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**
	)	
UNITED CITIES GAS COMPANY, a Division of ATMOS ENERGY CORPORATION, PETITION TO AMEND THE PERFORMANCE BASED RATEMAKING MECHANISM RIDER	)	

CONSUMER ADVOCATE'S POST HEARING BRIEF

Comes now Paul G. Summers, Attorney General and Reporter for the State of Tennessee, through the Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate"), and hereby respectfully submits this Post Hearing Brief pursuant to the hearing officer's order of October 20, 2004.

I. INTRODUCTION

This matter is before the Tennessee Regulatory Authority ("TRA") for review of consolidated dockets. In TRA Docket No. 01-00704 Atmos Energy Corporation ("AEC") objects to the TRA Staff's audit finding regarding the performance based ratemaking mechanism ("PBR") approved by the TRA in TRA Docket No. 97-01364. In TRA Docket No. 02-00850 AEC seeks to amend the PBR. The Consumer Advocate objects to the extraordinary relief sought by AEC in these dockets.

II. ARGUMENT

A. AEC is not entitled to share in the "savings" it seeks in TRA Docket Nos. 01-00704 and 02-00850

Much of the relevant discussion on these issues may be found in the Consumer Advocate's *Memorandum in Support of Partial Summary Judgment Motion* filed on June 17, 2002 and the TRA Staff *Brief in Support of Summary Judgment* filed on July 31, 2002 in TRA Docket No. 01-007004. The record has matured since those presentations. All additions to the record make it more clear that AEC's claims should be rejected.

1. AEC's interpretation of the transportation cost adjustor is flawed.

In proposing a flawed interpretation of the PBR, specifically a flawed interpretation of the transportation cost adjustor, AEC does not provide a market-tested method for the TRA to judge whether AEC ratepayers have benefitted from the incentive program proposed by AEC. The Consumer Advocate requests that the TRA not be swayed by AEC's attempts to distract the participants in this matter from a judgment based on the merits. At the core of this proceeding is the issue of whether the PBR as interpreted by AEC and the proposed amendment to the PBR result in a calculation of "savings" based on the idea that AEC has delivered to its city gate natural gas at the lowest or best possible cost.[1] The difficulty for AEC rests with its inability to establish a measure by which AEC's interpretation of the PBR and AEC's proposed amendment to the PBR will actually result in real savings. When the gas arrives at an AEC city gate the commodity savings can be identified by comparison to the predefined basket of indices[2] established in TRA Docket No 97-01364. The claimed "savings" for transporting the gas to the

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[1] Ron McDowell's pledge to the TRA in testimony in TRA Docket No. 97-01364 was delivery of gas at the "least cost feasible". *Phase Two Order*, p 18.

[2] These indices are based on market transactions between buyer and seller.

city gate is measured, not against a market index, but the **maximum** FERC rate.[3] Unlike the PBR mechanism actually approved by the TRA, which is an example of the spirit and intent of the PBR envisioned in the Phase Two plan, there is no adequate market proxy by which to measure the conduct of AEC.[4] AEC identifies "savings" as transportation purchases at a reduction off the maximum FERC rate, but never compares the delivered price at the city gate to a purchase linked to the predefined market indices actually used in the PBR.[5] What AEC proposes on the surface of its presentations in each docket is already available in the PBR. However, AEC eschews a proper interpretation of the PBR. AEC has not satisfied AEC's burden of proof regarding AEC's objection to the TRA Staff audit findings in TRA Docket 01-00704 and AEC's proposed amendment to the PBR in TRA Docket 02-00850.[6]

Within the record in this matter, this point is probably drawn most distinctly by the exchange between legal counsel for AEC and Consumer Advocate witness Dan McCormac at the hearing of this matter. From page 92 to page 106 of the hearing transcript there appears dialogue which captures the essence of the dispute in this matter. The predefined indices scrutinized at length and accepted as market proxies in TRA Docket No. 97-01364 do not include downstream transportation costs from the pipeline receipt point to the city gate [7] There is no similar market

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[3] This rate is the maximum rate a pipeline may charge and is set by a regulatory agency and does not take into account the market pressures resulting in a gas distribution company like AEC getting rates that are below the maximum rate allowed.

[4] *Direct Testimony of Steve Brown*, July 30, 2004, pp.4, 7 & 10, *Rebuttal Testimony of Steve Brown*, October 5, 2004, p.24

[5] This is the case regardless of the conduct of AEC's commodity purchasing agent

[6] The burden rests with AEC in both dockets in accord with T.C.A. § 65-5-103 and TRA Rule 1220-1-2-.16(2). *See also*, Hearing Transcript, October 19, 2004, Vol.I p 8.

[7] Hearing Transcript, October 19, 2004, Vol.II p 92.

index for transportation contracts, and there never has been and AEC has always known there is no such market index [8] The PBR is intended to capture total cost of gas, which includes commodity and transportation cost.[9] The transportation costs are captured by the PBR in the transportation cost adjuster.[10] There is nothing else in the current PBR plan or the tariff that can reasonably be suggested as a mechanism to capture the reported transportation savings other than the transportation cost adjuster.[11] The transportation cost adjuster allows for a comparison of two costs: 1) the actual cost AEC pays for the natural gas delivered to it's city gate; and 2) the actual cost AEC would have paid if the natural gas was purchased at the Henry Hub and then delivered to the city gate.[12]

The second cost reference contains the avoided cost.[13] Mr. Creamer makes reference in his testimony to an attempt to "reduce" costs as an alternative to the "avoided" costs language actually in the tariff.[14] Mr. Creamer even chooses to highlight AEC's claimed effort to "reduce transportation costs" on page 6 of his rebuttal testimony. It is not "reduced" costs which are addressed by the transportation cost adjustor, but "avoided cost."[15] This distinction is not without

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[8] *Id* , p.92 See also, *Direct Testimony of Steve Brown*, July 30, 2004, pp.4, 7 & 10; *Rebuttal Testimony of Steve Brown*, October 5, 2004, p.24

[9] Hearing Transcript, October 19, 2004, Vol.II p 93

[10] *Id.*, p.94

[11] *Direct Testimony of Frank Creamer*, July 30, 2004 p.8, line 177.

[12] Hearing Transcript, October 19, 2004, Vol.II p. 94

[13] *Id.*

[14] AEC defines the cost as "reduced" costs when compared to the maximum FERC rate. *Direct Testimony of Frank Creamer,* July 30, 2004 p.17

[15] *Rebuttal Testimony of Daniel McCormac*, October 5, 2004 pp. 2-3.

import.[16] While the transportation contracts at issue may have resulted in a reduction in the rate paid when compared to the maximum FERC rate, no leg or section of travel along the pipeline was eliminated or avoided Further, it is not a matter of excluding transportation costs, as AEC tries to suggest, but a matter of adjusting for differing costs related to the difference in receipt points.[17] As more descriptively stated by Dan McCormac:

> So whether you subtract it from a delivery price and then compare it to the index, or you add the actual transportation costs that you avoided paying by buying at the city gate, if you add it to the index and then compare it to your city gate price, you get the same result - Hearing Transcript, October 19, 2004, Vol.II p. 94

It would be inappropriate to change or make adjustments to the predefined market indices as suggested by AEC. There is simply no need. It would be especially problematic to inject into the TRA-approved basket of indices a value that does not reflect market pressures.

Instead, it is appropriate to allow for the transportation costs avoided by purchasing the gas at the city gate.[18] AEC attempts to inaccurately characterize Mr. McCormac's testimony as limiting city gate purchases to local gas purchases [19] This is incorrect. In fact, this highlights the deficiency in AEC's approach in how it wants to interpret the present PBR and how it wants to amend it. It is a mistake to draw the focus away from the transportation cost adjustor by focusing

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[16] On page 17 of his direct testimony, Mr. Creamer states that purchases made under the NORA contract "avoid or reduce" Atmos's transportation cost Ms. Childers, on page 4 of her testimony refers to "avoided costs" regarding the current PBR tariff, but nowhere in her testimony does she refer to "reduced costs." On pages 2 and 4 Mr. Hack of his testimony Mr. Hack specifically notes that the PBR should allow the company to share in savings from "avoided costs" Again Mr. Hack's references are to "avoided costs" but not to "reduced costs." In essence, AEC's claim is analagous to a car salesman who attempts to collect commissions based on the original sticker price

[17] Hearing Transcript, October 19, 2004 Vol.II p. 94 & p.101

[18] *Id.* p.94

[19] *Id* p.98

on the definition of city gate. The city gate purchase is defined by the operation of the transportation cost adjustor For instance, a NORA purchase[20] is treated as a city gate purchase and is consistent with how the transportation cost adjustor works.[21] Potentially there are other purchases that may trigger the transportation cost adjustor which are not local in nature.[22] However, there are at least two (2) components differentiating the transactions. There must be a true bundled price that AEC pays.[23] Moreover, there is no need to use the transportation cost adjustor when the commodity is purchased at receipt points with a related predefined market index, such as the Henry Hub [24] In other words, AEC's claim that all its purchases are city gate purchases is flawed. Otherwise, the transportation cost adjustor becomes more than an adjustor; more than an exception. It becomes the rule The definition by AEC of "city gate" includes every purchase that makes it to the city gate. AEC actually proposes to eliminate the distinction contained within the transportation cost adjustor.

Mr. Creamer's objection, on page 5 of his direct testimony, to Dr. Brown's testimony which states that the current PBR mechanism was intended to exclude the cost of transportation

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[20] This is a NORA purchase properly included in the PBR and is not a purchase as consistent with the flawed interpretation of the PBR by AEC.

[21] Hearing Transcript, October 19, 2004 Vol II p.98

[22] Id.

[23] Hearing Transcript, October 19, 2004 Vol.II p.98 & pp 100-102. AEC dismisses this distinction without analysis, slumping into a school yard approach not appropriate in this arena The lone Exhibit it submitted at the Hearing to address this issue is an invoice that combines commodity and transportation cost, but is not a bundling of any sort. More importantly, AEC fails to take the next step required by the transportation cost adjustor and compare the final price to what could have been purchased at the Henry Hub and delivered to the city gate.

[24] Hearing Transcript, October 19, 2004 Vol.I p.19 AEC witness John Hack stated that gas purchases which are the subject of these dockets are made at the Henry Hub. *See also*, Hearing Transcript, October 19, 2004 Vol.II p 101.

as a factor in determining savings, is inaccurate. Both Dr. Brown and Mr. McCormac speak of excluding the impact of transportation costs.[25] The real goal is to identify the avoided cost. Consequently, an examiner can either do it as excluding the transportation costs involved with the NORA purchase or the city gate purchase or view it as including the transportation cost necessary for any purchase at the Henry Hub. The goal is to put both purchases on an even par so that the NORA purchase can be compared to the predefined benchmarks or basket of indices as established in the current PBR. In the end, it is important to ascertain whether or not the city gate purchase or the NORA purchase is more or less than the purchase would have been had the receipt point been at the Henry Hub. The equation involved is rather simple: a + b = c; therefore a = c - b, where a = the gas cost at the Henry Hub; b = actual transportation costs; and c = the city gate cost. AEC errs in its proposals by trying to redefine b to = the maximum FERC rate, rather than the actual transportation costs. The issue is not whether transportation costs, in a generic sense, are to be taken into consideration. The issue is whether the delivered cost of gas achieves real savings with the avoided transportation costs taken into account. Anywhere AEC makes references to the fact that their interpretation of the NORA contract leads to a calculation that is the same approached used in the 97-01364 proceeding, they are merely claiming that the maximum FERC rate was used then as the cost of transportation. The correct view is that the calculation for the NORA contract used the actual transportation cost as is the case now.

Another critical flaw in Mr. Creamer's reasoning is that he completely ignores the phrase "would have been paid" on Tariff Sheet 45.2 which clearly defines the avoided transportation costs adjuster It states "For city gate purchases, these indexes will be adjusted for the avoided

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[25] *Direct Testimony of Dr Brown*, July 30 2004 p. 15, Hearing Transcript, October 19, 2004 p 94; *Rebuttal Testimony of Daniel McCormac*, October 5 2004 pp 4 and 13.

transportation costs that **would have been paid** if the upstream capacity were purchased versus the demand charges actually paid to the supplier". (Emphasis added.) All this allows is a comparison of two actual costs of transportation. One is the transportation costs that would have been paid if the purchase was made at the Henry Hub. The second is the demand charges actually paid for a purchase at the city gate (or at NORA). These words are directly from Atmos' tariff. These words clearly define the meaning of "avoided transportation costs."[26]

AEC admits that the NORA contract is an exception.[27] AEC admits that the purchase of local gas is the exception.[28] It was these particular exceptions that fostered the transportation cost adjustor.[29] The TRA's accounting for transaction costs are addressed at pp. 17-19 of the Final Phase Two Order Mr. McCormac's testimony was central to the TRA's evaluation of how the PBR would take into account transportation costs.[30] Mr McCormac's testimony in TRA Docket # 97-01364 is fully in sync with his testimony in the present matter and in particular with his testimony beginning at page 92 and ending at page 106 of the hearing transcript in this case.[31]

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[26] *Rebuttal Testimony of Daniel McCormac*, October 5 2004, p 13.

[27] Hearing Transcript, October 19, 2004, pp.39-40 & p.42.

[28] *Id*

[29] TRA Docket # 97-01364, *Phase Two Order*, p 18.

[30] The significance of footnote 46 from the phase II order is important according to Mr. Creamer in that it recognized that gas costs include both the commodity price and the transportation. *Direct Testimony of Frank Creamer*, July 30 2004 p.7, line 36; *See also, AEC Summary Judgment Response,* October 21, 2002, p 8-9.

[31] This may be the precise reason AEC went to such extraordinary lengths to keep Mr. McCormac from testifying in this matter AEC's *Motion to Disqualify Witness,* May 14, 2002.

Further, the Consumer Advocate recognizes that the PBR should embody an inclusive approach. The problem is that AEC offers a false conclusion from these agreed facts and opinions:

> If transportation costs had been excluded from the PBR program and simply passed on in full to the consumers, the PBR plan would have a material defect. UCG could increase its savings on the commodity portion, which it would share in, by entering into relatively high transportation cost arrangements (which would be passed on to the ratepayer) in order to lower commodity costs. Under this scenario, UCG could earn benefits at the ratepayers' expense. This is completely inconsistent with the goals of the PBR program, and explains why transportation costs were included in the program from its inception. *AEC Summary Judgment Response,* filed October 21, 2002, p.9.

This describes the "material defect" Frank Creamer claims exist with the present PBR.[32] The correct interpretation of the PBR demonstrates that this "material defect" is a red herring. As described by Mr. McCormac in his testimony in TRA Docket 97-01364 and in the present dockets, transportation costs are accounted for in the transportation cost adjustor. Properly interpreted, the PBR eliminates the problem of AEC "entering into relatively high transportation cost arrangements."[33] Under the PBR, AEC has incentive to make gas purchases that result in savings. When AEC makes purchases at receipt points other than the Henry Hub AEC, the PBR provides incentives to make gas purchases and transportation arrangements for delivery to the city gate that are at a lower total cost (gas and commodity) than could have been purchased at the

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[32] *Direct Testimony of Frank Creamer*, July 30, 2004, p.8.

[33] Mr. Creamer appears to suggest AEC is capable of manipulating the current PBR for its own good, but at the disadvantage of ratepayers. This conclusion is a compelling reason justifying the call for a full audit of AEC. *Direct Testimony of Frank Creamer*, July 30, 2004 p.8

Henry Hub and then delivered to the city gate.[34] The appropriate mechanism is in place. However, AEC has chosen not to use the method approved by the TRA.

AEC calculated the savings correctly in the first plan year. The 1999-2000 annual report calculated the savings consistent with the PBR.[35] However, in the second plan year AEC made a distinct choice to abandon the PBR to seek "savings" using it's flawed interpretation of the PBR, because AEC could generate more "savings" in this manner and therefore increase the money going to AEC.[36] These "savings", moreover, are not real because they are based on a false proxy.[37]

Under the TIF and AEC's proposed interpretation of the current PBR, AEC intends to calculate the transportation "savings" based on the difference between the actual cost to transport the gas and what this entire transportation path would cost if the maximum FERC rate were used. This amount results in the "savings" AEC seeks to claim. At no time, however, does AEC compare the gas cost (commodity cost plus transportation) for the entire trip to the cost necessary to bring gas purchased at the Henry Hub to the city gate. Because of the "discounts" off the FERC maximum transportation rate, there may be "reduced costs" as it relates to the particular trip AEC has chosen. The problem is that the calculation of the transportation

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[34] AEC must use prudent management to seek the lowest transportation costs for gas delivered from the Henry Hub receipt point to the city gate. AEC must seek the lowest rate for transportation for this purchase as well. The "actual cost" of this transportation option (Henry Hub to city gate) is the "actual cost" to be used in the "transportation costs adjuster" in the PBR for the "upstream capacity" or Henry Hub purchase option.

[35] *Direct Testimony of Pat Childers*, July 30, 2004, p 3.

[36] TRA Staff's *Brief in Support of Motion for Summary Judgement,* filed July 31, 2002, citing Pat Murphy's Affidavit at page 4; *Direct Testimony of Pat Murphy*, July 30, 2004, Exhibit A, pp 17-18.

[37] The use of the maximum FERC rate is discussed in the following section.

"savings" is derived solely from the discount off the maximum FERC rate solely within the construct of the transportation path chosen by AEC. The "savings" are intrinsic only to the price of transportation and is independent of the actual cost of gas at the city gate. This result is the very outcome AEC claims is a problem with the way TRA Staff has interpreted the PBR. AEC's approach simply separates the transactions from commodity and transportation, seeking "savings" based primarily on the transportation element.[38]

There is actually little difference between AEC's interpretation of the present PBR and the TIF [39] Each leaves out the critical performance measure demonstrating the costs "avoided" by purchasing the gas commodity at a different point than the Henry Hub. There is no meaningful comparison performed which would reveal whether the "Atmos trip" results in a higher or lower gas cost to consumers. In fact, there is nothing to limit AEC from adding additional legs to the "Atmos trip" which include "discounts" off the maximum FERC rate.[40]

Using the transportation cost adjustor, AEC has a mechanism for calculating the real savings from its gas purchases that include both commodity and transportation costs. The key is that AEC must compare the delivered price of gas at the city gate to a purchase at the Henry Hub with an appropriate adjustment for the transportation cost AEC is able to avoid by purchasing gas

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[38] *Direct Testimony of Frank Creamer*, July 30, 2004, pp. 8 & 20.

[39] The only advantage the TIF calculation has is it skips the gymnastics involved with Mr Creamer's attempt to combine the gas commodity cost with the transformation cost to assert that the total cost is somehow a bundled component under the present PBR The real difference is that the TIF (although equally flawed) is simpler and easier to calculate and more straightforward in approach. Further, the TIF is a clearer indication of how AEC inaccurately interprets the present PBR.

[40] This possibility appears unlikely. However, AEC has been quite clear that it believes it is not presently under any obligation to deliver gas to its customers at the lowest feasible cost

at the city gate Which price is lower? Before delivering the gas to its customers has AEC achieved the "lowest cost feasible?"

AEC has an obligation to purchase the gas at the least total cost. This was an unequivocal commitment on the part of AEC in getting the PBR approved. The importance of this commitment should not be diluted. In considering Consumer Advocate complaints about the use of an affiliate for gas purchasing, the TRA found the following:

> Further, Company witness, Ron McDowell, testified that the operational plans called for delivery at the ***least cost feasible***, taking into consideration United Cities' transportation and storage contracts and other factors. TRA Docket #97-01364, *Final Order Phase Two*, p. 18 (Emphasis added).

In Mr Hack's direct testimony at page 2, he proclaims that it is Atmos' goal to provide customers with lower rates. AEC should not be allowed to retreat from this commitment as suggested by John Hack [41] In fact, AEC is judicially estopped from this reversal.[42]

Further proof of the flaws with AEC's position is that AEC's proposals depend on the insertion of a false index into the approved basket of indices. The index proposed by AEC has 2 significant problems 1) the index is not market based, and 2) the index was not approved by the TRA

2. The maximum FERC rate does not serve as a proxy for the transportation market.

AEC's claims in both dockets depend on the conclusory assertion that the maximum FERC rate may serve as a proxy for transportation costs. AEC has clearly failed to meet its burden of proof in this instance In fact, the proof in this matter is completely contrary to the idea that the maximum FERC rate is anything like a market index. Additionally, it is inaccurate for

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[41] Hearing Transcript, October 19, 2004 Vol I, pp. 25&34-35

[42] *Bubis v Blackman*, 58 Tenn. App. 619, 435 S.W.2d 492, 498-499; *Melton v Anderson*, 32 Tenn. App. 335, 222 S.W.2d 666 (Tenn. App 1948).

AEC to suggest that any part of the testimony of its witnesses on this subject has not been refuted by the proof in this matter.[43] Certainly, any salient portion of Frank Creamer's testimony has been adequately rebutted in this record. Further, Mr Creamer's testimony at many points is simply devoid of logic. No market index exists for transportation costs.[44] As an alternative, AEC suggests that a proxy for the market might be found in the maximum FERC rate. However, the maximum FERC rate is not set by any market influence. Further, Mr. Creamer chooses to ignore obvious market influences

Dr. Brown and Mr. Creamer are certainly at odds over what constitutes a market indicator. However, the Consumer Advocate and AEC agree that the market for transportation contracts changed in 1999. Specifically, the market changed in the fall of 1999. The AEC admits in its brief at page 42:

> It is obvious that if transportation discounts were not available in the marketplace before 1999, but were available after 1999, that some change occurred in 1999 within the marketplace that altered the economic conditions so as to provide some incentive for the pipelines to offer discounts when they did not have the incentive to do so before The competition between SONAT and East Tennessee referenced in the background allegations of the FTC's complaint merely explains what may have caused the shift in the marketplace that ATMOS has always maintained occurred sometime in 1999

Even with this admission of the rather obvious circumstances, AEC's witness, Frank Creamer, maintains his flawed conclusion that the maximum FERC rate represents the market for transportation contracts. Dr. Brown's research on this issue is conclusive. With the "altered... economic conditions" which "caused [a] shift in the marketplace" in 1999, AEC may not rely on

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[43] *AEC Post-Hearing Brief*, November 22, 2004 p 26.

[44] *Rebuttal of Steve Brown*, October 5, 2004 p. 25, *Direct Testimony of Frank Creamer*, July 30, 2004 p. 11.

a pre-1999 standard as a proxy for the market. To hold the maximum FERC rate up as a proxy, both Mr. Creamer and AEC ignore "altered ... economic conditions" in the "marketplace" which have a rather obvious import. The maximum FERC does not presently represent the appropriate confluence between buyer and seller relationships so as to qualify as a market proxy.

Mr. Creamer maintains his conclusions are correct in the face of numerous important countervailing facts Mr. Creamer identifies the crucial component of the PBR mechanism as to whether it provides for a "pre-agreed upon standard of performance." Creamer Rebuttal, page 3, line 64 However, prior to August 16, 1999, Mr. Creamer did not address in any reports or in testimony before the Tennessee Public Service Commission or the Tennessee Regulatory Authority references to the maximum FERC rate.[45] Mr. Creamer's table included his direct testimony at page 6, is not found anywhere in TRA Docket No. 97-01364.[46] In fact, the entire bundling concept Mr Creamer presents is not found in TRA Docket No 97-01364.[47] There is nothing in TRA Docket No 97-01364 that suggests that the maximum FERC rate was established as a benchmark [48] Negotiated transportation contracts are not mentioned in the PBR.[49]

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[45] AEC discovery response to Request To Produce No. 5, filed September 27, 2004.

[46] *Id.*

[47] *Direct Testimony of Frank Creamer*, July 30 2004 pp. 13-20; AEC discovery response to Request To Produce No. 5, filed September 27, 2004; Record of TRA Docket No. 97-01364.

[48] Hearing Transcript, October 19, 2004 Vol I, p. 59

[49] AEC *Post-Hearing Brief*, November 22, 2004 p 48

The maximum FERC rate is set by a federal regulatory agency.[50] The participants in setting the maximum FERC rate are FERC and the pipelines.[51] That regulatory agency is FERC or the Federal Energy Regulation Commission and it is set based on the underlying cost of the company, plus a reasonable return as determined by FERC.[52]

The basket of indices approved by the TRA in TRA Docket No. 97-10364 are compiled in a completely different manner. There is a demonstrable nexus between the basket of indices and actual transactions within the market place.[53] These are transactions between an actual buyer and an actual seller.[54] The buyer and seller set or agree to the price.[55] Each of these indices within this basket, gives us this compilation of actual transactions to arrive at an average.[56] This average sets the market index.[57] The TRA carefully reviewed these indices in a contested matters culminating in TRA Docket No 97-01364. In the end the TRA did not choose just one market index.[58] In fact, they chose a basket of the market indices available.[59]

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[50] AEC discovery response to Request To Produce No. 2, filed September 22, 2004.

[51] *Id*

[52] *Id*

[53] *Direct Testimony of Steve Brown*, July 30, 2004 pp 17-18

[54] *Id*

[55] *Id*

[56] *Id*

[57] *Id*

[58] TRA Docket # 97-01364, *Phase One Order*, p. 29.

[59] *Id*

One of the market indices, the NYMEX was actually considered for exclusion from the basket.[60] At no time was the maximum FERC rate scrutinized in such a manner by either the Tennessee Public Service Commission or the TRA.[61] In other words, the maximum FERC rate was never in the bundle of factors used to fill the basket. Mr. Creamer's discussion of the bundled market index, was not included in the previous testimony before the Tennessee Public Service Commission and the TRA.[62] None of the discussion on page 13 or 14 of Mr. Creamer's testimony, including the bundled market index, was included in anything that Mr. Creamer or anyone on behalf of Atmos submitted to the commission or the Authority prior to August 16, 1999.[63] AEC's performance under the current PBR plan is evaluated when compared to "predefined benchmarks which act as surrogate for the market".[64] The maximum FERC rate is not one of these predefined benchmarks.[65] Moreover, the maximum FERC rate is a rate that is unique to each pipeline.[66] Each market Mr Creamer identifies is really just for that particular pipeline.[67] In other words, it is a market that is held captive or has an environment that does not extend beyond that pipeline Mr. Creamer's entire market is made up of only one entry. Mr. Creamer characterizes it as "a population of '1'" in his rebuttal testimony at page 2. However,

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[60] *Id*

[61] AEC discovery response to Request To Produce No. 5, filed September 27, 2004.

[62] *Id*

[63] *Id*

[64] *Direct Testimony of Frank Creamer*, July 30, 2004, p.4.

[65] Record of TRA Docket 97-01364; AEC discovery response to Request To Produce No. 5, filed September 27, 2004.

[66] *Direct Testimony of Frank Creamer*, July 30, 2004, p 12

[67] *Id* p.12; *Rebuttal Testimony of Frank Creamer*, October 5, 2004, p 9

this entry itself does have two prices. There is a price for the maximum FERC rate and AEC's "discount" rate. Even within this one unique market, Mr. Creamer has chosen the maximum rate, not the discounted rate as setting the market. Oddly he also turns away from the idea of choosing at least the average between the two.[68]

The more logical approach and one grounded in a solid understanding of economic influences recognizes that a PBR operates through carefully determined formulas which are benchmarks representing the current and future state of the market, not the market's historical condition.[69] As an historical rate, which is not market sensitive, the FERC Maximum Rate is a poor replacement for widely published market indices actually approved in TRA Docket No. 97-01364.[70] Nowhere in the entire record in 97-01364 is there a mention of the FERC Maximum Rate [71] There is no index to serve as the market proxy for transportation prices.[72] The maximum amount cannot be the market rate, if a market exits. If a true market rate exists, it would have to be established by objective market studies and calculation and, moreover, it necessarily postulates that the market rate is lower than the FERC maximum rate. Consider the testimony of James Harrington, company witness:

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[68] The Consumer Advocate does not propose this average as a market indicator. In fact, the real market indicator is the actual price agreed upon by the seller and the buyer The point is that AEC is shopping for a method that serves its interests, not one that furthers the TRA's interests or strikes a balance between its interests and the interests of consumers.

[69] *Direct Testimony of Steve Brown*, July 30, 2004, p. 4.

[70] *Id* , pp 16-17

[71] *Id.*, p. 4

[72] *Rebuttal Testimony of Steve Brown*, p. 22, *Direct Testimony of Frank Creamer*, July 30, 2004, p.11.

> "For an index price to be an accurate measure of the market price, some purchases will be above the index and some will be below " [Direct Testimony of James Harrington, page 24, Docket 97-01364]

No maximum rate can be a part of the PBR, which can be properly implemented only through an index or average reflecting the market as a measure of performance.[73]

B. AEC is attempting to distract the TRA from considering the merits of its request.

Much of AEC's brief is an attempt to distract the TRA from the merits of this matter. AEC hopes that instead of looking to the merits, the TRA will ignore the problems with it's approach in these dockets. This type of discussion does not assist the professional decision making that the Consumer Advocate anticipates from the TRA.

Instead of focusing on the merits of this matter, AEC would like for the TRA to permit a windfall to AEC because the Consumer Advocate is biased or the TRA Staff is somehow inept. In order to turn this school yard trick, AEC stomps its feet and inventively claims it has been misled by the TRA as a result of head nods from the TRA Staff; whines again about rough play of the Consumer Advocate during AEC's two (2) year effort to settle this matter; attempts to assert that the Consumer Advocate is biased against AEC; proclaims on its own that an AEC witness is suspected of lying; and suggests that the efforts of AEC employees somehow caused a dramatic shift in the pipeline transportation market. All this, so that the participants in this matter might ignore AEC's attempt to push an improper agenda related to its PBR.

In essence, AEC accuses everyone in the process of some sort of misdeed in order that it may achieve a windfall at the expense of consumers There is no doubt that the Consumer Advocate is in an adversarial position However, the Consumer Advocate objects to AEC's charge that it is biased. AEC's claim that the TRA Staff is inept is also incorrect. The Consumer

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[73] *Direct Testimony of Steve Brown*, July 30, 2004, pp. 9-10

Advocate would dearly like to see the TRA and its staff watch AEC more closely, but the TRA Staff's participation in the review of AEC's PBR is no reason to sanction an annual giveaway to AEC of over $600,000.00 of Tennessee consumers' money.[74]

The Consumer Advocate takes exception to AEC's claim that AEC's focus in this matter has been to "litigate" or proceed to a hearing on the merits.[75] In fact, AEC has done everything it could to prevent a decision on the merits in this matter. AEC attempted to persuade the TRA Staff to accept a flawed interpretation of the PBR at the January 31, 2001 meeting. Subsequently, AEC submitted inaccurate quarterly reports. AEC requested, pursuant to the TRA Docket No. 97-01364, that the TRA include the NORA arrangement in its incentive based ratemaking program, but included in that filing an exhibit which is inconsistent with the PBR approved in TRA Docket No. 97-01364. When the TRA Staff called AEC on its deception, AEC went into a two (2) year effort to settle this matter short of a hearing on the merits.[76] The settlement process included talks among the parties and even the assistance of a mediator. Now, AEC appears to hope that the TRA will draw on the content of these settlements talks in some way. AEC representations of these settlement discussions are inaccurate More importantly, the substance of these settlement talks have no bearing on the merits of AEC's request and revelation

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[74] The $600,000 figure is a very conservative amount. This is less than the amount in the 2000-2001 audit finding. The amount for following years is likely to be higher. For the plan year 2002-2003 AEC states it would be $760,000. *AEC Post-Hearing Brief*, November 22, 2004 p. 7.

[75] *AEC Post-Hearing Brief*, November 22, 2004, p. 31

[76] This effort concluded with the hearing officer's denial of the motion to approve the settlement between AEC and the TRA Staff. The Consumer Advocate was not a party and had recently renewed its request that the matter move forward toward decision on the merits. *Consumer Advocate's Motion for Disposition of United Cities Gas Company's Motion to Disqualify Witness,* filed November 21, 2003.

of such is improper.[77] Moreover, the statements of legal counsel in a post-hearing brief are not proper evidence.[78] The TRA should disregard AEC's discussion of settlement talks. If the TRA fails to strike or disregard the settlement negotiations, then counsel for AEC must withdraw. Counsel's backdoor effort to testify about the settlement negotiations through AEC's post-hearing brief is incompetent and, if allowed, would require counsel for AEC to withdraw. The hearing officer, therefore, should strike or disregard any reference to settlement material, thereby mooting the need for counsel to withdraw.[79]

More telling are AEC's position changes regarding its interpretation of the PBR. The PBR was approved in 1999. Shortly afterwards, AEC submitted its 1999-2000 annual report which was compiled in reliance on the correct interpretation of the PBR.[80] On January 31, 2001, AEC met with the TRA Staff and claims to have described the change AEC wished to make in its reporting of "savings."[81] Subsequently, AEC submitted two (2) quarterly reports consistent with how it claims to have described its plans to the TRA Staff at the January, 2001 meeting [82] The Consumer Advocate and the TRA Staff have challenged these reports as inaccurate in relation to the proper interpretation of the PBR. However, AEC has also acknowledged that the quarterly reports and its presentation to the TRA Staff are not accurate even under its own flawed

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[77] *Consumer Advocate Division's Reply Opposing Approval of the Proposed Settlement*, May 28, 2004, pp. 2-12. *See also*, Tenn.R.Evid 408.

[78] *Nathaway v Nathaway*, 98 S.W. 3d 675 (Tenn App.2003).

[79] Counsel cannot cure this problem by submitting affidavits from their clients discussing settlement negotiations. In fact, this would merely be an unavailing attempt to corroborate their backdoor testimony, after the evidentiary record in this case has been closed.

[80] *Direct of Pat Childers*, July 30, 2004, p. 3

[81] *Id.*

[82] *Id* , p. 5.

interpretation of the PBR [83] In other words, the presentation to the TRA Staff at the January, 2001 was incorrect even as AEC understands it. In his testimony Mr. Creamer provides a different approach from that used by AEC at the January 31, 2001 meeting, the two (2) quarterly reports subsequently filed by AEC and the 2000-2001 annual report which is the subject of TRA Docket No. 01-00704 [84] The amendment to the PBR plan is different from the approach taken in by Mr. Creamer's approach in TRA Docket No. 01-00704.[85] In fact, the proposed amendment would separate the transportation costs and the commodity costs [86] Separating the two (2) components violates the very rule AEC, and Mr. Creamer, devote so much effort to establish. the PBR should include both commodity and transportation costs.

AEC and its witness, Frank Creamer, suggest that other commissions have approved the use of the maximum FERC rate as some sort of proxy.[87] AEC has actually identified only one state where a similar concept has been approved.[88] It is very important to note as well that of the two (2) Kentucky decisions cited by AEC, one decision is approval of a settlement following a contested matter in the other. The Louisville Gas and Electric Company decision setting the policy of the Kentucky Commission found the following·

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[83] *Id.*, p. 5.

[84] AEC response to Discovery Request No 13 filed September 1, 2004, Docket 01-00704.

[85] *Id*

[86] *Direct Testimony of Frank Creamer*, July 30, 2004, p 20

[87] *Id.*, p 12.

[88] AEC discovery response to Interrogatory No. 5, filed September 1, 2004.

Hence, there is no definitive means by which to say whether or not ratepayers were better or worse off under the PBR compared to traditional regulation. *Modification to Louisville Gas and Electric Company's Gas Supply Clause to Incorporate an Experimental Performance Based Ratemaking Mechanism*, Case No. 20001-017, p. 4, filed in TRA Docket No. 97-01364 on September 1, 2004, as an attachment to AEC discovery responses.

Consequently, no commission has found that the proposals made by AEC in TRA Docket Nos. 01-00704 and 02-00850 actually benefit ratepayers.

1. Estoppel is not available to AEC as a means of forcing the TRA to surrender to its claims without considering the merits of this matter.

Estoppel may not be used by AEC to support AEC's claims. The general rule in Tennessee is that the doctrine of estoppel does not apply to public officials or public agencies.[89] According to *Bledsoe County*, "very exceptional circumstances are required to invoke the doctrine against the State and its governmental subdivisions."[90] "Estoppel is appropriate against government agencies only when the agency induced the party to give up property or a right in exchange for a promise. Thus, estoppel is appropriate when the facts clearly evidence an implied contract, [citations omitted], or when the government induces a private party to relinquish a cause of action[ ]" *Elizabethton Housing and Development Agency, Inc v Price*, 844 S.W.2d 614, 618 (Tenn App 1992)

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[89] *Bledsoe County v McReynolds*, 703 S.W.2d 123, 124 (Tenn. 1985)

[90] *Id*

In the case at bar, neither the TRA nor its staff made any promise to Atmos. Also, Atmos did not give up any property or right in exchange for any alleged promise There clearly is no implied contract, and Atmos did not relinquish a cause of action. Therefore, there is no basis in the law even to reach the issue of estoppel in the case at bar.

"It is significant to observe that in those Tennessee cases where estoppel was applied, or could have been applied, the public body took affirmative action that clearly induced a private party to act to his or her detriment, as distinguished from silence, non-action or acquiescence." *Bledsoe County v McReynolds*, 703 S.W.2d 123, 125 (Tenn. 1985). It is precisely the silence, non-action or (alleged) acquiescence of the TRA and its staff that Atmos alleges as the basis for estoppel. The facts alleged by Atmos clearly do not establish the "very exceptional circumstances" required to invoke the doctrine of estoppel against a state agency.

In *Paduch v City of Johnson City*, 896 S.W.2d 767 (Tenn. 1995), the Paduchs entered into a contract with the State of Tennessee to construct buildings on their property and then lease them to the state. *Id.* at 768. The city refused to issue a building permit until the Paduchs paved the portion of a street adjacent to their land *Id.* The Paduchs paved the portion of the street at their own expense and sued the city. *Id.* The trial court found that the city should not have conditioned the issuance of the building permit on the Paduchs' paving a portion of the street. *Id.* at 769. The Court of Appeals affirmed the decision and increased the damages awarded to the Paduchs. *Id.* In reversing the Court of Appeals, the Tennessee Supreme Court reasoned as follows:

> Like the property owners in *Bledsoe County*, the plaintiffs in the present case were not affirmatively induced by the city to improve a public street. The Paduchs paved Quarry Drive in order to obtain a building permit and in order to provide more convenient access to their property The city's wrongful denial of the building permit did not obligate the city to reimburse the Paduchs for the cost of

> improvements made by them These facts do not present the exceptional circumstances required to invoke equitable estoppel against a public agency. *Id.* at 773.

In *Thompson v. Department of Codes Administration*, 20 S W.3d 654 (Tenn. App. 1999), the Court of Appeals cited and discussed *Paduch* as an example of the significant burden that a party must carry in order to assert estoppel against a government agency. *Id.* at 663-64. The Court made clear that "the type of inducement necessary to impose estoppel on a governmental agency is that which leads to an implied contract between a party and an agency or causes the party to relinquish a cause of action." *Id* at 664. In the case at bar, the alleged acquiescence of the TRA or its staff did not create an implied contract with Atmos and did not induce Atmos to relinquish a cause of action.

> Tennessee recognizes "two distinct types of implied contracts, namely, contracts implied in fact and contracts implied in law, commonly referred to as quasi contracts." [Citations omitted.] A contract implied in fact is "one that 'arises under circumstances which show mutual intent or assent to contract.'" [Citations omitted.] However, in order for a contract implied in fact to be enforceable, it must be supported by mutual assent, consideration, and lawful purpose.
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> ..
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> Contracts implied in law are created by law without the assent of the party bound, on the basis that they are dictated by reason and justice. [Citation omitted.] A party seeking to recover on an implied in law or quasi contract theory must prove the following: A benefit conferred upon the defendant by the plaintiff, appreciation by the defendant of such benefit, and acceptance of such benefit under such circumstances that it would be inequitable for him to retain the benefit without payment of the value thereof. *Thompson v Hensley*, 136 S.W.3d 925, 930-31, (Tenn App. 2003).

In the case at bar, there was no mutual assent or consideration and thus no implied contract in fact. There was no benefit conferred upon the TRA or its staff and thus no implied contract in law. Therefore, there is no basis in the law even to reach the issue of equitable estoppel in the

case at bar. The contracts were executed before any contact with the TRA or the TRA Staff.[91] Even AEC merely claims that the impetus for executing these contracts was AEC's conclusion that the transportation "savings" would be included in the PBR plan approved in 97-01364.[92] John Hack admits that the contracts were renegotiated because of the automatic renewal provision in the contracts.[93] The TRA Staff did not have any input into AEC's decision to enter into the subject contracts.[94]

Estoppel cannot be invoked against the public interest or to defeat the police power. *Memphis Light, Gas & Water Division v Auburndale School System*, 705 S.W 2d 652, 654 (Tenn. 1986). Clearly, reaching the merits of the case at bar is in the public interest. This case should not be decided on the basis of estoppel.

"The courts, too, have held that the doctrine of estoppel generally does not apply to the acts of public agents and should not be held ever to apply to a mere employee or servant as contended for in this cross-bill." *Moulton v Williams*, 343 S.W.2d 857, 861 (Tenn 1961)

"Estoppel is not favored and it is the burden of the party seeking to invoke the estoppel to prove each and every element of an estoppel." *Bokor v Holder*, 722 S.W.2d 676, 680 (Tenn. App. 1986).

> The essential elements of an equitable estoppel as related to the party estopped are said to be (1) Conduct which amounts to a false representation or concealment of material facts, or, at least, which is calculated to convey the impression that the facts are otherwise than, and inconsistent with, those which the party subsequently attempts to assert; (2) Intention, or at least expectation that such

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[91] Hearing Transcript, October 19, 2004, Vol.I pp. 49-50

[92] *Id* , p.50

[93] *Id.* pp.27-28.

[94] *Id* p 50.

> conduct shall be acted upon by the other party; (3) Knowledge, actual or constructive of the real facts. As related to the party claiming the estoppel they are (1) Lack of knowledge and of the means of knowledge of the truth as to the facts in question; (2) Reliance upon the conduct of the party estopped; and (3) Action based thereon of such character as to change his position prejudicially[.] *Buchholz v. Tennessee Farmers Life Reassurance Company*, 145 S.W.3d 80, 84-85 (Tenn. App. 2003).

Considering first the elements that are required of the TRA or its staff, there was no conduct which amounted to a false representation or concealment of material facts. There was no conduct which was calculated to convey the impression that the facts were otherwise than, and inconsistent with, those which the TRA or its staff subsequently attempted to assert. There was no intention or expectation by the TRA or its staff that such conduct would be acted upon by Atmos. There was no superior knowledge, actual or constructive, of the real facts, because neither the TRA nor its staff misrepresented or concealed the real facts. It is clear that the facts alleged by Atmos do not constitute the type of deceptive acts that justify the application of the doctrine of equitable estoppel.

Considering next the elements required of Atmos, there was no lack of knowledge and of the means of knowledge of the truth as to the facts in question, because there were no facts in question that were misrepresented by the TRA or its staff. There was no reliance upon the conduct of the party estopped, because there was no culpable conduct at all by the parties allegedly estopped. There was no action based thereon of such character as to change the position of Atmos prejudicially. Atmos did not change its position prejudicially. It simply booked the profits Under the facts of this matter there is no detrimental reliance.

The elements of promissory estoppel are virtual the same.

> The key element in finding promissory estoppel is, of course, the promise. It is the key because the court must know what induced the plaintiff's action or forbearance, only then would the court be

> able to prevent the injustice resulting from a failure to keep the promise.
> ...
> Regardless of how one arrives at a conclusion that a promise has been made, however, the resulting promise must be unambiguous and not unenforceably vague *Amacher v Brown-Forman Corporation*, 826 S.W.2d 480, 482 (Tenn App. 1991).

In the case at bar, there was no promise by the TRA or its staff.

> No injustice results in refusal to enforce a gratuitous promise where the loss suffered in reliance is negligible, nor where the promisee's action in reliance was unreasonable or unjustified by the promise. The limits of promissory estoppel are: (1) the detriment suffered in reliance must be substantial in an economic sense; (2) the substantial loss to the promisee in acting in reliance must have been foreseeable by the promisor; (3) the promisee must have acted reasonabl[y] in justifiable reliance on the promise as *made Alden v Presley*, 637 S.W 2d 862, 864 (Tenn. 1982)

There was no detrimental reliance that was substantial in an economic sense. Simply making an entry in the books is not a substantial economic change in position. Atmos has not and cannot identify a substantial economic loss that was induced by any alleged promise of the TRA or its staff

> The trend of modern cases is to extend the rule of estoppel to ***promissory statements***, where ***the evidence clearly shows*** that the statements were made ***to induce action*** and ***the promisor was culpable in some respects***. But in order for the doctrine of promissory estoppel to apply, the ***promise*** which is sought to be enforced must have ***induced action*** of a ***definite and substantial character*** by the promisee. Also, ***justifiable reliance*** and ***irreparable detriment*** to the promisee are ***necessary factors*** to enable him to invoke the doctrine of promissory estoppel. Generally speaking, the mere fact that a promisee relies upon a promise made without other consideration ***does not impart validity to what before was void***. There must be some ground for saying that the ***acts done in reliance*** upon the ***promise*** were ***contemplated by the contract***, either impliedly or in terms, as ***the conventional inducement, motive, and equivalent for the promise***. *Foster & Creighton Company v Wilson Contracting Company*, 579 S.W.2d 422, 427 (Tenn. App. 1978) (Emphasis added.)

Clearly, "estoppel is not favored and it is the burden of the party seeking to invoke the estoppel to prove each and every element of an estoppel."[95] In the case at bar, the argument against estoppel is overwhelming. Not only does Atmos fail to prove all of the essential elements of estoppel; it fails to prove any of the essential elements. Similarly, this estoppel theory cannot be adopted by misdirection to allow relief to AEC for the intervening years after the audit

2. AEC's "negotiations" were not the cause of the change in market conditions that occurred in 1999

AEC is concerned that participants in this matter believe that John Hack, Pat Childers and Frank Creamer "lied" in their descriptions of the motivation for and the conduct of the negotiations AEC contends are of some importance in this matter.[96] AEC Brief, p. 36. These concerns probably arise from the fact that the circumstances surrounding the "negotiations" do not support AEC's claims and AEC's witnesses have given different accounts of the negotiations.

AEC claims its employees invested a significant portion of time negotiating the transportation contracts which are the subject of the contest A more careful review of the record reveals that John Hack's time estimates for this work are incomplete with respect to two (2) of the pipelines involved.[97] With respect to the time estimates he did provide, it appears John Hack devoted somewhere in the range of 15 to 30 hours of time in his efforts over a period of approximately eight (8) months on the one contract he gives his total time estimates for.[98] AEC presented no documentation regarding the time AEC employees spent on these "negotiations"

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[95] *Bokor v Holder*, 722 S.W 2d 676, 680 (Tenn. App 1986)

[96] *AEC Post-Hearing Brief*, November 22, 2004, p.36.

[97] Hearing Transcript, October 19, 2004, Vol.I, pp.28-30

[98] *Id* pp.29-30

other than the contracts involved, either in support of AEC's claims or in response to discovery in the case.[99] The contracts themselves lack the professional appearance expected of such an intensive endeavor as AEC claims. In parts, the contracts were not even redrawn but contain hand written adjustments. Moreover, there are no phone records, travel records, time sheets, drafts of the contracts, phone messages, research documents.[100] In fact, the only documents supplied to Frank Creamer by AEC are the contracts themselves [101]

Consider the following varied descriptions related to the negotiations:

-Before the hearing-

"Transportation discounts first became available in the marketplace during the fall of 1999." *Direct Testimony of Frank Creamer*, July 30, 2004, p. 9

"At the January 31 meeting, Atmos told the TRA staff that Atmos, motivated by the PBR provisions allowing the company to share in savings from avoided costs, **had actually begun efforts to negotiate discounted transportation rates in late 1999**". *Direct Testimony of Pat Childers*, July 30, 2004, p. 2. (Emphasis added)

These discounted transportation contracts first came available in late 1999. *Direct Testimony of John Hack*, July 30, 2004, p. 2, line 16.

"By October of 1999, Atmos had successfully completed negotiations for discounted rates for three of its smaller transportation contracts." *Direct Testimony of John Hack*, July 30, 2004, p 2 , line 24.

-At the hearing-

The "negotiations" for Columbia gulf began in "early spring" of 1999. Hearing Transcript, October 19, 2004, Vol.I, p 28

The "negotiations" began eight (8) months before the East Tennessee negotiations were finalized in late 1999. *Id.* pp.29-30.

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[99] AEC discovery response to Interrogatories Nos 1-3, filed September 1, 2004; AEC discovery response to Request To Produce No 5, filed September 27, 2004.

[100] AEC discovery response to Interrogatories Nos 1-3, filed September 1, 2004; AEC discovery response to Request To Produce No 5, filed September 27, 2004.

[101] Hearing Transcript, October 19, 2004, Vol.II p 72.

AEC's original testimony stated that the discounted rates became available in the fall of 1999 and that negotiations for renewal of the contracts began in the fall of 1999. Shortly after that, very shortly afterwards, Atmos had executed contracts for discounted transportation. According to Mr. Hack, by October, 1999. The hearing testimony was different. Obviously reacting to the pressure of Dr. Brown's rebuttal testimony AEC now claims that it began negotiating the transportation contracts much earlier. In fact, according to AEC's witness, the negotiations began as early as March, 1999. This is eight (8) months before the TRA issued it's final order on August 16, 1999. It was not until January 31, 2001, that AEC claims it actually informed the staff of the TRA of it's alternative interpretation of the current PBR [102] Childers Direct, p. 3. During the "negotiations" in 1999 no one from AEC informed the TRA of its alternative interpretation of the PBR: not during the reconsideration phase; nor before the issuance of the final order in August (just two (2) short months from finalizing the first set of contracts).

Additionally, John Hack admitted at the hearing that the "negotiations" were prompted by the fact that the contracts were up for renewal and AEC did not want to just allow the contracts to automatically roll to another five (5) years.[103] AEC had to renegotiate the contracts anyway Mr Hack did not even mention the PBR plan, until prompted later by his attorney [104] Mr. Hack

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[102] *Direct Testimony of Pat Childers*, July 30, 2004, p. 3

[103] Hearing Transcript, October 19, 2004, Vol I, pp 27-28.

[104] *Id* pp.34-35

references items related to the "negotiations" that AEC would have resource expenditures that AEC were required to commit anyway.[105]

AEC makes reference to the fact that Dr. Brown does not have personal knowledge of what Mr. Hack may have done.[106] However, Frank Creamer does not have personal knowledge of Mr. Hack's whereabouts and conduct either.[107] Further, Frank Creamer's testimony at the hearing that he called Duke Energy is inconsistent with his previously filed testimony.[108] Further, it is apparent that AEC kept Mr. Creamer in the dark about the FTC findings, failing to inform him that the FTC's regulatory actions created the opportunity for the "negotiations" referred to by Mr. Hack.[109] In any event, AEC bears the burden of proof on this issue.

All the assets Mr. Creamer references that AEC put at risk in negotiating these contracts are paid for through the rates that are charged to consumers. Creamer Rebuttal, p.3, H58

Additionally, the Consumer Advocate takes issue with the testimony that the financial incentives in the PBR were the "driving force" that motivated AEC. The Consumer Advocate does not take issue with the obvious fact that AEC has attempted to manipulate the PBR through an impossibly strained interpretation of the transportation cost adjustor to increase its revenues. However, these contracts were renegotiated because they were up for renewal. The contracts were settled at a certain amount because of the particular market conditions existing at the time. AEC puts a significant amount of effort into a spurious attempt to discredit Dr. Brown. It is

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[105] *Id* pp.32-33

[106] *AEC Post-Hearing Brief*, November 22, 2004, p.36.

[107] Hearing Transcript, October 19, 2004, Vol.II, p 71.

[108] *Direct Testimony of Frank Creamer*, July 30, 2004, p. 3

[109] Hearing Transcript, October 19, 2004, Vol.II, p. 71.

difficult to understand how AEC looks past the discrepancies in the testimony of its witnesses described above. Further, to suggest Dr. Brown is mistaken based on AEC's claim that it made misrepresentations during the discovery in this matter, is a bit much. Neither Dr. Brown, nor the Consumer Advocate, forced AEC to respond in the manner it chose to the discovery requests which are the subject of page 24 of Dr. Brown's Rebuttal testimony Having admitted that it does not compensate its employees for their efforts regarding the PBR, AEC now deny that answer. To suggest an impropriety of some sort on the part of Dr. Brown is absurd.

As for AEC claimed "most egregious example" of Dr. Brown "misuse of facts" regarding the FTC's January 2000 Order, AEC either does not understand the FTC's work or hopes to distract the TRA from the importance of the FTC's work AEC spends four (4) pages of its brief describing its claims against Dr. Brown.[110] In the end of the discourse AEC admits to the very point Dr Brown makes in his testimony regarding the FTC investigation. In fact, it clearly appears that AEC agrees with Dr. Brown that the market for transportation contracts changed in 1999. Specifically, the market changed in the fall of 1999 The AEC admits in its brief at page 42:

> It is obvious that if transportation discounts were not available in the marketplace before 1999, but were available after 1999, that some change occurred in 1999 within the marketplace that altered the economic conditions so as to provide some incentive for the pipelines to offer discounts when they did not have the incentive to do so before. The competition between SONAT and East Tennessee referenced in the background allegations of the FTC's complaint merely explains what may have caused the shift in the marketplace that ATMOS has always maintained occurred sometime in 1999.

[110] *AEC Post-Hearing Brief*, November 22, 2004, pp. 38-42.

It is significant that AEC attempts to claim that these contracts are difficult to negotiate However, AEC has "discounted" contracts with one half of the pipelines with which it deals.[111] Further, at least two (2) of these contracts are center on the very pricing concerns addressed by the FTC.[112]

Contained within this discussion is an example of the many instances in AEC's presentation of its case in this matter where AEC attempts to mislead the participants in this matter regarding the facts and either ignores pertinent facts in drawing sweeping conclusions or fails to link the facts AEC chooses to highlight to the conclusions it draws. Consider this statement by AEC on page 40-41 of its Brief:

> It is impossible for the FTC-ordered notifications to have motivated or formed the basis for Atmos' negotiations of its transportation discounts. (footnote omitted) The FTC order containing the notification requirement was issued on January 6, 2000, almost a full year after Atmos began negotiating for discounts, and almost four months after Atmos had completed its negotiations with East Tennessee Gas. (citations omitted)

First, if January 6, 2000, is "almost a full year" after AEC claims it began negotiations and four months after AEC claims to have "completed its negotiations" with East Tennessee Gas, then AEC appears to have moved the claimed start date back to January or February of 1999, very near in time to when the TRA announced its decision in TRA Docket No. 970-1364. Second, the

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[111] *Direct Testimony of Frank Creamer*, July 30, 2004, p. 9.

[112] *Direct Testimony of Steve Brown*, July 30, 2004, pp.13-15; *Direct Testimony of Frank Creamer*, July 30, 2004, p. 9.

actual impact of El Paso's rate action influenced the transportation much earlier.[113] Dr. Brown's conclusion beginning on pages 8 and 9 of his Rebuttal Testimony is correct:

> Thus the PBR was not the cause for Atmos receiving lower rates from ETNG and TGP because El Paso offered lowered rates to its customers in general in Tennessee Atmos' lowered rate from ETNG and TGP cannot be the result of the PBR, because Atmos is the only gas distributor with a PBR.
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> Instead, such lower rates were offered by El Paso to many local gas distribution organizations in Tennessee, including Atmos.
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> .....
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> Clearly Atmos (United Cities in 1999) was just one of several beneficiaries of El Paso preventing Sonat from building a competing pipeline in Tennessee. Atmos did not "beat the market", but merely accepted an offer extended by El Paso which meant to block Sonat's effort to build a pipeline.

AEC continues to ignore the simple fact that there were market changes in 1999 that were much more significant than any conduct on the part of any AEC employee.[114]

Moreover, AEC's unsupported conclusion is inconsistent with its claim that the TRA Staff's conduct in this matter is improper. AEC claims that the TRA is estopped from enforcing the PBR as approved in 1999, because of head nods and actions that took place in 2001, even though the subject contracts were all executed in 2000 (including NORA).

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[113] *RebuttalTestimony of Steve Brown*, October 5, 2004, pp 4-9. Information regarding the results of the FTC investigation was released on October 22, 1999. By this time the FTC's investigation was complete The date of "October 22, 2002" in Dr. Brown's Direct Testimony at page 4 is a typo. The result of the "notification" referenced by AEC regarding the January, 2000 FTC Order is that the same market 1999 market conditions carried over into 2000, influences all the contracts at issue in this matter.

[114] The Consumer Advocate will leave it to the TRA to decide if a company's effort to lower prices to keep a specific competitor from entry into the market is anti-competitive

Dr. Brown's statement about whether AEC's witnesses lied was an honest and professional response and gave Atmos witnesses the benefit of any doubts about discrepancies in their testimony.

3. AEC should not be allowed to simply gather the lowest fruit on the tree (the import of the uncollectibles docket)

Earlier this year the TRA decided the "uncollectibles docket" in TRA Docket No. 03-00209. The Consumer Advocate, for the purposes of this argument only, accepts AEC's statement that:

> The uncollectibles ruling simply clarified that the gas costs portion of bad debts is indeed gas costs, and therefore is within the intent of the scope of the PGA rule.
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> AEC Post-Hearing Brief, p. 47.

What AEC attempts to gloss over in its presentation is Mr. McCormac's point that allowing AEC to pass through to customers bad debts, that are by definition difficult to collect, allows AEC to leave the fruit at the top of the tree for consumers to pick. Mr. McCormac compares this circumstance with AEC's proposal to amend the PBR so that AEC may collect the fruit along the bottom of the tree that is within easy reach. Of course, the AEC proposal actually goes a step further By creating "savings" based on a false proxy, AEC is actually taking its fruit right out of the crate after the fruit has already been gathered.

4. An Audit is needed

AEC 's argument regarding the need for an audit is puzzling.[115] What Dan McCormac's direct testimony on page 6 addresses is the need for an audit. AEC and the TRA Staff have also

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[115] *AEC Post-Hearing Brief*, p 48-50

called for an audit.[116] This is not the same reasoning used by the Consumer Advocate, but it arises from the same seed. It is hard to understand why AEC makes such caustic statements about this subject, when it appears that the parties are in agreement that an audit is necessary. Further, Mr. McCormac did not state at the hearing that the Consumer Advocate did not have the time nor the expertise to conduct the audit. H127-129. What he states is that the Consumer Advocate has not conducted an investigation which would lead to the conclusions resulting from an audit of AEC. H129. This audit is better performed by the TRA. H129. One option would be for the TRA to hire a consultant to do the audit The expense of the consultant could be paid through the PGA.

An audit of AEC is suggested by the cavalier manner in which AEC approaches its obligations under the PBR An audit would have other benefits as well. Some type of review is obviously needed given AEC's conduct with respect to the PBR and the proceedings in this matter. At the very least, the review may have brought the FTC's actions to light saving the parties (and the taxpayers of this state) the effort expended in this matter examining AEC's flawed claims [117] AEC did not inform the TRA of its alternative interpretation of the PBR until January 31, 2001 AEC actually attempted to amend the PBR through a informational meeting with the TRA Staff In fact, AEC sought every avenue it could conjure to get the PBR amended without consideration of the merits of the matter. Most telling might be the attitude of AEC regarding it obligations under the PBR. AEC has consistently stated that it does not believe it is under the requirement to negotiate transportation contracts in an effort to lower gas cost without compensation over and above its currently approved rates.

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[116] *Id* , p. 20.

[117] *Rebuttal Testimony of Steve Brown*, October 5, 2004, p. 27

5. AEC wants the TRA to ignore the fact that its requested amendment will result in Retroactive Ratemaking

Implementing the proposed amendment to the PBR with an effective date of April 1, 2001 constitutes retroactive ratemaking. The pertinent facts are undisputed. The amendment to the PBR proposed in TRA Docket No. 02-00850 is a ratemaking [118] AEC seeks to make the amendment to the PBR effective April 1, 2001 [119] The amendment to the PBR has not been approved by the TRA.[120] Whether the decision regarding retroactive ratemaking is strictly a legal question is not up to a non-lawyer to decide. Significant proof on this issue was presented by Dan McCormac and Dr Brown.[121] There was no rebuttal The testimony of Frank Creamer confirms that AEC should have understood that the terms of the PBR had to be established before the PBR could be implemented

> But that's the point of the PBR (sic). It's to establish a target against which the company will be judged next year, the year after, and the year after that. So it makes it clear for everybody to understand and see how rewards are being earned, how penalties are being absorbed, and the standards against which gas purchase prudencies will be measured against." [Hearing Transcript, Vol. II, p. 477]

Further, nothing has changed since the TRA decided that:

> AEC "has the burden to prove that any and all changes in rates are just and reasonable under Tenn Code Ann. §65-5-203(a)." [Phase One Order, p. 29].

Not only does AEC carry the burden in this matter it is clear that it is seeking a rate change with its proposed amendment to the PBR The case law cited by AEC does not change this fact.

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[118] *Direct Testimony of Steve Brown*, July 30, 2004, p.6.

[119] *Petition of AEC*, TRA Docket No. 02-00850.

[120] TRA Docket No. 02-00850.

[121] *Direct Testimony of Steve Brown*, July 30, 2004, pp. 7-9; *Direct Testimony of Daniel McCormac*,July 30, 2004, p. 11.

The facts of *Consumer Advocate Division v Tennessee Regulatory Authority*, 2000 WL 13794 (Tenn. Ct. App. Jan 10, 2000) are complex The case arose after the Tennessee Court of Appeals remanded a prior appeal stating that the TRA's predecessor should have approved the telephone company's price regulation plan based on its rates as of June 6, 1995. *Consumer Advocate Division*, 2000 WL 13794, *1. As a result of the instruction on remand, the TRA entered an order approving a price regulation plan effective as of October 1, 1995. *Id* In the order, the Commission decided that the indexing for annual adjustments was to be calculated from December 1, 1998. *Id.*

Consumer Advocate Division is distinguishable from Atmos's proposed rate change because the TRA is not under the instruction of a high court to approve a regulation plan based on rates existing at a particular time. Although the court did assert that the rate changes in the Authority's order were prospective, the chief reason for the rejection of the retroactive ratemaking argument seems to be a desire to place the telephone company "as nearly as possible in the position they would have been in except for the Commission's error," which it states "was the goal of the Authority on remand." *Consumer Advocate Division v Tennessee Regulatory Authority*, 2000 WL 13794, *3 (Tenn. Ct App. Jan. 10, 2000). The case appears distinguishable partly because of the unique procedural setting in which the Authority had to follow the court's instruction on remand.

Another point of distinction lies in the court's finding that since the order was prospective, the "Authority avoided the charge that future ratepayers would 'pay for past use,' which is the essence of retroactive ratemaking." *Consumer Advocate Division v Tennessee Regulatory Authority*, 2000 WL 13794, *3 (Tenn. Ct App. Jan 10, 2000) (internal citations omitted). There seems to be no such assurance in Atmos's proposed amendment because the

proposal makes adjustments to future rates based upon the claimed savings resulting from a rate change in excess of 3 years before approval. With the "pay for past use" lodestar of retroactive ratemaking in mind, making adjustments to future rates does not in itself prevent the rates from being retroactive

In *AARP v Tennessee Public Service Commission*, 896 S.W 2d 127 (Tenn. Ct. App. 1994), the organization unsuccessfully argued that a provision within a regulatory reform rule that allowed the phone company to share in earnings in excess of a certain range constituted retroactive ratemaking 896 S.W.2d 127, 134 (Tenn. Ct App. 1994). The court rejected the argument because the sharing of earnings at a certain range, which was based on a forecasted range of rates of return locked-in a year before implementation, was deemed to be prospective. Id.

The proposed rate change in this case is not based on a forecasted range that was locked-in a year in advance of implementation. Far from being locked-in in advance of implementation, the rate change reaches back a period of over three years. Still, AEC asserts that these ad-hoc agreements on transportation cost savings after the filing of its annual report for past years is precisely the arrangement that was held valid in *AARP* despite the fact that in *AARP* the forecasted range of rates of return were "locked-in" a year before implementation. *American Ass'n of Retired Persons v. Tenn Pub Svc. Comm'n*, 896 S.W.2d 127, 134 (Tenn Ct App. 1994). Therefore, one arrives at the primary concern It is clear that the rates, for which AEC seeks to make adjustments on now, were set by approval of the TRA before implementation AEC's suggestion that this would be merely a "true-up"[122] really makes the point that the proposal is retroactive. It really depends on what method is used to calculate the "true-up" under

[122] *AEC Post-Hearing Brief*, November 22, 2004, p. 52.

the PBR. If the AEC approach proposed in the 01-00704 Docket and the 02-00850 Docket is used, then the calculation of the "true-up" will be much different than the "true-up" used under the appropriate interpretation of the PBR, because the rate will have changed. Making a rate change effective to April 1, 2001 would constitute retroactive ratemaking. The result is not merely "adjustments in future rates" based upon "agreed-upon losses and savings" as suggested by AEC.[123] There is presently no agreement as to what the "losses and savings" might be. The question of retroactive ratemaking in the 02-00850 Docket deals with the question of what rate applies, i.e. a rate change, rather than when to collect the rate from customers, i.e. an adjustment in rates Instead, a real "true-up" will occur when the TRA rejects AEC's proposals and orders that AEC submit annual reports for the years 2001-2002, 2002-2003 and 2003-2004, which are consistent with the current PBR.

In *Consumer Advocate Division v Tennessee Regulatory Authority*, 1998 WL 684536 (Tenn. Ct. App July 1, 1998) the TRA held a hearing on a rate increase on December 17, 1996 and issued an oral ruling approving the rate increase. 1998 WL 684536 at *1 (Tenn. Ct. App. July 1, 1998). It did not complete a written order of its ruling until after the new rates had gone into effect. Id. The court ultimately rejected the Consumer Advocate's objection that because the written order was issued after the rates went into effect, it was retroactive *Id* at *3. Apart from the procedural fault and an argument questioning the utility company's authority to implement this rate, the ratemaking is essentially prospective The "retroactiveness" in the AEC's proposed

[123] *Id* , p. 51

amendment to the PBR is much more material. The agreement between Atmos and Staff reaches back in time beyond any colorable claim of approval.[124]

Much of AEC's argument regarding the retroactive ratemaking issue, appears another attempt at distracting the TRA. AEC appears to be suggesting that because the court of appeals disagreed with the Consumer Advocate in previous litigation, the Consumer Advocate must be incorrect now. There really seems to be little that much of the case law cited by AEC has to do with the issues presently before the TRA In describing *Consumer Advocate Division v. Tennessee Regulatory Authority* (1998) to support its contention that the amendment to the PBR does not result in retroactive ratemaking, Atmos takes some liberties with the text that do not seem to be justified. Atmos asserts that "the court summarily rejected CAD's argument, noting that the *retroactive* argument "exalts form over substance " Within the "retroactive ratemaking" subsection of the case, the Consumer Advocate Division essentially argued two separate points. *See Consumer Advocate Division v Tennessee Regulatory Authority*, 1998 WL 684536, *3 (Tenn. Ct. App. July 1, 1998). The first, the retroactive argument, was that the written order was signed by the TRA after the rates had already gone into effect. *Id* at *3. The second argument put forth by the Consumer Advocate was that the six month period required for the utility company to implement increased rates during a TRA investigation had not passed because the utility company had to file a new petition after the Public Service Commission changed its name to the Tennessee Regulatory Authority. *Id.* at *3. Atmos' argument, and not the CAD's retroactive argument, however, "exalts form over substance." *Id* at *3.

[124] AEC's proposal actually requests that rates be set retroactive to April 1, 2001, a period in excess of 3 years.

In *Consumer Advocate Division v. Bissell*, 1996 WL 482970 (Tenn Ct. App. Aug., 28, 1996), the court rejected the Consumer Advocate's contention that the TRA's order, which required the utility company to pass a refund to consumers that was created when a rate increase was invalidated by the Federal Regulatory Commission, was retroactive ratemaking 1996 WL 482970 at *3 (Tenn. Ct. App. Aug. 28, 1996) While the court ultimately rejected the retroactive ratemaking argument, it stated "the only offending part of the tariff is the refund provision," which "otherwise operates prospectively " Id. Despite acknowledging that the refund was "offending", the court reasoned that the refund was the third step in a larger proceeding where the two prior steps were governed by federal law. Id.

The court also suggested that if the Consumer Advocate were correct that the refund constituted retroactive ratemaking, the logical conclusion would be that the telephone company would get to keep the refund it received from its supplier. *Consumer Advocate Division v Bissell*, 1996 WL 482970 at *3 (Tenn. Ct. App. Aug. 28, 1996). But previously, the same court added that consumers had some avenues of recourse. "If a company should be allowed to retain its 'windfall profits' because of invalidity of a commission order it would face the possibility of a class action by its patrons for unjust enrichment, or it would be confronted with its retention of excess profit in the consideration of future rate increases " *South Central Bell v Tenn. Pub Svc Comm'n*, 675 S.W. 2d 718, 720-721 (Tenn. Ct. App., 1984).

The cases cited by Atmos are distinguishable from Atmos's present settlement agreement because the cases cited are materially prospective and do not make future ratepayers "pay for past use".

Moreover, the TRA was equally clear on page 29 of the Phase One Order that the NORA contract would be excluded from the PBR plan because it predated the existence of the PBR

plan. For the same reasons, any amendment to the PBR should exclude the impact of contracts executed before the amendment to the PBR is approved.

6. AEC wants the TRA to ignore the importance of risk to incentive based ratemaking

Prudence requires hard work and dedication from AEC's employees whose salaries are paid for by the rate payers of Tennessee [125] These are the very resources cited by AEC as being at risk somehow.[126] AEC's witness certainly made this commitment to the TRA during the proceedings in TRA Docket No. 97-01364.[127] Performance based ratemaking is an appropriate alternative when an acceptable level of risk is assumed by AEC and its rate payers in order that the cost of gas might be lowered. In other words, there are no real savings on reductions in gas cost achieved through a concept that does not include risk, but is merely a result of the work of employees whose salaries have already been paid for by the rate payers of AEC. It is a mistake to ignore the work of the TRA in Docket No. 97-001364. AEC offered no rebuttal to the testimony of the Consumer Advocate regarding the importance of risk related to the previous review by the TRA. Instead, AEC asks that the TRA ignore the importance of the foundation laid by all involved in the TRA's initial approval the PBR.[128] In contrast, the Consumer Advocate's presentation is thoughtful and solidly based on the previous work at the TRA.[129] Much of this foundation is based on AEC witnesses and Dr Frank Creamer.[130] This testimony is clearly

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[125] *Hearing Transcript*, October 19, 2004, p. 58.

[126] *Rebuttal Testimony of Frank Creamer*, October 5, 2004, p 3.

[127] TRA Docket No. 97-01364, *Phase Two Order*, p. 18.

[128] *AEC Post-Hearing Brief*, November 22, 2004, p. 45.

[129] *Direct Testimony of Dr Brown*, July 30, 2004, pp 4-5, 9-14.

[130] Previously, Frank Creamer was an independent consultant. In the present dockets he is an expert hired by AEC for presentation of testimony that favors the requests of AEC.

important to the decision making of the TRA in TRA Docket No. 97-01364. In fact, it is a central part of the petition for approval of the PBR.[131] In initially approving the PBR the Public Service Commission relied directly on the assertion that risk-taking was an integral part of the PBR.[132] AEC should not be allowed to disavow the previous testimony and positions taken in route to seeking approval of the PBR.[133]

IV. CONCLUSION

The foregoing considered, the Consumer Advocate respectfully requests that the extraordinary relief sought by AEC in these dockets be denied.

FOR THE STATE OF TENNESSEE:

RUSSELL T. PERKINS
Deputy Attorney General
B P.R #10282

TIMOTHY C. PHILLIPS
Assistant Attorney General
B.P.R. #12751
Consumer Advocate & Protection Division
425 Fifth Avenue, North, 3RD Floor
Nashville, TN 37243-0491
(615) 741-3533

[131] TRA Docket No. 95-1134, *Application For Performance-Based Ratemaking Mechanism*, p. 2, a copy of which is attached as an exhibit to the TRA Staff's Motion for SJ.

[132] *Id*

[133] *Bubis v. Blackman*, 58 Tenn. App 619, 435 S.W.2d 492, 498-499, *Melton v Anderson*, 32 Tenn. App. 335, 222 S.W.2d 666 (Tenn. App. 1948)

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail, facsimile or hand delivery on December 13, 2004.

Jean Stone, Esq.
Hearing Officer
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505
(615) 741-2904

Randal Gilliam, Esq.
Office of Legal Counsel
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505
(615) 741-2904

Joe A Conner, Esq
Baker, Donelson, Bearman & Caldwell
1800 Republic Centre
633 Chestnut Street
Chattanooga, Tennessee 37450-1800
(423) 752-9527

Timothy C Phillips
Senior Counsel

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