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	)	

JOINT REPLY BRIEF OF THE CONSUMER ADVOCATE AND THE TRA STAFF IN OPPOSITION TO THE REQUEST OF ATMOS ENERGY CORPORATION TO REVIEW THE HEARING OFFICER'S ORDER

Comes now Robert E. Cooper, Jr., 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 the TRA Staff of the Utilities Division ("the Staff"), as a party to the above named dockets, and jointly submit this reply brief in opposition to *Atmos Energy Corporation's Motion For TRA Review Of Hearing Officer Order* and the brief titled *Atmos Energy Corporation's Brief on Review of Initial Order of Hearing Officer on the Merits and Request for Oral Argument* ("Atmos Review Brief") filed October 19, 2006. The Consumer Advocate and the Staff object to the relief sought. The arguments set forth by Atmos Energy Corporation ("Atmos") have been weighed in painstaking fashion. The findings, conclusions and decisions set forth in the

April 18, 2006 *Order Denying Motion for Reconsideration* and the March 14, 2006 *Initial Order of the Hearing Officer on the Merits* are compelling.

I. INTRODUCTION

This matter is before the Tennessee Regulatory Authority ("TRA") for review of consolidated dockets. In TRA Docket No. 01-00704, Atmos objects to the TRA Staff's audit finding regarding the performance based ratemaking mechanism ("PBR") approved by the TRA in Docket No. 97-01364. In TRA Docket No. 02-00850, Atmos seeks to amend the PBR. In both dockets, Atmos attempted to establish the maximum rate for transportation of natural gas allowed by the Federal Energy Regulatory Commission ("FERC") as a market proxy. The Consumer Advocate and Staff objected to the extraordinary relief sought by Atmos in these dockets. On March 14, 2006, the Hearing Officer ruled against Atmos on all matters at issue. On March 29, 2006, Atmos filed a motion requesting the Hearing Officer to reconsider her decision.

To say that these issues have been briefed fully in the past is certainly an understatement. Relevant discussions on these issues may be found in the Consumer Advocate's *Memorandum in Support of Partial Summary Judgment Motion* filed on June 17, 2002; the TRA Staff *Brief in Support of Summary Judgment* filed on July 31, 2002; *Consumer Advocate's Post Hearing Brief* filed on December 13, 2004; *Initial Order of Hearing Officer* on the Merits entered March 14, 2006; *Consumer Advocate's Reply to Motion for Reconsideration* filed on April 12, 2006; *Staff's Response to Atmos Energy Corporation's Motion for Reconsideration to Hearing Officer* filed on April 12, 2006; and the *Order Denying Motion for Reconsideration* entered on April 18, 2006.

II. ARGUMENT

1. The TIF Tariff Did Not Become Effective on June 6, 2003.

The Company's argument that the transportation index factor ("TIF") tariff became effective on June 6, 2003 is incorrect for multiple reasons. On August 9, 2002, Atmos filed a petition in TRA Docket No. 02-00850 to amend its PBR tariff. However, Atmos filed its petition in the alternative to the relief sought by Atmos in TRA Docket No. 01-00704. Atmos filed the petition specifically reserving the claims laid upon rate-payer funds made in TRA Docket No. 01-00704.[1] The two (2) dockets were consolidated and went to a hearing on the merits. Success by Atmos in TRA Docket No. 01-00704 would have been a disaster to rate-payers, resulting in more money flowing to Atmos below the line than Atmos would have garnered through its petition in TRA Docket No. 02-00850. There is no doubt had Atmos prevailed on its claims in TRA Docket No. 01-00704, then Atmos would have taken the relief granted as a result of its claims in TRA Docket No. 01-00704, rather than the alternative pleading it made in TRA Docket No. 02-00850.

The technical infirmities to this first claim of Atmos are fatal. Put simply, Atmos is not permitted to raise new issues subsequent to the hearing on the merits. By failing to plead this issue prior to its filing of the motion to reconsider, Atmos has waived the issue. "A party waives all defenses and objections which the party does not present either by motion as hereinbefore provided, or, if the party has made no motion, in the party's answer or reply, or any amendments thereto ... ." Tenn. R. Civ. P. Rule 12.08. Amendment of the pleadings at this time would not be appropriate, because the issue was not "tried by express or implied consent of the parties." Tenn. R. Civ. P. Rule 15.02.

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[1] TRA Docket No. 02-00850, Petition by [UCG] to Amend the [PBR] Mechanism Rider to its Tariff, p. 1, filed August 9, 2006.

Also, in its Motion for Reconsideration, Atmos failed to comply with the TRA rule regarding petitions for reconsideration.

> If the petitioners seek to present new evidence, the petition shall contain a statement of the cause for the failure to introduce the proposed new evidence in the original proceeding, a detailed description of any such new evidence proposed to be introduced, including copies of documents sought to be introduced, identities of proposed witnesses, and summaries of any testimony sought to be presented.

Tenn. Comp. R. & Regs. 1220-1-2-.20(1).

Furthermore, "[i]t is well-settled that issues not raised at trial may not be raised for the first time on appeal." *Cantrell v. Walker Die Casting*, 121 S.W.3d 391, 396 (Tenn. Ct. App. 2003). This rule applies to post-hearing briefs, including the Company's Motion for Reconsideration.

> No matter how informal the proceeding, a person appearing before an administrative tribunal must make timely objections to procedural errors and must raise in a timely manner the issues and questions he deems material before he will be permitted to raise them in a petition for review. To require otherwise would undercut the effectiveness of administrative proceedings and would cause serious waste of effort by the parties and the administrative tribunal itself. ... ***We therefore hold that ITI*** cannot raise in this appeal, and ***could not validly raise in its post hearing brief to the PSC, issues which it clearly chose not to pursue at the hearing itself.***

In re Billing and Collection Tariffs of South Central Bell, 779 S.W.2d 375, 380 (Tenn. Ct. App. 1989) (Emphasis added). Because Atmos did not raise this issue in the pleadings or at the hearing, it cannot raise the issue for the first time in a motion for reconsideration subsequent to the hearing.

In any event, Atmos is incorrect about this issue factually. Atmos has agreed that the tariff is not in effect and has represented to the TRA that the tariff is not in effect. In its Motion to Consolidate and for Approval of Settlement Agreement filed on March 8, 2004, Atmos said, "Docket No. 02-00850 was placed on hold pending the resolution of the audit case in Docket No. 01-00704

since resolution of the audit case would materially impact Docket No. 02-00850." Based at least in part on the Company's representation that Docket No. 02-00850 "was placed on hold," the Hearing Officer's Order Granting Motion to Consolidate and to Approve Settlement Agreement in Part, Granting Motion for Extension of Time to Respond in Part, and Setting Procedural Schedule, said, "Docket No. 02-00850 shall be deemed closed after entry of this Order." (Order, p. 5).

At the March 3, 2003 TRA Conference, Atmos represented to the TRA that the Company would not and could not know whether it would pursue the TIF tariff until after the resolution of the contested case.

> Director Jones: I will accept that amendment, and can I add a further one to that?
>
> And, Mr. Conner, this is a statement and question for you. I'm assuming that if the -- if you prevail in Docket 01-00704 that you would not desire to go forward with this tariff in Docket 02-00850; is that correct?
>
> Mr. Conner: Not necessarily, Director. What -- we may wish to proceed in an effort to clear up any confusion to the extent they're -- the staff may find that there is some confusion in the original language, and so there is a possibility that in the event that we are successful in the prior pending case that we may also wish to proceed, but in that instance we would hope that it would be with the approval of both the Consumer Advocate's office as well as the staff and not in an adversary nature.
>
> Director Jones: So, regardless of how -- regardless of the outcome in 01-00704, you would pursue this particular tariff filing?
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> Mr. Conner: Well, again, I can't really say for sure until I know what the outcome is.
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> Director Jones: Okay.
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> Mr. Conner: But I think to say that this case would simply go away based on a particular result in the prior proceeding, I can't say that either at this stage.
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> Director Jones: I understand. I will accept that amendment.

(Transcript, page 113, line 16 through page 114, line 19, March 3, 2003 Conference).

The uncontradicted testimony of Ms. Pat Murphy at the hearing on the merits, during the cross examination by the Company's lawyer, was the following:

> Question: With respect to the 850 docket, isn't it true that there has been also an agreement to stay the implementation of the 850 docket pending the outcome of this proceeding?
> Answer: Yes.

(Hearing Transcript, page 88, lines 15-19).

Given that Atmos intentionally elicited this testimony at the hearing with a leading question on cross examination, it is both inexplicable and unacceptable that Atmos now seeks to refute the testimony.

> The rule is well established that during the course of litigation a party is not permitted to assume or occupy inconsistent and contradictory positions, and while this rule is frequently referred to as 'judicial estoppel,' it more properly is a rule which estops a party to play fast-and-loose with the courts.

Webber v. Webber, 109 S.W.3d 357, 359 (Tenn. Ct. App. 2003).

2. The Initial Order is Not Null and Void.

The statute on which Atmos relies for its argument that the initial order is null and void does not say that the failure to render the order within 90 days makes the order null and void. "A final order rendered pursuant to subsection (a) or initial order 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). It also is significant that none of the three cases cited by Atmos held that the decision at issue was null and void. This argument by Atmos is unprecedented at the TRA and would have an unacceptably chaotic effect on the regulation of public utilities in Tennessee. If the Hearing Officer cannot rule against Atmos and for Tennessee consumers after 90 days, she also cannot rule for Atmos and against

Tennessee consumers after 90 days. The apparent result would be that the entire process of litigating this contested case would have to start from scratch, which would be an absurd result.

In *Garrett v. State*, the Tennessee Supreme Court refused to nullify an administrative order for forfeiture of a truck.

> As we have said in the past, forfeiture statutes are to be strictly construed because forfeitures are not favored in the law. Also, because forfeiture proceedings are *quasi criminal* in nature, we cannot ignore the presumption of innocence that attaches in our courts. Similarly, we cannot allow the taking of private property by forfeiture without sufficient proof of wrongdoing. ... Although the legislative intent behind the ninety day requirement is not clear, ***the general rule in this state is that statutory provisions relating to the time of doing an act to which the statute applies are directory rather than mandatory.*** This is ***especially*** true absent some showing of prejudice. Thus, in cases like the present one where no prejudice has been shown, we can infer that the legislature intended for the ninety day provision to be directory in nature. Since the statute is directory rather than mandatory, violation of the ninety day rule does not nullify the forfeiture hearing or order.

Garrett v. State, 717 S.W.2d 290, 291 (Tenn. 1986) (Internal citations omitted; emphasis added).

A careful reading of this decision shows that Atmos has exaggerated the significance of the case. The case says that ***the general rule is that such statutes are directory rather than mandatory***. The general rule is ***especially*** true in the absence of prejudice. The case does ***not*** say that a claim of prejudice by the losing party defeats the general rule. A party that has failed to establish the merits of its case has ***not*** shown prejudice. *Id.*

Atmos claims as prejudice the theory that it could have filed the tariff again with additional proof, but it does not say what that additional proof would have been. Furthermore, Atmos has not explained why it held back this hypothetical proof from the current contested case. *Garrett* does not say that an order that is rendered after 90 days is null and void on the mere claim of a hypothetical and theoretical prejudice. The reality is that Atmos has not suffered any prejudice, and it certainly

has failed to establish any real prejudice in its Motion for Reconsideration. In its Motion for Reconsideration Atmos again failed to comply with the TRA rule regarding petitions for reconsideration.

> If the petitioners seek to present new evidence, the petition shall contain a statement of the cause for the failure to introduce the proposed new evidence in the original proceeding, a detailed description of any such new evidence proposed to be introduced, including copies of documents sought to be introduced, identities of proposed witnesses, and summaries of any testimony sought to be presented.

Tenn. Comp. R. & Regs. 1220-1-2-.20(1). Atmos failed to comply with this rule in the context of the hypothetical proof that supposedly supports its theoretical tariff. The simple fact is that such proof does not exist. Should such proof exist then Atmos should have proffered the proof, so that the Hearing Officer could decide whether supplementing the record was appropriate.

If the Authority were to reverse the decision in this case on the basis of prejudice to Atmos, such decision would prejudice Tennessee consumers who would be deprived of the opportunity to challenge the Company's theoretical new tariff based on its hypothetical new proof. Again, the result would be that the entire contested case process would have to begin from scratch. There is no Tennessee case law in which an order has been nullified by a court for failure to render the order within 90 days. Also, the statute explicitly permits the rendering of an order beyond ninety days "for good cause shown." Tenn. Code Ann. § 4-5-314(g). Furthermore, "No agency decision pursuant to a hearing in a contested case shall be reversed, remanded or modified by the reviewing court unless for errors that affect the merits of such decision." Tenn. Code Ann. § 4-5-322(i). The initial order in this contested case is not null and void on the basis of hypothetical proof supporting a theoretical tariff that Tennessee consumers have had no opportunity to challenge.

3.The Hearing Officer Was Not Wrong To Reject the Proposed Settlement of March 8, 2006.

It is quite difficult to pull Atmos' complaints asserted into Section VII of its brief into a legal analysis. Although, Atmos makes claims of due process deficiencies of constitutional proportions, Atmos does not actually site any case law or constitutional provisions that might apply in this circumstance. The only discernable complaint seems to be the rejection by the Hearing Officer of the proposed settlement filed on March 8, 2004.

Atmos has done everything it could to prevent a decision on the merits in this matter. Atmos attempted to persuade the TRA Staff to accept a flawed interpretation of the PBR at the January 31, 2001 meeting. Subsequently, Atmos submitted inaccurate quarterly reports. Atmos 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 Atmos on its deception, Atmos went into a two (2) year effort to settle this matter short of a hearing on the merits.[2] The settlement process included talks among the parties and even the assistance of a mediator. Now, Atmos appears to hope that the Authority will draw on the content of these settlement talks in some way.

There is no need to comment on Atmos representations of these settlement negotiations. More importantly, the substance of these settlement talks have no bearing on the merits of Atmos'

[2] This effort concluded with the hearing officer's denial of the motion to approve the settlement between Atmos 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.

request and revelation of such is improper.[3] Moreover, the statements of legal counsel in a post-hearing brief are not proper evidence.[4]

Inconsistent with Atmos' assertions in pp. 13-14 of *Atmos Review Brief*, Atmos did not offer to simply withdraw its "objections to the 2000-2001 audit." Instead, the settlement proposed by Atmos and the TRA Staff on March 8, 2004, compensated Atmos for withdrawing its "objections to the 2000-2001 audit" with approval of the TIF proposed in TRA Docket No. 02-00850. If Atmos actually wanted to withdraw its "objections to the 2000-2001 audit" then it simply could have conceded to the summary judgment motions filed by both the TRA Staff (7/31/02) and Consumer Advocate (7/19/02). Instead, on October 21, 2002, Atmos responded in opposition to the summary motions regarding its objections. Further, Atmos could withdraw its objections now.

What really is at the heart of Atmos' complaints here is the Hearing Officer's rejection of the proposed settlement agreement filed on March 8, 2004, which did not have the agreement of all the parties involved, namely the Consumer Advocate. The Hearing Officer correctly relied on *Harbour v. Brown*, 732 S.W.2d 598 (Tenn. 1987).

"Settlement" may be defined in several ways:

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

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

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

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

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

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

It would appear that there have been no instances at the TRA, nor its predecessor the Tennessee Public Service Commission ("TPSC") in which a proposed settlement has been accepted where all the parties have not joined the settlement agreement. Instead, the TRA rightfully rejects efforts to settle matters where all parties are not represented in the settlement. Squarely addressing the issue in 2000, the TRA stated:

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

Order Rejecting Proposed Settlement Agreement And Dismissing Show Cause Petition, Docket No. 00-00170, pages 4-5.

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

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

In Sections VIII and IX of the *Atmos Review Brief,* Atmos attempts to discredit the Hearing Officer's decision by asserting two (2) things: 1) "The TIF Tariff Is Supported by Sufficient Evidence in the Record;" and 2) "The Sharing of Savings from Discounted Transportation Rates through the Transportation Cost Adjuster is within the intent and scope of the Original PBR Plan." Each assertion lacks merit.

A. At the very heart of this matter lies a flawed attempt to modify the PBR mechanism.

Atmos has for over five (5) years sought a method for disguising the character and nature of the maximum FERC rate into something it is not. The correct conclusion remains rather obvious. As evidenced by logic and the obvious fact that Atmos has not been able to present the necessary supporting proof in this mature record, the maximum FERC rate cannot function as a proxy for the market and could not have been accidentally included in the PBR in prior TRA orders.

At each stage of this process, Atmos has attempted to raise procedure over substance. Initially, Atmos attempted to circumvent TRA approval and the necessary public scrutiny of its flawed approach by meeting with TRA Advisory Staff rather than filing a proper petition to amend its incentive program. Atmos has tried mediation, settlement negotiations, and lengthy arguments containing conclusory statements without supporting citations. Atmos laced its requests with attempts to embarrass the TRA Advisory Staff, unfounded allegations against the Consumer Advocate and misrepresentations of the record and the positions of the parties.[5]

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[5] During the litigation of these dockets, the Consumer Advocate has responded to many of the unsupported allegations of Atmos, both the substantive and the personal. However, the Consumer Advocate has not responded to all. It is a difficulty faced in every instance where these types of groundless, unsupported and conclusory claims are presented to the trier of fact. To the extent the Authority is concerned with the extraneous Atmos arguments, the Consumer Advocate is available to submit supplemental information. In all other respects, the Consumer Advocate

Wading through the extraneous, bulky filings in this docket could not have been an easy task. The Consumer Advocate and Staff understand the task undertaken by the Hearing Officer. Further, we note the Hearing Officer's work and determination evidenced by the fact that Atmos was not able to distract or redirect this review from the substantive issues involved.

Atmos should accept the responsibility for the time required for the Hearing Officer's decision. Atmos is not dissatisfied with the time passing between the hearing in this matter and the Hearing Officer's decision of March 14, 2006.[6] Rather, Atmos is disappointed that its efforts to push through a flawed plan have failed. What should not be missed is the fact that over five (5) years have passed since Atmos began its attempts to pass off the maximum FERC rate as a proxy for the market. The fact is that Atmos' position is untenable. Only this fact prevents Atmos from producing the credible evidence necessary to establish the maximum FERC rate as a market proxy.[7] Production of this evidence, in light of the substantial evidence in the record running contrary to this conclusion, was incumbent on Atmos.[8] Certainly, Atmos witness Frank Creamer was given ample opportunity to produce the necessary information. Attempts to recast Mr. Creamer's testimony, either at the hearing or at this stage, add nothing of substance to the debate.

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incorporates by reference its previous pleadings in this docket.

[6] The record contains no filing by Atmos following the hearing in this matter, which would suggest Atmos objected to any perceived "delay."

[7] Nothing prevented Atmos from producing the information during the fourteen (14) month period that Atmos highlights in its pleadings.

[8] The situation is analogous to the missing witness rule. A party in possession of evidence supporting its position that fails to present such evidence at trial suffers the permissive inference that the evidence was actually inconsistent with the position of the party in possession of the evidence. *State v. Bigbee*, 885 S.W.2d 797 (Tenn.1994); *Balderacchi v. Ruth*, 256 S.W.2d 390, 392 (Tenn.Ct.App. 1952).

B. Atmos' 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, Atmos does not provide a market-tested method for the TRA to judge whether Atmos ratepayers would benefit from the incentive program proposed by Atmos. The Consumer Advocate and Staff request that the TRA not be swayed by Atmos' 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 Atmos and the proposed amendment to the PBR result in a calculation of "savings" based on the idea that Atmos has delivered to its city gate natural gas at the lowest feasible cost.[9] The difficulty for Atmos rests with its inability to establish a measure by which Atmos' interpretation of the PBR and Atmos' proposed amendment to the PBR will actually result in real cost minimization. When the gas arrives at an Atmos city gate the commodity savings can be identified by comparison to the predefined basket of indices[10] established in TRA Docket No. 97-01364. However, the claimed "savings" for transporting the gas to the city gate is measured, not against a market index, but the **maximum** FERC rate.[11] Unlike the PBR mechanism actually approved by the TRA, there is no adequate market proxy by which to measure the conduct of Atmos.[12] Atmos 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

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[9] 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.

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

[11] 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 Atmos getting rates that are below the maximum rate allowed.

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

to the predefined market indices actually used in the PBR.[13] What Atmos proposes on the surface of its presentations in each docket is already available in the PBR. However, Atmos eschews a proper interpretation of the PBR. Atmos has not satisfied its burden of proof regarding Atmos' objection to the TRA Staff audit findings in TRA Docket 01-00704 and Atmos' proposed amendment to the PBR in TRA Docket 02-00850.[14]

Within the record in this matter, this point is probably drawn most distinctly by the exchange between legal counsel for Atmos 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.[15] There is no similar market index for transportation contracts, there never has been, and Atmos has always known there is no such market index.[16] The PBR is intended to capture total cost of gas, which includes commodity and transportation cost.[17] The transportation costs are captured by the PBR in the transportation cost adjuster.[18] 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

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[13] This is the case regardless of the conduct of Atmos' commodity purchasing agent.

[14] The burden rests with Atmos 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.

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

[16] *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

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

[18] *Id.*, p.94

cost adjuster.[19] The transportation cost adjuster allows for a comparison of two costs: 1) the actual cost Atmos pays for the natural gas delivered to it's city gate; and 2) the actual cost Atmos would have paid if the natural gas was purchased at the Henry Hub and then delivered to the city gate.[20]

The second cost reference contains the avoided cost.[21] 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.[22] Mr. Creamer even chooses to highlight Atmos' 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."[23] This distinction is not without import.[24] While the transportation contracts at issue may have resulted in a reduction in the rate paid when compared to the maximum FERC rate, no portion or section of travel along the pipeline was eliminated or avoided. Further, it is not a matter of excluding transportation costs, as Atmos tries to suggest, but a matter of adjusting for differing costs related to the difference in receipt points.[25] As more descriptively stated by Dan McCormac:

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

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

[21] *Id.*

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

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

[24] 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 of Mr. Hack's 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, Atmos' claim is analogous to a car salesman who attempts to collect commissions based on the original sticker price.

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

> So whether you subtract it [transportation cost] 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 Atmos. 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 adjust for the transportation costs avoided by purchasing the gas at the city gate.[26] Atmos attempts to inaccurately characterize Mr. McCormac's testimony as limiting city gate purchases to local gas purchases.[27] This is incorrect. In fact, this highlights the deficiency in Atmos' 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 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[28] is treated as a city gate purchase and is consistent with how the transportation cost adjustor works.[29] Potentially there are other purchases that may trigger the transportation cost adjustor which are not local in nature.[30] However, there are at least two (2) components differentiating the transactions. There must be a true bundled price that Atmos pays.[31]

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[26] *Id.* p.94

[27] *Id.* p.98

[28] 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 Atmos.

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

[30] *Id.*

[31] Hearing Transcript, October 19, 2004 Vol.II p.98 & pp.100-102. Atmos 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, Atmos fails to take the next step required by the transportation cost adjustor and

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.[32] In other words, Atmos' 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 Atmos of "city gate" includes every purchase that makes it to the city gate. Consequently, Atmos 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 as a factor in determining savings, is inaccurate. Both Dr. Brown and Mr. McCormac speak of excluding the impact of transportation costs.[33] 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.[34] 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 issue is not whether transportation costs, in a generic sense, are to be taken into consideration. The

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compare the final price to what could have been purchased at the Henry Hub and delivered to the city gate.

[32] Hearing Transcript, October 19, 2004 Vol.I p.19. Atmos 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.

[33] *Direct Testimony of Steve 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.

[34] *Rebuttal Testimony of Daniel McCormac*, October 5, 2004 pp. 3-4..

issue is whether the delivered cost of gas achieves real savings with the avoided transportation costs taken into account. Anywhere Atmos makes references to the fact that their interpretation of the NORA contract leads to a calculation that is the same approach 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 cost adjuster. It states "For city gate purchases, these indexes will be adjusted for the avoided transportation costs that **would have been paid** if the upstream capacity were purchased versus the demand charges actually paid to the supplier". (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 gas cost actually paid for a purchase at the city gate (or at NORA). These words clearly define the meaning of "avoided transportation costs."[35]

Atmos admits that the NORA contract is an exception.[36] Atmos admits that the purchase of local gas is the exception.[37] It was these particular exceptions that fostered the transportation cost adjustor.[38] The TRA's accounting for transportation 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

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

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

[37] *Id.*

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

would take into account transportation costs.[39] 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.[40]

The PBR should embody an inclusive approach. The problem is that Atmos 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. *Atmos Summary Judgment Response,* filed October 21, 2002, p.9.

This describes the "material defect" Frank Creamer claims exists with the present PBR.[41] 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 Atmos "entering into relatively high transportation cost arrangements."[42] Under the PBR, Atmos has incentive to make gas purchases that result in savings.

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[39] 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, Atmos Summary Judgment Response,* October 21, 2002, p. 8-9.

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

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

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

When Atmos makes purchases at receipt points other than the Henry Hub, 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 Henry Hub and then delivered to the city gate.[43] The appropriate mechanism is in place. However, Atmos has chosen not to use the method approved by the TRA.

Under the TIF and Atmos' proposed interpretation of the current PBR, Atmos 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" Atmos claims. At no time, however, does Atmos 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 Atmos has chosen. The problem is that the calculation of the transportation "savings" is derived solely from the discount off the maximum FERC rate solely within the construct of the transportation path chosen by Atmos. The "savings" are intrinsic only to the price of transportation and are independent of the actual cost of gas at the city gate. This result is the very outcome Atmos claims is a problem with the way TRA Staff has interpreted the PBR. Atmos' approach simply separates the transactions from commodity and transportation, seeking "savings" based primarily on the transportation element.[44]

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[43] Atmos must use prudent management to seek the lowest transportation costs for gas delivered from the Henry Hub receipt point to the city gate. Atmos 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.

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

There is actually little difference between Atmos' interpretation of the present PBR and the TIF.[45] 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 Atmos from adding additional legs to the "Atmos trip" which include "discounts" off the maximum FERC rate.[46] The result is increased "savings" as defined by Atmos, but also higher gas costs which become the burden of rate-payers.

Using the transportation cost adjustor, Atmos has a mechanism for calculating the real savings from its gas purchases that include both commodity and transportation costs. The key is that Atmos 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 Atmos is able to avoid by purchasing gas at the city gate. Which price is lower? Before delivering the gas to its customers, has Atmos achieved the "lowest cost feasible?"

Atmos has an obligation to purchase the gas at the least cost feasible. This was an unequivocal commitment on the part of Atmos 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

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[45] The only advantage the TIF calculation has is it skips the effort involved with Mr. Creamer's attempt to combine the gas commodity cost with the transportation 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 Atmos inaccurately interprets the present PBR.

[46] This possibility appears unlikely. However, Atmos 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.

> 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. Atmos should not be allowed to retreat from this commitment as suggested by John Hack.[47] In fact, Atmos is judicially estopped from this reversal.[48]

In focusing on what interpretation the TRA, its Staff, the Consumer Advocate and Atmos gave to the original PBR, it is very telling that Atmos calculated the savings correctly in the first plan year. The 1999-2000 annual report calculated the savings consistent with the PBR.[49] However, in the second plan year Atmos made a distinct choice to abandon the PBR to seek "savings" using it's flawed interpretation of the PBR, because Atmos could generate more "savings" in this manner and therefore increase the money going to Atmos.[50] These "savings", moreover, are not real because they are based on a false proxy.[51]

More telling are Atmos' position changes regarding its interpretation of the PBR. The PBR was approved in 1999. Shortly afterwards, Atmos submitted its 1999-2000 annual report which was compiled in reliance on the correct interpretation of the PBR.[52] On January 31, 2001, Atmos met with the TRA Staff and claims to have described the change Atmos wished to make in its reporting

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

[48] *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).

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

[50] 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.

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

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

of "savings."[53] Subsequently, Atmos submitted two (2) quarterly reports consistent with how it claims to have described its plans to the TRA Staff at the January, 2001 meeting.[54] The Consumer Advocate and the TRA Staff have challenged these reports as inaccurate in relation to the proper interpretation of the PBR. However, Atmos has also acknowledged that the quarterly reports and its presentation to the TRA Staff are not accurate even under its own flawed interpretation of the PBR.[55] In other words, the presentation to the TRA Staff at the January, 2001 was incorrect even as Atmos understands it. In his testimony Mr. Creamer provides yet another interpretation from that used by Atmos at the January 31, 2001 meeting, the two (2) quarterly reports subsequently filed by Atmos and the 2000-2001 annual report which is the subject of TRA Docket No. 01-00704.[56] The amendment to the PBR plan in Docket 02-00850 is different from the approach taken by Mr. Creamer in TRA Docket No. 01-00704.[57]

Atmos and its witness, Frank Creamer, suggest that other commissions have approved the use of the maximum FERC rate as some sort of proxy.[58]Atmos has actually identified only one state where a similar concept has been approved.[59] It is very important to note as well that of the two (2) Kentucky decisions cited by Atmos, one decision is approval of a settlement following a contested

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[53] *Id.*

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

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

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

[57] *Id.*

[58] *Id.*, p.12.

[59] Atmos discovery response to Interrogatory No. 5, filed September 1, 2004.

matter in the other. The Louisville Gas and Electric Company decision setting the policy of the Kentucky Commission found the following:

> 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. 2001-017, p. 4, filed in TRA Docket No. 97-01364 on September 1, 2004, as an attachment to Atmos discovery responses.

No commission has found that the proposals presented by Atmos in TRA Docket Nos. 01-00704 and 02-00850 actually benefit ratepayers.

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

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

Atmos' claims in both dockets depend on the assertion that the maximum FERC rate may serve as a proxy for transportation costs. Atmos 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 Atmos to suggest that no part of the testimony of its witnesses on this subject has been refuted by the proof in this matter.[60] 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

[60] *Atmos Post-Hearing Brief*, November 22, 2004 p.26.

exists for transportation costs.[61] As an alternative, Atmos 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 Atmos agree that the market for transportation contracts changed in 1999. Specifically, the market changed in the fall of 1999. Atmos 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, Atmos' 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, Atmos may not rely on a pre-1999 standard as a proxy for the market. To hold the maximum FERC rate up as a proxy, both Mr. Creamer and Atmos ignore "altered ... economic conditions" in the "marketplace" which have a rather obvious import. The maximum FERC rate does not presently represent the appropriate confluence between buyer and seller relationships so as to qualify as a market proxy.

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

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.[62]Mr. Creamer's table submitted in his direct testimony at page 6, is not found anywhere in TRA Docket No. 97-01364.[63] In fact, the entire bundling concept Mr. Creamer presents is not found in TRA Docket No. 97-01364.[64] There is nothing in TRA Docket No. 97-01364 that suggests that the maximum FERC rate was established as a benchmark.[65] Negotiated transportation contracts are not mentioned in the PBR.[66]

The maximum FERC rate is set by the Federal Energy Regulation Commission ("FERC"), a federal regulatory agency.[67] The participants in setting the maximum FERC rate are FERC and the pipelines.[68] The maximum FERC rate is set based on the underlying cost of the company, plus a reasonable return as determined by FERC.[69]

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

[63] *Id.*

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

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

[66] Atmos *Post-Hearing Brief*, November 22, 2004 p.48.

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

[68] *Id.*

[69] *Id.*

The basket of indices approved by the TRA in TRA Docket No. 97-01364 are compiled in a completely different manner. There is a demonstrable nexus between the basket of indices and actual transactions within the market place.[70] These are transactions between an actual buyer and an actual seller.[71] The buyer and seller set or agree to the price.[72] Each of these indices within this basket, gives us this compilation of actual transactions to arrive at an average.[73] This average sets the market index.[74] The TRA carefully reviewed these indices in contested matters culminating in TRA Docket No 97-01364. In the end the TRA did not choose just one market index.[75] In fact, they chose a basket of the market indices available.[76]

One of the market indices, the NYMEX, was actually considered for exclusion from the basket.[77] At no time was the maximum FERC rate scrutinized in such a manner by either the TPSC or the TRA.[78] 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 TPSC and the TRA.[79] 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.

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

[71] *Id.*

[72] *Id.*

[73] *Id.*

[74] *Id.*

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

[76] *Id.*

[77] *Id.*

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

[79] *Id.*

Creamer or anyone on behalf of Atmos submitted to the TPSC or the Authority prior to August 16, 1999.[80] Atmos' performance under the current PBR plan is evaluated when compared to "predefined benchmarks which act as surrogates for the market".[81] The maximum FERC rate is not one of these predefined benchmarks.[82] Moreover, the maximum FERC rate is a rate that is unique to each pipeline.[83] Each market Mr. Creamer identifies is really just for that particular pipeline.[84] 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, this entry itself does have two prices. There is a price for the maximum FERC rate and the Atmos' "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.[85]

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.[86]

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[80] *Id.*

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

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

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

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

[85] 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 Atmos 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.

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

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.[87] Nowhere in the entire record in 97-01364 is there a mention of the FERC maximum rate.[88] There is no index to serve as the market proxy for transportation prices.[89] 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:

> "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.[90]

5. Staff properly disallowed the transportation "savings" under the plain language of the PBR tariff.

In an effort to salvage a portion of the "savings" improperly sought in this matter, Atmos seeks to impugn Staff. Claiming that Staff did not object in time to a revision in the PBR mechanism, Atmos seeks to recover the $627,212 disallowed by the Staff in the in the 2000-2001 audit.

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[87] *Id.*, pp. 16-17

[88] *Id.*, p. 4

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

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

No obligation exists for Staff to provide written notification of exceptions to the quarterly reports within 180 days. These are interim reports and subject to change. The reports referred to in the tariff that require a written notification are the annual reports.[91] The annual report filings are the ones that are audited and the audit report lists the exceptions to the filing. The 180 days is strictly adhered to during these audits. In the referenced audit, Staff consented to a delayed filing date by United Cities. The filing was received on August 7, 2001. The 180 days expired on February 3, 2002. The Company requested an extension to March 12, 2002. And Staff requested an additional extension to April 23, 2002.[92]

The Staff's interpretation of the filing requirement is based on the Purchased Gas Adjustment rules.[93] The Company's position that the tariff requires the Staff to audit and comment on the quarterly reports leads to an absurd conclusion. Quarterly reports are filed sixty (60) days following the end of a quarter. Adding another 180 days for Staff review results in an eight (8) months lag after the end of the quarter before the Company would know if its filing was in compliance with the tariff. Staff would be forced to conduct four (4) audits each year. This is simply not reasonable and in no way was contemplated in the formulation of the incentive plan. Further, Staff was not now, as the Company says, raising exceptions to the previously filed quarterly reports. The exceptions in this report refer to the annual report.

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[91] See attachment 1 to the Staff's *Compliance Audit Report,* filed April 10, 2002, TRA No. 1, Original Sheet No. 45.6.

[92] Extension of the 180 days is allowed by mutual consent of the Staff and the Company. See letters of extension attached as Attachment 7 to the Staff's *Compliance Audit Report,* filed April 10, 2002.

[93] *Final Order* on Phase Two (Docket No. 97-01364) page 28 states:
"The tariff should incorporate all the changes as ordered by the [TRA], in addition to specifying that the gains and losses derived from the mechanism are to be accounted for in an incentive plan account with similar language, true-up attributes, **audit, and filing requirements** as the Actual Cost Adjustment clause of the existing Purchased Gas Adjustment rules." (emphasis added). See Attachment 10 to the Staff's *Compliance Audit Report,* filed April 10, 2002.

6. The findings in the audit report are not barred by estoppel.

Estoppel may not be used by Atmos to support its claims. The general rule in Tennessee is that the doctrine of estoppel does not apply to public officials or public agencies.[94]According to *Bledsoe County*, "very exceptional circumstances are required to invoke the doctrine against the State and its governmental subdivisions."[95] "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).

In the present matter, 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.

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

[95] *Id.*

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.
> ...
> 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 instant case, 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 transportation contracts were executed before any contact with the TRA or the TRA Staff.[96] Even Atmos merely claims that the impetus for executing these contracts was Atmos' conclusion that the transportation "savings" would be included in the PBR plan approved in 97-01364.[97] John Hack admits that the contracts were renegotiated because of the automatic renewal provision in the contracts.[98] The TRA Staff did not have any input into Atmos' decision to enter into the subject contracts.[99]

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.

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

[97] *Id.*, p.50

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

[99] *Id.* p.50.

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 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 virtually 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."[100] 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 Atmos for the intervening years after the audit.

7. The due process rights and equal protection rights of Atmos have been protected.

The United States Supreme Court already has rejected the type of equal protection and due process argument asserted by Atmos. "[T]he Fourteenth Amendment does not, in guaranteeing equal protection of the laws, assure uniformity of judicial decisions, any more than in guaranteeing due

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

process it assures immunity from judicial error." *Milwaukee Electric v. State of Wisconsin*, 252 U.S. 100, 105, 40 S.Ct. 306, 309 (1920) (Internal citations omitted). "We have said time and again that the Fourteenth Amendment does not 'assure uniformity of judicial decisions (or) immunity from judicial error.' Were it otherwise, every alleged misapplication of state law would constitute a federal constitutional question." *Beck v. Washington*, 369 U.S. 541, 554-55, 82 S.Ct. 955, 962-63 (1962) (Internal citations omitted). The decision of a hearing officer in a contested case in the TRA is judicial or at least quasi judicial in nature. *Gulf Mobile & Ohio Railroad v. Railroad and Public Utilities Commission*, 271 S.W.2d 23, 27 (Tenn. Ct. App. 1954). Administrative hearings at which witnesses were called, evidence was presented, and findings of fact were made are judicial or quasi judicial in nature. *Anderson v. City of Dallas*, 116 Fed.Appx. 19, 31 (5th Cir. 2004). Because the Hearing Officer's decision in this contested case was judicial or quasi judicial in nature, Atmos has no claim for equal protection or due process.

Furthermore, even if the Hearing Officer's decision were not judicial or quasi judicial in nature, Atmos has failed to show an equal protection or due process violation. First, Atmos has failed to argue a due process violation. All four of the case citations in the Company's brief address equal protection. Atmos has not cited authority for its alleged due process argument, and therefore, no additional response is needed to the unsupported allegation. Also, the Company's equal protection argument lacks merit. Because Atmos is not a suspect class, the analysis, if it were needed, would be under the rational basis test. *State of Tennessee v. Southern Fitness and Health*, 743 S.W.2d 160, 162 (Tenn. 1987). "Moreover in determining whether a rational basis exists, 'the burden of showing that a classification is unreasonable and arbitrary is placed upon the individual challenging the statute; and if any state of facts can reasonably be conceived to justify the

classification or if the reasonableness of the class is fairly debatable, the statute must be upheld.'" *Id.* at 163.

"[T]he Equal Protection Clause does not require things which are different in fact or opinion to be treated in law as though they were the same." *Champion's Auto Ferry v. Michigan Public Service Commission*, 588 N.W.2d 153, 164 Mich. Ct. App. 1998). The Company's argument that the TRA has an "established policy" in which natural gas monopolies are "entitled" to "deference" is unsupported by the facts. Neither of the two examples cited by Atmos involved a claim that the natural gas monopoly should be allowed to charge Tennessee consumers for theoretical "savings" every time the natural gas monopoly paid anything less than the ***maximum*** transportation rate permitted by FERC. The argument that Atmos, as a natural gas monopoly, is "entitled" to "deference" in this context pursuant to an "established policy" of the TRA lacks any basis whatsoever in fact or law. If the TRA had intended to require the Hearing Officer to rule in favor of Atmos and against Tennessee consumers in this context pursuant to an "established policy" in which natural gas monopolies are "entitled" to "deference," the TRA would not have convened a ***contested case***. The argument that the Equal Protection Clause requires the Hearing Officer to rule in favor of Atmos and against Tennessee consumers in this ***contested case*** is obviously incorrect.

In the Chattanooga Gas example discussed in the Company's brief, the TRA did not convene a contested case. (Transcript of Authority Conference, December 13, 2004, page 59, lines 4 through 13). According to Director Kyle, "There is no evidence that Chattanooga Gas Company violated its interruptible margin credit rider tariff regarding the sharing of gross profit margin on off-system sales, because absent a tracking system audit staff had no way to determine if such violation exists[.]" (Transcript of Authority Conference, December 13, 2004, page 56, lines 8 through 13). Even in rejecting the staff's recommendation, Director Jones said, "This conclusion should not,

however, be construed to represent that I approve of the bailment agreement as an appropriate affiliate transaction vehicle." (Transcript of Authority Conference, December 13, 2004, page 52, lines 5 through 8). Chattanooga Gas did not assert that the ***maximum*** FERC rate should be a benchmark for determining alleged "savings" on transportation costs. Obviously, for these reasons and many others too numerous to elaborate, the facts in the Chattanooga Gas example were very different than the facts in the case at bar.

In the Nashville Gas example discussed in the Company's brief, Nashville Gas claimed that the asset management fee that it received in exchange for turning over its excess capacity to the asset manager should be treated as a capacity release transaction for purposes of its incentive plan account. Nashville Gas did not claim that the ***maximum*** FERC rate should be a benchmark for determining alleged "savings" on transportation costs. Quite simply, the Nashville Gas example is a different case with different facts and different issues, and the differences are too numerous to elaborate. The Company's argument that the Equal Protection Clause compels a specific result in this ***contested case*** is unsupported by the facts or the law.

CONCLUSION

The foregoing considered, the Consumer Advocate respectfully requests that the motion for reconsideration filed by Atmos be denied. The positions set forth by Atmos have been weighed in painstaking fashion. Atmos knew from the very beginning of this process that it had to show that the maximum FERC rate could in some manner function as a proxy to the market for the transportation of natural gas. Atmos has failed to do so, even though it has had over five (5) years to generate a colorable claim of such.

The foregoing considered, the Consumer Advocate and the Staff respectfully request that the motion filed by Atmos be denied.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via U.S. Mail and electronic transmittal on Thursday, November 9, 2006.

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