Aquila Energy Marketing Corp.	
Atlanta Gas Light Co. and Chattanooga Gas Co.	P
Bethlehem Steel Corp.	
Brooklyn Union Gas Co.	
Central Hudson Gas and Electric Corp.	C
Cities of Clarksville, Springfield, and Portland, Tennessee; the Northwest Alabama Gas District, the West Tennessee Public Utility District, the Humphreys County Utility District, and the Greater Dickson Gas Authority, Tennessee	P
CNG Transmission Corp.	
Connecticut Natural Gas Corp.	C
Consolidated Edison Co. of New York and Southern Connecticut Gas Co.	P
Coastal Gas Marketing Co. 1/	
Columbia Gas of Kentucky, Inc.; Columbia Gas of Ohio, Inc., and Columbia Gas of Pennsylvania, Inc.	C
Columbia Gas Transmission Corp.	
Conoco Inc.	
Dakota Gasification Co. 1/	
East Tennessee Group	
Enron Capital & Trade Resources Corp. 1/	
Entergy Services, Inc.	
Exxon Corp.	P
Indicated Shippers (11 producers)	P
JMC Power Projects (5 co-gen projects)	C
Koch Gateway Pipeline Co.	
LG&E Natural Marketing Inc.	
Long Island Lighting Co.	
Marathon Oil Co.	
National Fuel Gas Distribution Corp.	P
Nashville Gas Co.	
Natural Gas Clearinghouse	
New England Customer Group	

New York, Public Service Commission of the State of	P
New York State Electric and Gas Corp.	
Niagara Mohawk Power Corp.	
NorAm Gas Transmission Co.	

APPENDIX B
(Continued)

Party	Protest/Comments
Northern Illinois Gas Co. and Northern Indiana Public Service Co.	P
Orange and Rockland Utilities, Inc.	
Owens-Corning	
Penn Fuel Gas, Inc. 1/	
Pennsylvania Office of Consumer Advocate 1/	P
PG Energy Inc.	
Phillips Petroleum Co. and Phillips Gas Marketing Co.	P
Process Gas Consumers Group	P
Rochester Gas and Electric Corp.	
Tennessee Small Customer Group (jointly and 23 LDCs individually)	C
Texaco Natural Gas Co. 1/	P
Transcontinental Gas Pipe Line Corp.	
Yankee Gas Services Co.	

1/Late motion to intervene

Exhibit 3

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

October 4, 2000

IN RE:	)	
	)	
PETITION TO REQUIRE BELLSOUTH TELECOMMUNICATIONS, INC. TO APPEAR AND SHOW CAUSE THAT CERTAIN SECTIONS OF ITS GENERAL SUBSCRIBERS SERVICES TARIFF AND PRIVATE LINE SERVICES TARIFF DO NOT VIOLATE CURRENT STATE AND FEDERAL LAW	)	DOCKET NO. 00-00170

ORDER REJECTING PROPOSED SETTLEMENT AGREEMENT AND DISMISSING SHOW CAUSE PETITION

This matter came before the Tennessee Regulatory Authority ("Authority") at a regularly scheduled Authority Conference held on July 11, 2000 for approval of a *Proposed Settlement Agreement* filed by and entered into between BellSouth Telecommunications, Inc. ("BellSouth") and the Tennessee Regulatory Authority Staff Investigative Team ("Staff Investigative Team") in connection with the Staff Investigative Team's *Petition to Require BellSouth Telecommunications, Inc to Appear and Show Cause that Certain Sections of its General Subscriber Services Tariff* ("GSST") *and Private Line Services Tariff* ("PLST") *Do Not Violate Current State and Federal Law* ("Show Cause Petition").

Procedural History

At a regularly scheduled Authority Conference held on July 13, 1999, the Authority considered the Fourth Report and Recommendation of the Pre-Hearing Officer in Docket No. 98-00559.[1] During the deliberations, the Directors discussed the following recommendations put forth by the Pre-Hearing Officer in the Fourth Report and Recommendation 1) that the Authority open a rulemaking docket to examine the use of CSAs on an industry-wide basis, 2) that the list of issues developed in Docket No. 98-00559 be considered in the context of the two consolidated contested case CSA dockets (Nos. 99-00210 and 99-00244); and 3) that the Authority open a separate docket for the purpose of investigating grounds for commencing a show cause proceeding addressing whether the termination liability provisions in BellSouth's existing general tariffs (GSST and PLST) are punitive in nature and have an anti-competitive impact on the local telecommunications market.[2]

During the July 13, 1999 Authority Conference, the Directors unanimously approved the first two recommendations. A majority of the Directors[3] voted to approve the third recommendation.[4]

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[1] Docket No 98-00559 was opened by the Authority on August 12, 1998 for the purpose of addressing the competitive effects of contract service arrangements ("CSAs") filed by BellSouth in Tennessee A number of parties intervened in that docket, including BellSouth, NEXTLINK, SECCA and the Consumer Advocate After the completion of discovery between the parties, the filing of briefs and the conduct of several pre-hearing conferences, the Pre-Hearing Officer issued his Fourth Report and Recommendation on July 8, 1999.

[2] *See Proceeding for the Purpose of Addressing Competitive Effects of Contract Service Arrangements Filed by BellSouth Telecommunications, Inc in Tennessee*, Docket No 98-00559 (July 8, 2000) (Fourth Report and Recommendation of the Pre-Hearing Officer)

[3] Director Greer did not vote to approve the third recommendation because he was of the opinion that a show cause action would be redundant to the initiation of a rulemaking proceeding

[4] A hearing was held on August 17 and 18, 1999 in the contested case dockets 99-00210 and 99-00244, and the Authority rendered its decision in those dockets, unanimously approving the CSAs in question, on September 2, 1999 On July 11, 2000, the Authority officially opened Docket No 00-00702 for the purpose of promulgating rules for the provisioning of tariff term plans and special contracts. The proposed rules were published for comment in the September, 2000 Administrative Register

Pursuant to the Authority's July 13, 1999 decision, the Staff Investigative Team was established and initiated its investigation of BellSouth's GSST and PLST tariffs.[5] The Staff Investigative Team determined that there was sufficient cause to justify the commencement of a show cause proceeding pursuant to Tenn. Code Ann. § 65-2-106. On March 6, 2000, the Staff Investigative Team filed in this docket and served on BellSouth its Show Cause Petition. In advance of filing a response to the Show Cause Petition, representatives of BellSouth contacted the Staff Investigative Team and entered into a series of meetings to address the concerns raised in the Show Cause Petition. During the course of these meetings, the Staff Investigative Team and BellSouth negotiated an agreement. On May 9, 2000, the Staff Investigative Team and BellSouth filed the Proposed Settlement Agreement for consideration by the Authority. The Proposed Settlement Agreement's stated intent was to resolve expeditiously the concerns raised in the Show Cause Petition and apply the proposed resolution of those concerns to incumbent local exchange companies as well as competing telecommunications services providers.

On June 13, 2000, the Consumer Advocate Division ("Consumer Advocate") filed a *Petition to Intervene, Object to the Proposed Settlement and to Consolidate with Docket 99-00246*. On June 14, 2000, NEXTLINK, Tennessee Inc ("NEXTLINK") and the Southeastern Competitive Carriers Association ("SECCA") filed a joint letter of comments. Later that day, NEXTLINK and SECCA each filed a *Petition to Intervene*. On June 19, 2000, BellSouth responded to the comments and petitions to intervene by filing a *Memorandum in Opposition to*

[5] The Staff Investigative Team consisted of Joe Werner and Joe Shirley of the Telecommunications Division, Chris Klein of the Economic Analysis Division and Gary Hotvedt of the Legal Division These persons were designated parties in interest and did not serve in an advisory capacity to the Directors or other Authority members on matters involving contract service arrangements

NEXTLINK's "Petition to Intervene;" SECCA'S "Petition to Intervene;" and the CAD's "Petition to Intervene, Object to the Proposed Settlement Agreement and to Consolidate with Docket 99-00246" The Staff Investigative Team filed a "*Collective Response*" to all of these filings on June 27, 2000.

During the July 11, 2000 Authority Conference, the Directors heard arguments from the Staff Investigative Team, BellSouth, NEXTLINK, SECCA, and the Consumer Advocate. After considering the filings and the arguments of the parties, the Authority voted to deny the *Proposed Settlement Agreement* and subsequently voted to dismiss the Show Cause Petition.

Findings and Conclusions

During the July 11, 2000 Conference, the Authority found that the terms of the *Proposed Settlement Agreement* ultimately affected the rights and liabilities of competing local exchange carriers who were not a part of the settlement negotiations between the Staff Investigative Team and BellSouth. Having determined that all affected parties had not been extended the opportunity to participate in the negotiations leading up to the *Proposed Settlement Agreement*, the Authority concluded that the *Proposed Settlement Agreement* would not be enforceable as to those parties. In addition, the Authority concluded that an approval of the *Proposed Settlement Agreement* could be interpreted as the adoption of a rule of general applicability relating to termination provisions in the context of an adjudicatory proceeding, i.e. the show cause proceeding, which would not be the proper proceeding within which to establish such a rule.[6]

[6] Under *Tennessee Cable Television Assoc v Tennessee Pub Serv Comm'n*, 844 S.W.2d 151, 160-61 (Tenn. App 1992*), perm. app denied* (Tenn 1992), an agency should use a rulemaking proceeding if the determination

> (1) is intended to have wide coverage encompassing a large segment of the regulated or general public, rather than an individual or a narrow select group, (2) is intended to be applied generally and uniformly to all similarly situated persons; (3) is designed to operate only in future cases, that is, prospectively; (4) prescribes a legal standard or directive

Having determined not to approve the *Proposed Settlement Agreement*, a majority of the Authority voted to dismiss the Show Cause Petition. Without making any determination as to the validity of the show cause petition, the majority found that there was no efficiency or positive benefit to continuing with a show cause proceeding as to BellSouth while, at the same time, the Authority would be engaged in a rulemaking proceeding addressing the use of CSAs on an industry-wide basis.[7] Moreover, the majority found that proceeding with the show cause action would likely delay the rulemaking proceeding which is intended to address a broader range of issues surrounding CSAs and specifically, issues related to termination provisions in CSAs for the telecommunications industry as a whole.[8]

IT IS THEREFORE ORDERED THAT:

1. The *Proposed Settlement Agreement* entered into by and between the Tennessee Regulatory Authority Staff Investigative Team and BellSouth Telecommunications, Inc. is rejected.

> that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authorization; (5) reflects an administrative policy that (i) was not previously expressed in any official and explicit agency determination, adjudication or rule, or (ii) constitutes a material and significant change from a clear, past agency position on the identical subject matter; and (6) reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy Citing, *Metromedia, Inc v. Director, Div of Taxation*, 97 N.J 313, 47 A.2d 742, 751 (1984).

Because the adoption of the *Proposed Settlement Agreement* would necessarily involve the criteria for a rulemaking proceeding, the Authority concluded that such a determination should not be made in this show cause proceeding

[7] *Transcript of Proceedings* of July 11, 2000 Authority Conference, p 84 (July 11, 2000).

[8] Director Malone did not vote with the majority. Director Malone stated that he had not been provided any information which would cause him to question the previously recognized need and approved action by the Authority to examine the initiation of a show cause proceeding Director Malone concluded that the best approach would be to proceed with the entry of a show cause order against BellSouth, commencing the show cause proceeding, and then advance with the rulemaking proceeding.

2. The *Petition to Require BellSouth Telecommunications, Inc. to Appear and Show Cause that Certain Sections of its General Subscriber Services Tariff and Private Line Services Tariff Do Not Violate Current State and Federal Law* is dismissed.

3. Having dismissed the *Petition to Require BellSouth Telecommunications, Inc. to Appear and Show Cause that Certain Sections of its General Subscriber Services Tariff and Private Line Services Tariff Do Not Violate Current State and Federal Law*, the Consumer Advocate Division's *Petition to Intervene, Object to the Proposed Settlement and to Consolidate with Docket 99-00246*, NEXTLINK, Tennessee Inc.'s *Petition to Intervene*, and the Southeastern Competitive Carriers Association's *Petition to Intervene* have been rendered moot.

4. Any party aggrieved by the Authority's decision in this matter may file a Petition for Reconsideration within fifteen (15) days of the entry of this Order.

Sara Kyle, Chairman

H. Lynn Greer, Jr., Director

Melvin J. Malone, Director*

ATTEST:

K. David Waddell, Executive Secretary

* Director Malone concurs in part and dissents in part.