

**IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE**

IN RE:)	
)	
UNITED CITIES GAS COMPANY,)	
a Division of ATMOS ENERGY)	Consolidated Docket Nos. 01-00704 and
CORPORATION INCENTIVE)	02-00850
PLAN (IPA) AUDIT)	
)	
UNITED CITIES GAS COMPANY,)	
a Division of ATMOS ENERGY)	
CORPORATION, PETITION TO)	
AMEND THE PERFORMANCE)	
BASED RATEMAKING)	
MECHANISM RIDER)	

ATMOS ENERGY CORPORATION'S BRIEF ON REVIEW OF *INITIAL ORDER OF HEARING OFFICER ON THE MERITS* AND REQUEST FOR ORAL ARGUMENT

On May 3, 2006, Atmos Energy Corporation ("Atmos" or "Company") filed in this docket a *Motion for TRA Review of Hearing Officer Order* requesting that the presiding panel review the March 14, 2006 *Initial Order of the Hearing Officer on the Merits* ("Initial Order") pursuant to Tenn. Code Ann. § 4-5-315. On August 1, 2006, the parties were directed to submit briefs to the panel.¹ Atmos files this as its initial brief to the panel as directed by Authority.

As discussed more thoroughly below, Atmos requests that the Authority reject the findings of the Hearing Officer for the following reasons:

1. By operation of law, the TIF tariff Atmos proposed in Docket No. 02-00850 became effective in June 2003, when the last TRA order suspending the tariff expired.
2. The Hearing Officer's Initial Order, issued 511 days after the hearing, is null and void due to failure to comply with the requirement in Tenn. Code Ann. § 4-5-314(g) that written orders be issued within 90 days of the hearing.

¹ *Notice of Briefing Schedule* (August 1, 2006) and *Notice of Revised Briefing Schedule* (August 21, 2006).

3. The Hearing Officer's denial of the joint request by Atmos and TRA Staff to allow the Company to withdraw its objections to the 2000-2001 audit at issue in Docket No. 01-00704 is arbitrary and capricious, and deprived Atmos of due process by forcing the Company to litigate objections it wished to concede.
4. The Hearing Officer acted arbitrarily and capriciously in unreasonably disregarding uncontradicted and expert testimony demonstrating that the TIF tariff Atmos proposed and Staff endorsed is just and reasonable.
5. The Hearing Officer acted arbitrarily and capriciously in disregarding the uncontradicted evidence demonstrating that the sharing of transportation savings is within the scope and intent of the original PBR plan.
6. The Hearing Officer's disallowance of the transportation savings is precluded by both the plain language of the original PBR tariff and the doctrine of estoppel.
7. The Hearing Officer's decision violates Atmos' rights to due process and equal protection by refusing to follow the TRA's policy and practice that gas companies which notify the TRA of their intentions with regard to incentive plans, and rely in good faith on the tacit approval they receive in response, should not be penalized.

For these reasons, Atmos requests that the panel reject the findings of the Hearing Officer and issue an order sustaining Atmos' objections to the 2000-2001 audit of its Incentive Plan Account at issue in Docket No. 01-00704, or in the alternative, that the panel issue an order granting the TIF tariff amendment to its PBR plan as requested in Docket No. 02-00850.

I. **REQUEST FOR ORAL ARGUMENT.**

The issues in this case span two separate dockets and over 4 years of litigation. The hearing on the merits was held on October 19, 2004, more than 2 years ago. Given the number of issues presented by these dockets and the length of time that has passed, the panel may benefit from the opportunity to hear oral argument and ask questions of the parties. Therefore, Atmos

respectfully requests that the panel permit the parties an opportunity to present oral argument on issues presented for review.

II. **INTRODUCTION.**

These two dockets were convened to determine:

1. The proper application of Atmos' Performance-Based Ratemaking Mechanism ("PBR") to Atmos' Incentive Plan Account for the 2000-2001 plan year (Docket No. 01-00704); and
2. Whether an amendment to the PBR jointly proposed by TRA Staff and the Company should govern the audits of subsequent plan years (Docket No. 02-00850).

Pursuant to an agreement between the parties, Atmos postponed the filing of all quarterly and annual PBR reports pending the resolution of this docket, and those audit years remain open.² Four audit years have now ended during the pendency of this case: (1) the 2001-2002 audit year; (2) the 2002-2003 audit year; (3) the 2003-2004 audit year; and (4) the 2004-2005 audit year. The Company is now in the midst of the 2006-2007 audit year, which will end on March 31, 2007.

III. **BACKGROUND OF ATMOS' PBR PLAN.**

In 1999, after a two-year experimental period and extensive hearings, and over the objections of the Consumer Advocate and Protection Division ("CAPD"), the TRA approved an amendment to Atmos' tariff implementing a permanent PBR plan. The permanent PBR plan is encompassed within the April 1999 Phase Two Order in Docket No. 97-01364 ("PBR Phase 2 Order"), and became effective April 1, 1999.³

² *Initial Order* (March 14, 2006), p. 5; Hearing Trans. Vol. II, pp. 87-88 (Oct. 19, 2004) (Test. of Pat Murphy).

³ At the October 19, 2004 hearing in this matter, Atmos' Request to Take Official Notice was granted. (Hearing Trans. Vol. I, p. 6.) As such, the TRA may take official notice of all filings in this consolidated docket, the original PBR docket (Docket No. 97-01364), and the docket granting the Company's request to include the NORA Contract in the permanent PBR plan (Docket No. 00-00844).

The purpose of the PBR plan is to eliminate the need for the TRA to hire a consultant to conduct a yearly prudency review of Atmos' gas procurement, storage, and capacity activities, by giving the Company an incentive to find and aggressively pursue cost savings in all of its purchasing activities on an ongoing basis.⁴ Under the PBR plan, Atmos' performance is evaluated on a monthly basis by comparing the Company's purchases with defined benchmarks which act as surrogates for the market.⁵ The PBR creates an incentive for Atmos to out-perform the market in its acquisition of gas supply and transportation services by allowing Atmos to share in savings obtained.⁶

The PBR plan allows Atmos to share in savings it generates through two mechanisms: (1) the Gas Procurement Incentive Mechanism (also referred to as Gas Commodity Cost Mechanism); and (2) the Capacity Management Incentive Mechanism (also referred to as the Capacity Release Sales Mechanism.)⁷ The parties agree that the issues of this consolidated docket deal solely with the proper treatment of transportation costs under the Gas Procurement Incentive Mechanism.⁸

Under the Gas Procurement Incentive Mechanism, Atmos, on a monthly basis, must compare its gas costs to a benchmark amount defined within the PBR.⁹ The benchmark amount consists of an average of various published industry price indexes. If Atmos' gas costs fall within a deadband of 97.7% to 102% of the total of the benchmark amount, no incentive savings or costs are computed.¹⁰ If Atmos' gas costs are above 102% of the benchmark amount, Atmos must pay 50% of the costs incurred above the 102% mark.¹¹ If Atmos' total gas costs for the month are below 97.7% of the benchmark amount, Atmos is entitled to retain 50% of those savings. The

⁴ *PBR Phase 2 Order*, pp. 1-2. The *PBR Phase 2 Order* is attached as an exhibit to the *Initial Order* in this docket.

⁵ *Id.*

⁶ *Id.*

⁷ *Initial Order* (March 14, 2006), p. 5; *PBR Phase 2 Order*, pp. 23-24.

⁸ See *Direct Test. of D. McCormac* (July 30, 2004), p. 6.

⁹ *Initial Order* (March 14, 2006), p. 5; Atmos Energy Corporation Tariff, Sheet Nos. 45.1-45.7 ("PBR Tariff").

¹⁰ *Id.*

¹¹ *Id.*

remaining 50% of any costs incurred or savings obtained outside the deadband are retained by the consumers.¹²

Under the PBR, 100% of the savings generated initially flow through to the consumers through the PGA. Atmos must file annual and quarterly reports of the savings and losses in the Incentive Plan Account, which is the Company's calculation of its share of savings obtained and losses incurred under the PBR mechanisms.¹³ The annual report is audited by the Energy and Water Division (now the Utilities Division) of the TRA, and Atmos is authorized to collect its share of savings (or pay additional costs) through an adjustment to rates over the following 12-month period.¹⁴

IV. **PROCEDURAL BACKGROUND AND TRAVEL OF THE CASE.**

A. *The Audit Case (Docket No. 01-00704).*

On August 7, 2001, Atmos filed its annual report of the Incentive Plan Account for the second year of the permanent PBR plan, which encompassed the period from April 1, 2000 to March 31, 2001.¹⁵ Pat Murphy of the Energy and Water Division conducted the audit. On March 28, 2002, the Staff issued its preliminary audit findings, and the Company responded on April 5, 2002.¹⁶ The Staff's Audit Report was modified to include the Company's responses and filed in Docket No. 01-00704 on April 10, 2002.¹⁷

In its Audit Report, the Staff disallowed the \$526,265 in savings the Company reported from discounted transportation contracts and \$100,947 in savings from the Company's contract with the East Tennessee-NORA gas pipeline ("NORA Contract"). The Company disputed both of

¹² *Id.*

¹³ PBR Tariff at Sheet No. 45.6.

¹⁴ *Id.*

¹⁵ *Initial Order*, p. 6.

¹⁶ *Id.*

¹⁷ *Id.*

these findings.¹⁸ Shortly thereafter, the Authority granted the CAPD's petition to intervene and convened a contested case to determine whether the Company's objections to the two findings within the audit should be sustained.¹⁹ Early on during the contested case, the parties began working toward settlement of the case through mediation.

B. *The TIF Tariff Case (Docket No. 02-00850).*

On August 9, 2002, while the parties conducted discovery in the Audit Case, the Company filed its petition in Docket No. 02-00850 to amend its PBR tariff to add a transportation index factor ("TIF"), which would provide a more detailed and specific method for calculation of savings from discounted transportation contracts.²⁰ The Company's petition stated that it was filed without waiving the Company's objections, defenses and positions taken in the pending Audit Case.²¹ The CAPD intervened in the tariff filing, and on three separate occasions, the TRA suspended the effective date of the TIF tariff pending the resolution of the disputed issues in the Audit Case for the 2000-2001 plan year.²²

C. *Settlement Attempts.*

Settlement negotiations between the parties began shortly after the CAPD intervened in the Audit Case in May 2002.²³ A few months later, during the summer of 2002, it appeared the parties were close to an agreement to resolve both dockets. Atmos had agreed to withdraw its objections to the 2000-2001 audit and allow consumers to retain all of the \$627,212 in savings in exchange

¹⁸ *Id.* at pp. 7-12 (quoting the Audit Report pp. 13-19). The Audit Report is attached as an exhibit to the *Initial Order*.

¹⁹ *Initial Order*, p. 13.

²⁰ *Initial Order*, p. 14.

²¹ TRA Docket No. 02-00850, *Petition* (Aug. 9, 2002), p. 1.

²² *Initial Order*, p. 15.

²³ *Order on Motions for Summ. J.*, (April 1, 2003), p. 13.

for implementation of the TIF tariff going forward.²⁴ Atmos and the Staff were in agreement on all of the settlement terms.

The CAPD agreed with the terms of the settlement, but would not agree to an effective date of April 1, 2001 for the new TIF tariff.²⁵ The CAPD insisted that, in addition to refunding all transportation savings for the 2000-2001 audit year, Atmos also forego recovery of transportation savings for the 2001-2002 plan year, which would result in an additional loss to the Company of approximately \$800,000.²⁶ The CAPD's reasoning was that even though Atmos had not yet filed its annual report for 2001-2002, using the new TIF tariff for the first plan year following the audit year would amount to impermissible retroactive ratemaking.²⁷

At the time of the settlement negotiations in the summer of 2002, the CAPD would, however, agree to an effective date of April 1, 2002 for implementation of the revised transportation calculations of the TIF tariff.²⁸ Since the CAPD was not in total agreement with the settlement, the Staff elected not to finalize the agreement at that time.²⁹

Settlement negotiations continued as the parties engaged in extensive discovery. In June 2003, the parties agreed to mediate both cases in front of Chairman Tate.³⁰ At that time, the only objection the CAPD was asserting to the proposed settlement was its position that an April 1, 2001 effective date for the TIF would constitute retroactive ratemaking. As such, Chairman Tate asked that both parties set forth their positions on that issue, including case cites, in mediation position

²⁴ *Resp. of Atmos to the CAPD's Objections to the Mot. for App. of Settlement Agrmt.*, (May 21, 2004), pp. 2-4. The CAPD waived any confidentiality these settlement negotiations may have had by revealing the content of the negotiations in previous filings in this docket. (See *CAPD Mot. for Extension of Time to Respond to Mot. to Consolidate and for Approval of Settlement Agrmt.*, p. 6.) *Ray v. Richards*, 2001 WL 799756 at *10 (Tenn. Ct. App. July 17, 2001) (noting that "Tennessee has long recognized a 'good-for-the-goose, good-for-the-gander' rule that if a party opens the door for the admission of incompetent evidence, he is in no plight to complain that his adversary followed through the door thus opened....") (internal citations omitted).

²⁵ *Resp. of Atmos to the CAPD's Objections to the Mot. for App. of Settlement Agrmt.*, (May 21, 2004), pp. 2-4.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ See *CAPD's Mot. for Leave to Submit Pre-Mediation Stmt.*, (June 19, 2003), p.1.

statements that would not be shared with the opposing side.³¹ Before the mediation, the CAPD had taken the position it **would** agree to the settlement proposal if the effective date of the TIF were made April 1, 2002, which would force the Company to forego savings for two plan years - the 2001-2002 audit year (approximately \$600,000 in savings) and the 2001-2002 plan year (approximately \$800,000 in savings).³²

At the mediation, the CAPD surprised the parties by announcing it was retreating from its earlier position. The CAPD stated that since so much time had passed since the last settlement discussions, the CAPD's position was now that the effective date of the TIF must be April 1, 2003, not April 1, 2002. The CAPD's new position would force the Company to forego an additional plan year's savings (approximately \$760,000 for the 2002-2003 plan year) for a total of not two, but three plan years worth of savings the Company would not recover, which would require the Company give up over \$2 million.³³ During the mediation, the CAPD steadfastly refused to entertain any settlement proposal that required less than the Company's full relinquishment of the over \$2 million in savings from all three plan years. As a result, no settlement was reached at the mediation.

D. *Atmos and TRA Staff's Joint Proposal to Allow Atmos to Withdraw its Objections in Docket No. 01-00704 and Set Docket No. 02-00850 for Hearing.*

Having been unable to obtain the CAPD's agreement, despite repeated and prolonged settlement discussions, and faced with the prospect of more years of financial uncertainty and protracted litigation with the CAPD, the TRA Staff and the Company presented a joint proposal to the Hearing Officer on March 8, 2004 that would resolve the issues in the Audit Case, and set the

³¹ *Id.*

³² *Resp. of Atmos to the CAPD's Objections to the Mot. for App. of Settlement Agrmt.*, (May 21, 2004), pp. 2-4.

³³ *Id.*

issues in the TIF case for final resolution by hearing.³⁴ The proposal contained in the joint motion reflected substantially the same agreement the Staff and Company reached two years earlier in the summer of 2002: the Company would withdraw its objections in the Audit Case and allow consumers to retain the entire \$627,000 in savings at issue, and proceed, with the support of the Staff, on the TIF case only.³⁵ Since the Company was willing to withdraw all of its objections and accept the 2000-2001 audit as filed, the proposal rendered the issues in the Audit Case moot and would have presented the TIF tariff to the Authority for approval so that the CAPD could finally make its substantive objections known, a hearing could be held, and a final determination could be reached.³⁶

After an extension to allow the CAPD additional discovery, on June 8, 2004, the Hearing Officer denied the Company's and Staff's joint request to allow Atmos to withdraw its objections in the Audit Case and set the TIF tariff case for a full hearing on the merits.³⁷ In August 2004, the Hearing Officer entered a procedural schedule which provided for additional discovery, as well as pre-filed testimony, and which set both dockets for hearing on merits the following October.³⁸

E. ***The October 19, 2004 Hearing.***

The parties simultaneously submitted pre-filed direct testimony on June 30, 2004. Atmos submitted the direct testimony of Pat Childers, Atmos Vice President of Rates and Regulatory Affairs; John Hack, Atmos Director of Gas Supply Planning; and TRA PBR consultant Frank Creamer. The CAPD submitted the direct testimony of analyst Dan McCormac and economist Dr. Stephen Brown. The Staff submitted the direct testimony of TRA financial analyst Pat Murphy.³⁹

³⁴ *Initial Order* (March 14, 2006), pp. 16-17.

³⁵ *Mot. to Consolidate and for Approval of Settlement*, (March 8, 2004), p. 3 and Ex. 1.

³⁶ *Id.*

³⁷ *Initial Order* (March 14, 2006), pp. 16-17.

³⁸ *Id.*

³⁹ *Initial Order* (March 14, 2006), p.18.

After an opportunity for post-testimony discovery, Atmos and the CAPD submitted pre-filed rebuttal testimony of those same witnesses on October 5, 2004. The hearing in both dockets was held on October 19, 2004.

At the hearing, the pre-filed direct and rebuttal testimony of each witness was admitted into the record of the proceedings, and the parties and TRA advisory staff were given the opportunity to cross-examine the witnesses.⁴⁰ The Hearing Officer issued the *Initial Order* on March 14, 2006, and denied Atmos' Motion for Reconsideration on April 18, 2006.

V. **PURSUANT TO TRA RULES, THE TIF TARIFF ATMOS FILED ON AUGUST 9, 2002 BECAME EFFECTIVE JUNE 6, 2003.**

The Company's petition in Docket No. 02-00850 to amend its PBR tariff to add a TIF factor was filed on August 9, 2002. Pursuant to Authority rules, the TIF tariff would automatically become effective 30 days after filing, or on September 9, 2002, unless the effective date was suspended by order of the TRA. Tenn. Rules & Regs. 1220-4-1-.04; *Consumer Advocate and Protection Division v. Tennessee Regulatory Authority*, 2005 WL 3193684 at *7 (Tenn. Ct. App. Nov. 29, 2005) (slip copy) (holding that unless suspended by the TRA, tariffs are automatically effective 30 days after filing and have the force of law).

The TRA suspended the effective date of Atmos' TIF tariff on three separate occasions:

- (1) On September 17, 2002, the TRA issued an order memorializing its August 19, 2002 decision to suspend the effective date of the TIF tariff 90 days, from September 8, 2002 through December 7, 2002.⁴¹
- (2) On December 2, 2002, the TRA suspended the effective date of the tariff an additional 90 days, from December 8, 2002 through March 7, 2003.⁴²

⁴⁰ *Id.*

⁴¹ *Order Suspending Tariff Ninety Days*, (September 17, 2002), p. 1.

- (3) On March 3, 2003, the TRA suspended the effective date of the TIF tariff for the final time for an additional 90 days, from March 8, 2003 through June 5, 2003.⁴³

There is no subsequent order suspending the effective date of the TIF tariff beyond June 5, 2003. As such, as a matter of law, Atmos' TIF tariff became effective June 6, 2003. Tenn. Rules & Regs. 120-4-1-.04; Consumer Advocate, 2005 WL 3193684 at *7.

VI. **THE INITIAL ORDER IS NULL AND VOID.**

The Tennessee Administrative Procedures Act, which governs proceedings before the TRA, *Public Service Commission v. General Telephone Co.*, 555 S.W.2d 395, 397 (Tenn. 1977), requires that all final and initial orders be issued within 90 days after the conclusion of the hearing:

A final order rendered pursuant to subsection (a) or initial order rendered pursuant to subsection (b) shall be rendered in writing within ninety (90) days after conclusion of the hearing or after submission of proposed findings in accordance with subsection (f) unless such period is waived or extended with the written consent of all parties or for good cause shown.

Tenn. Code Ann. § 4-5-314(g). The hearing in this case was held October 19, 2004.⁴⁴ The Initial Order was not issued until March 14, 2006, which was 511 days after the hearing.⁴⁵ Where an agency's failure to issue an order within the prescribed 90 days results in prejudice to a party, the failure to comply with the 90 day requirement renders the order null and void. *Garrett v. State Dept. of Safety*, 717 S.W.2d 290, 291 (Tenn. 1986); *Daley v. University of Tennessee*, 880 S.W.2d 693, 695 (Tenn. Ct. App. 1994); *Murray v. Wood*, 1987 WL 7966 at *4 (Tenn. Ct. App. March 18,

⁴² *Order Suspending Tariff for an Additional Ninety Days, Convening a Contested Case Proceeding, Granting Intervention and Appointing a Pre-Hearing Officer*, (April 9, 2003), p. 1.

⁴³ *Id.*, p. 2.

⁴⁴ *Initial Order* (March 14, 2006), p. 18.

⁴⁵ *Id.*, p. 1.

1987) (unpub.). In this case, Atmos suffered substantial prejudice as a result of the 14 month delay in issuing the Initial Order, and therefore the Order is null and void.

The Initial Order denied Atmos' requested TIF tariff because the Hearing Officer found insufficient evidence in the record to support the TIF methodology.⁴⁶ The Initial Order specifically contemplates that the Company may refile its petition with additional supporting evidence, and provides that "nothing in this order is intended to preclude the Company from filing a similar tariff in the future with additional supporting documentation."⁴⁷ However, because any new tariff Atmos filed after the conclusion of this case would take effect prospectively only⁴⁸, the more than year-long delay in issuing the Initial Order has deprived Atmos of any opportunity to share in the transportation savings the Company achieved during the 14 months it waited for the Initial Order, an amount which is in excess of \$1 million. The prejudice Atmos has suffered as a result of the 14 month delay renders the Initial Order void for failure to comply with the 90 day deadline mandated by Tenn. Code Ann. § 4-5-314. *Cf. Garrett*, 717 S.W.2d at 291 (finding no prejudice where order was filed 112 days after hearing); *Daley*, 880 S.W.2d at 695 (finding no prejudice where order was filed 19 days late due to delay in obtaining the transcript); *Murray*, 1987 WL 7966 at *4 (refusing to reverse agency decision absent a showing of prejudice from the delay).

⁴⁶ *Initial Order* (March 14, 2006), p. 36.

⁴⁷ *Id.*, p. 37.

⁴⁸ Per agreement with TRA Staff, Atmos has not filed any audit reports for the 5 audit years that have passed during the pendency of this case. (Hearing Trans. Vol. II, pp. 87-89.) TRA Staff and Atmos agree that because the Staff has yet to even begin the audits for the 2001-02, 2002-03, 2003-04, 2004-05, and 2005-06 audit years, those audit years remain open. (*Id.*) Therefore, if Atmos' petition in Docket No. 02-00850 is granted, the TIF tariff proposed therein will become effective April 1, 2001, the first audit year following the audit year in dispute in Docket No. 01-00704. (*Atmos' Post-Hearing Brief* (Nov. 23, 2004), pp. 51-54.)

VII. **THE HEARING OFFICERS' DECISIONS IN THIS CASE HAVE DEPRIVED ATMOS OF THE DUE PROCESS PROTECTIONS AFFORDED BY THE STATE AND FEDERAL CONSTITUTIONS.**

The prejudice to Atmos resulting from the 14 month delay in issuing the order is compounded in this case by arbitrary and capricious rulings which have violated the Tennessee Administrative Procedures Act and deprived Atmos of the due process protections of the federal and state constitutions. *See* Tenn. Code Ann. § 4-5-322.

The prospect of prejudice resulting from delay was at the forefront of the proceedings in this case from the beginning. Both Atmos and the TRA Staff recognized the impact of the passage of time on the parties' rights and positions. As Atmos faced years of uncertainty and litigation, the TRA Staff watched 4 years of audit deadlines pass with no standard under which to conduct the audits. The CAPD, as the only party unaffected by the passage of time, attempted to use the delay to its advantage by constructing a retroactive ratemaking argument which, contrary to well established caselaw, would have deprived the Company of the right to share in any savings generated for each audit year commenced during the pendency of the case by delaying the effective date of the TIF tariff until the first full audit year commencing after the decision was rendered in this case. Not incidentally, the CAPD's retroactive ratemaking argument would also invalidate all incentive based ratemaking plans, as well as the PGA rule, both of which CAPD witness Dan McCormac strongly opposes.

In an attempt to avoid continued delay, on March 8, 2004, the Company and TRA Staff made a joint request to the Hearing Officer to permit Atmos to withdraw its objections to the 2000-2001 audit at issue in Docket No. 01-00704 and accept the initial report of the audit staff, thus rendering Docket No. 01-00704 moot. The joint request also asked that the TIF tariff be set

for final resolution by hearing.⁴⁹ The parties' joint proposal also notified the Hearing Officer that TRA Staff was in agreement with the Company that the TIF tariff was in the public interest and should be approved effective with the 2001-2002 audit year, the first year following the disputed audit year.⁵⁰ In reply, the CAPD claimed that it needed more discovery to respond to the TIF tariff, even though at that point the petition had been pending for two years.⁵¹ After being granted several additional months of discovery, the CAPD opposed the joint request to allow Atmos to withdraw its objections to the 2000-2001 audit.⁵² Not content with winning by default, the CAPD claimed that allowing Atmos to withdraw its objections and give up any right to recover its share of transportation savings from the 2000-2001 audit year would deprive the CAPD of the opportunity to litigate, even though Atmos' withdrawal of its objections left nothing to litigate about.⁵³ At a hearing on June 8, 2004, the Hearing Officer denied the Staff and Company's joint request to allow Atmos to withdraw its objections to the 2000-2001 audit.⁵⁴ The Hearing Officer's decision was arbitrary and capricious, and deprived Atmos of due process by forcing the Company to litigate objections it wished to withdraw.

VIII. THE TIF TARIFF IS SUPPORTED BY SUFFICIENT EVIDENCE IN THE RECORD.

The Initial Order finding that the TIF tariff is not supported by sufficient record evidence is in error. The Initial Order states that "the record does not contain sufficient evidence to support the percentage sharing split between the Company and its customers in the proposed TIF Tariff."⁵⁵ However, the Order does not address the fact that the sharing percentages presented in the

⁴⁹ *Motion to Consolidate and for Approval of Settlement* (March 8, 2004), p. 1.

⁵⁰ *Id.*

⁵¹ *CAPD's Motion for Extension of Time to Respond to the Motion to Consolidate* (March 26, 2004), pp. 4-5.

⁵² *CAPD's Objections to the Motion Filed by Atmos and TRA Staff* (May 17, 2004), pp. 8-10.

⁵³ *Id.*

⁵⁴ *Initial Order* (March 14, 2006), p. 16.

⁵⁵ *Initial Order* (March 14, 2006), p. 36.

proposed TIF tariff were initially agreed to by all parties, including TRA Staff and CAPD. As demonstrated in the record, during the summer of 2002, the parties (the Company, TRA Staff and the CAPD) reached agreement on the substance of the TIF tariff, including the sharing percentages.⁵⁶ The CAPD's only objection was to the effective date of the TIF. The CAPD would not agree to an effective date of April 1, 2001, but instead insisted that the TIF not become effective until one year later, April 1, 2002.⁵⁷ The CAPD made no challenge to the appropriateness of the sharing percentages at the hearing.⁵⁸

The parties' agreement aside, the record is replete with uncontradicted evidence supporting the sharing percentages and operation of the TIF tariff. Through pre-filed and live testimony at the hearing, Atmos presented the opinions of Frank Creamer, the TRA consultant who advised on the creation of the original PBR plan, and who is the author of the proposed TIF tariff.⁵⁹ Mr. Creamer testified at length about the marketplace for transportation contracts and the economic realities of such purchases, and provided a detailed explanation of how the TIF tariff would balance the interests of both ratepayers and the Company, while accomplishing the goals and intent of the PBR plan.⁶⁰ TRA Staff presented testimony asserting that it agreed with Mr. Creamer's conclusions.⁶¹ The CAPD did not challenge Mr. Creamer's testimony regarding the market for downstream transportation purchases and the genesis and operation of the TIF tariff at the hearing.⁶² Given the uncontradicted testimony in support of the TIF tariff and the sharing percentages therein, and the failure of the Hearing Officer or advisory staff to ask any additional questions on the issue at the hearing, the Hearing Officer's ruling that the record contained

⁵⁶ *Resp. to CAPD's Objections to the Mot. for App. Of Settlement Agrmt.* (May 21, 2004), pp. 2-4; *Atmos' Post-Hearing Brief* (Nov. 23, 2004), pp. 6-8.

⁵⁷ *Id.*

⁵⁸ Hearing Trans. Vol. II (October 19, 2004), pp. 67-67.

⁵⁹ Hearing Trans. Vol. II, (October 19, 2004), pp. 67-76.

⁶⁰ *Id.*

⁶¹ Hearing Trans. Vol. II (October 19, 2004), pp. 83-84.

⁶² Hearing Trans. Vol. II (October 19, 2004), pp. 67-76.

insufficient evidence on that issue is arbitrary and capricious, and should be reversed. *Tennessee American Water Co. v. Public Serv. Comm'n*, 1985 Tenn. App. LEXIS 2800 at *13 (Tenn. Ct. App. April 11, 1985) (unpub.) (holding that an agency acts arbitrarily when it unreasonably rejects expert opinion or disregards uncontradicted testimony without sufficient reason), *citing South Central Bell v. Tennessee Pub. Serv. Comm'n*, 579 S.W.2d 429 (Tenn. Ct. App. 1979).

The Initial Order is also in error in finding insufficient evidence in the record to support use of the maximum FERC rate as a benchmark for downstream transportation costs. As demonstrated in the record in this case, the TRA has already accepted the maximum FERC rate as the benchmark for downstream transportation costs, and has continuously used the maximum FERC rate as the benchmark for calculating transportation discounts in the Company's NORA contract since the inception of the original PBR plan a decade ago.⁶³ Furthermore, Atmos established through the unchallenged testimony of Frank Creamer that the maximum FERC rate: is the market-clearing price for the majority of the firm transportation contracts industry-wide and is the basis for the negotiations of any future discounts; is the benchmark that would be used for any prudence review of Atmos' purchases; and is the accepted benchmark used by other state public utility commission to measure avoided downstream transportation costs.⁶⁴ Again, Mr. Creamer's assertions were unchallenged by the CAPD at the hearing, and TRA Staff submitted testimony asserting its agreement with Mr. Creamer's conclusions.⁶⁵ In light of the uncontradicted proof in the record that the maximum FERC rate is the appropriate benchmark to measure avoided downstream transportation costs, the Hearing Officers' finding of insufficient evidence to support use of the maximum FERC rate is arbitrary and capricious, and should be reversed. *Tennessee*

⁶³ Hearing Trans. Vol. II (October 19, 2004), pp. 67-76.

⁶⁴ Hearing Trans. Vol. II (October 19, 2004), pp. 67-76.

⁶⁵ Hearing Trans. Vol. II (October 19, 2004), pp. 83-84.

American Water Co., 1985 Tenn. App. LEXIS 2800 at * 19 (holding that the Commission acted arbitrarily by ignoring evidence in the form of expert opinion and acting on speculation).

Atmos and the TRA Staff have produced sufficient evidence in this case, much of it uncontradicted, to show that the TIF tariff is just and reasonable and in the public interest. The Hearing Officer's finding to the contrary is unreasonable, and should be reversed.

IX. THE SHARING OF SAVINGS FROM DISCOUNTED TRANSPORTATION RATES THROUGH THE TRANSPORTATION COST ADJUSTER IS WITHIN THE INTENT AND SCOPE OF THE ORIGINAL PBR PLAN.

The Initial Order found that because transportation discounts were not specifically referenced within the PBR plan, the TRA could not have intended that such discounts be included within the plan.⁶⁶ This finding is in error. The evidence demonstrated, and all parties in this case agreed, that the TRA's intent in implementing the PBR was to avoid the necessity of prudence audits by putting incentives in place that span the entire spectrum of gas purchasing activities, including transportation.⁶⁷ Further, the evidence demonstrated, and all parties agree, that if the transportation costs are wholly excluded from the PBR, as the Initial Order found, it would be impossible to achieve the original goal and intent of the PBR, and the TRA would have no choice but to conduct prudence audits, the precise activity the PBR was designed to avoid.⁶⁸ Just as the TRA found in Docket No. 03-00209 that recovery of the gas cost portion of bad debt is within the intent and scope of the PGA despite the fact the PGA rule did not address the issue specifically, the TRA should find in this case that the sharing of transportation discounts is within the intent and scope of the original PBR plan. The Initial Order's finding to the contrary is arbitrary and

⁶⁶ *Initial Order* (March 14, 2006), p. 32.

⁶⁷ Hearing Trans. Vol. II (October 19, 2004), pp. 83-84; 93; 99-100; *Staff Memo. in Supp. of Mot. for Summ. J.* (July 17, 2002), pp. 10, 22-23; *CAPD Memo. in Supp. of Mot. for Partial Summ. J.* (July 17, 2002), p. 18.

⁶⁸ *Direct Test. of Dan McCormac*, p. 6 ; *Rebuttal Test. of Dr. Stephen Brown*, p. 25; *Staff's Resp. to the CAPD* (May 21, 2004), p. 13.

capricious and should be reversed. *Tennessee American Water Co.*, 1985 Tenn. App. LEXIS 2800 at * 19 – 22.

X. **STAFF’S DISALLOWANCE OF THE TRANSPORTATION SAVINGS IS PRECLUDED BY THE PLAIN LANGUAGE OF THE PBR TARIFF.**

The binding regulation contained within the PBR tariff, which has been approved and accepted by the Authority, states that Atmos’ incentive plan accounts “shall” be deemed in compliance for the periods of time covered by the quarterly reports if the TRA Staff does not object to such reports within 180 days.⁶⁹ The language of the PBR tariff is unequivocal: it requires Atmos to file annual and quarterly reports, and then states that the Incentive Plan Account will be deemed in compliance unless the Authority objects to *such reports* within 180 days, clearly indicating that the obligation to object applies to both quarterly and annual reports.⁷⁰ Atmos filed two quarterly reports which included the transportation savings, with no objection from TRA Staff.⁷¹ The Company did not try to hide the submission of these savings, but instead held a meeting with TRA Staff to notify it of the additional savings and how those savings would be reflected in the upcoming reports.⁷² Despite the Staff’s failure to object, the Initial Order upheld the Staff’s audit findings disputing the savings amounts. This holding is arbitrary and capricious.

The Initial Order applied a strict construction to that portion of the PBR tariff describing the Company’s sharing, finding that because discounted transportation contracts were not specifically referenced within the PBR, the TRA did not intend to include such discounts in the plan.⁷³ However, despite the fact that the Initial Order concedes the language of the objection

⁶⁹ Tariff Sheet 45.6.

⁷⁰ *Id.*

⁷¹ *Initial Order* (March 14, 2006), p.35.

⁷² *Id.*

⁷³ *Initial Order* (March 14, 2006), p. 32.

provision of the PBR tariff is “unclear,” the Order abandons the strict construction it applied to other portions of the tariff, and instead finds that, with regard to the objection provisions, the intent is something different than what the language says. Rather than apply the language as written, the Order finds that where the tariff references quarterly and annual reports (plural), and then requires the Staff to object to *such reports* (plural) that the language actually was intended to refer to only one of the reports – the annual report.⁷⁴ This finding is arbitrary and capricious and should be reversed. Atmos filed two quarterly reports in which it took pains to alert the Staff that it included the transportation savings, with no objection from TRA Staff. Under the plain language of the PBR tariff, the Company’s filings highlighting those savings are deemed in compliance, and the Staff’s disallowance of those savings must, under the terms of the tariff, be rejected.

XI. THE FINDINGS IN THE AUDIT REPORT ARE BARRED BY THE DOCTRINE OF ESTOPPEL.

The record in this case demonstrates that on January 31, 2001, shortly after successfully negotiating the discounted transportation contracts at issue, Atmos held a meeting with TRA Staff and explained in detail how the discounts were negotiated and how the savings would be reported and calculated under the PBR plan in the Company’s upcoming reports.⁷⁵ At the meeting, the Staff indicated that they agreed with Atmos’ position that the savings from the negotiated transportation discounts were included within the avoided costs provisions of the PBR plan, and that they accepted Atmos’ proposed method of calculating and reporting the savings.⁷⁶ At no point during the January 31, 2001 meeting did the Staff give any indication that Atmos could not rely on the Staff’s statements, or make any suggestion that Atmos needed to take any further

⁷⁴ *Initial Order* (March 14, 2006), p. 35.

⁷⁵ *Initial Order* (March 14, 2006), pp. 21-23.

⁷⁶ *Id.*

action before proceeding with its proposed reporting and calculations.⁷⁷ Atmos filed two quarterly reports which calculated the transportation savings exactly as described and agreed to in the meeting with TRA Staff.⁷⁸

The Initial Order found that despite Staff's actions, the audit findings were not barred by the doctrine of estoppel because the element of detrimental reliance was not present.⁷⁹ The finding is in error. The Order ignores the evidence in the record that the Company booked \$600,000 in income based on Staff's agreement with the proposed calculation method.⁸⁰ This reliance was clearly induced by the Staff's affirmative actions at the meeting with Atmos which led Atmos to believe Staff agreed and approved of the proposed reporting and calculation methods.⁸¹ As such, the element of detrimental reliance is present, and Staff is now barred from taking an inconsistent position and contesting the inclusion of the transportation savings as avoided costs under the PBR. The Hearing Officer's finding to the contrary is inconsistent with the evidence in this case, and should therefore be reversed. *Tennessee American Water Co.*, 1985 Tenn. App. LEXIS 2800 at * 14 (holding that agency action which is counter to the evidence presented is arbitrary).

XII. THE INITIAL ORDER VIOLATES ATMOS' RIGHTS TO DUE PROCESS AND EQUAL PROTECTION.

Two recent decisions represent a clear indication of TRA policy regarding the disallowance of incentive plan items for gas companies. Recognizing that the complex and ever changing nature of the natural gas industry prevents the Authority from being able to draft an incentive plan that will foresee and specifically address all possible purchasing arrangements, the TRA has twice refused to penalize gas companies that notify the Authority of their intentions, and

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Initial Order* (March 14, 2006), pp. 34-35.

⁸⁰ *Hearing Trans. Vol I* (October 19, 2004), pp. 60-61.

⁸¹ *Id.*

rely in good faith on the tacit approval they receive in response. In the case of Nashville Gas' 2003 plan year audit, the TRA Staff found that, under the terms of the company's incentive plan, Nashville Gas is not entitled to share in the proceeds of the fee paid by its asset manager.⁸² Nevertheless, the Staff declined to disallow those savings for the audit year, on the grounds that the company had acted in good faith and had relied on previous Authority approval in including those savings in its reports.⁸³ Instead, the Staff recommended that the TRA suspend Nashville Gas' incentive plan going forward until the issue of inclusion of the asset management fee could be resolved.⁸⁴ The TRA declined to suspend the incentive program, and instead asked for input from the company on the issue.⁸⁵

The second decision occurred on December 13, 2004. There, the Authority unanimously voted to reject a Staff finding disallowing reported savings in Chattanooga Gas' 2003 plan year audit.⁸⁶ Staff found that Chattanooga Gas had violated the terms of its tariff by entering into a flat-fee asset management arrangement with its affiliate, and sharing that fee rather than tracking the off-system sales individually and sharing in the profits as required by the terms of the tariff.⁸⁷ The TRA unanimously rejected the Staff's finding and permitted Chattanooga Gas to retain its share of the fee.⁸⁸ In rejecting the Staff finding, Director Jones noted for the record that his decision was influenced by the fact that Chattanooga Gas "has been very forthcoming in notifying the TRA of the agreement and its intended treatment of the revenues generated from that agreement and has included those revenues in previous tariff filings and audits."⁸⁹ Director Jones found it significant that at no point did the TRA notify Chattanooga Gas of a potential tariff violation, despite the fact

⁸² TRA Docket No. 03-00489, *Audit Report* p. 13.

⁸³ *Id.*

⁸⁴ *Id.* at p. 14.

⁸⁵ TRA Docket No. 03-00489, *Order* (October 1, 2004).

⁸⁶ TRA Docket No. 03-00516, *Trans. of Proceedings* (December 13, 2004), pp. 59-60.

⁸⁷ TRA Docket No. 03-00516, *Audit Report*, p. 9.

⁸⁸ TRA Docket No. 03-00516, *Trans. of Proceedings* (December 13, 2004), pp. 59-60.

⁸⁹ *Id.* at p. 52.

that Chattanooga Gas made several filings.⁹⁰ Director Tate agreed, finding that “it does seem reasonable that the company relied on, if not actual approval, some kind of tacit approval over the past few years”⁹¹ Director Kyle also agreed that the Staff’s disallowance should be rejected, finding the TRA’s decision “consistent with the policy constantly following by the Authority regarding actual cost adjustment filings.”⁹²

Atmos is entitled to the same deference extended to Nashville Gas and Chattanooga Gas. Atmos met with Staff to notify it of the newly negotiated discount transportation contracts, it reported the savings as outlined in the meeting, and the Company relied on the Staff’s indication of approval. The Company has acted in good faith. The Initial Order acknowledges as much.⁹³ Despite this acknowledgement, the Order fails to apply the TRA’s established policy in an evenhanded manner and instead treats Atmos differently from other similarly situated utilities, with no rational basis. The Order’s failure to apply the TRA’s policy to Atmos is arbitrary and capricious, and violates the due process and equal protection provisions of the state and federal constitutions. *Champion’s Auto Ferry, Inc. v. Michigan Public Service Com’n*, 588 N.W.2d 153, 164 (Mich. Ct. App. 1998) (“The Equal Protection Clause of the Fourteenth Amendment directs that all persons similarly situated shall be treated alike.”); *Wisconsin Hosp. Ass’n v. Natural Resources Bd.*, 457 N.W.2d 879, 891 (Wis. Ct. App. 1990) (noting that equal protection challenge is warranted when an administrative agency’s ruling treats similarly situated individuals differently); *Anco, Inc. v. State Health and Human Services Finance Com’n*, 388 S.E.2d 780, 786 (S.C. 1989) (“Equal protection requires that all persons of the statutory class shall be treated alike under similar circumstances and conditions, both in the privileges conferred and in the liabilities

⁹⁰ *Id.* at p. 52.

⁹¹ *Id.* at p. 54.

⁹² *Id.* at p. 56.

⁹³ *Initial Order* (March 14, 2006), p. 35.

imposed.”); *Miller v. State Civil Service Com’n*, 540 So.2d 482, 485 (La. Ct. App. 1989) (“the right to equal protection requires that state laws or administrative rules affect all persons similarly situated alike.”).

XIII. **CONCLUSION.**

The Initial Order of Hearing Officer on the Merits contains errors of fact and law, is procedurally deficient, and is arbitrary and capricious. Therefore, Atmos requests that the panel reject the findings of the Hearing Officer and issue an order sustaining Atmos’ objections to the 2000-2001 audit at issue in Docket No. 01-00704, or in the alternative, an order granting the TIF tariff requested in Docket No. 02-00850.

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

By: 

Misty Smith Kelley, TN BPR # 19450
1800 Republic Centre
633 Chestnut Street
Chattanooga, TN 37450-1800
(423) 209-4148
(423) 752-9549 (Facsimile)
mkelley@bakerdonelson.com
Attorney for Atmos Energy Corporation

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing has been served via electronic mail, facsimile or hand delivery, upon the following this the 19th day of October, 2006:

Timothy C. Phillips
Stephen R. Butler
Office of the Attorney General
Consumer Advocate & Protection Division
P.O. Box 20207
Nashville, TN 37202

Gary Hotvedt
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243

A handwritten signature in black ink, appearing to read "G. Hotvedt", is written over a horizontal line.