STATE OF TENNESSEE

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November 3, 2003

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

RE: PETITION OF CHATTANOOGA GAS COMPANY, NASHVILLE GAS COMPANY, A DIVISION OF PIEDMONT NATURAL GAS COMPANY, INC., ATMOS ENERGY CORPORATION FOR A DECLARATORY RULING REGARDING THE COLLECTIBILITY OF THE GAS COST PORTION OF UNCOLLECTIBLE ACCOUNTS UNDER THE PURCHASED GAS ADJUSTMENT ("PGA") RULES
Docket No. 03-00209

Dear Chairman Tate:

Enclosed is an original and thirteen copies of a Reply Memorandum to Petitioners' Response in Opposition to the Motion for Summary Judgment of the Consumer Advocate and Protection Division. Kindly file the attached in this docket. By copy of this letter, we are serving all parties of record. If you have any questions, please feel free to contact me at (615) 532-3382. Thank you.

Sincerely,

Shilina B. Chatterjee

Shilina B. Chatterjee
Assistant Attorney General
(615) 532-3382

Enclosures
cc: Kim Beals, Esq.
Hearing Officer
All Parties of Record

70252

IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	DOCKET NO. 03-00209
	)	
PETITION OF CHATTANOOGA GAS CO., NASHVILLE GAS CO., A DIVISION OF PIEDMONT NATURAL GAS CO., INC. AND UNITED CITIES GAS COMPANY, A DIVISION OF ATMOS ENERGY CORP. FOR A DECLARATORY RULING REGARDING THE COLLECTIBILITY OF THE GAS COST PORTION OF UNCOLLECTIBLE ACCOUNTS UNDER THE PURCHASE GAS ADJUSTMENT ("PGA") RULES.	)	

REPLY MEMORANDUM TO PETITIONERS' RESPONSE IN OPPOSITION TO THE MOTION FOR SUMMARY JUDGMENT BY THE CONSUMER ADVOCATE AND PROTECTION DIVISION

COMES NOW the Tennessee Attorney General, through the Consumer Advocate & Protection Division ("Consumer Advocate") and hereby responds to the Petitioners' Response in Opposition to the Consumer Advocate's Motion for Summary Judgment filed by Chattanooga Gas Company, Nashville Gas Company and Atmos Energy Corp (collectively referred to as "Petitioners") in the above captioned matter before the Tennessee Regulatory Authority ("TRA"). This Reply Memorandum to Petitioners' Response in Opposition to the Motion for Summary Judgment will support the position that summary judgment should be granted in favor of the Consumer Advocate because as a matter of law uncollectibles are not part of the Purchase Gas Adjustment Rules, 1220-4-7, *et seq.* ("PGA rules") and inclusion of uncollectibles is not consistent with the intent of the PGA rules. *See* attached Exhibit A, Affidavit of Daniel W. McCormac.

The Consumer Advocate reiterates that the declaratory order sought by the Petitioners is procedurally flawed because it would require an amendment/alteration of the PGA rules. Furthermore, the Consumer Advocate will show that adoption of the Petitioners' interpretation is inconsistent with the precedent of the TRA. *See* Exhibit A, Affidavit of Daniel W. McCormac. Finally, the Consumer Advocate states that a rule-making proceeding would be the appropriate mechanism for the relief sought by Petitioners.

I. ARGUMENT

A. THE CONSUMER ADVOCATE HAS STATED SUFFICIENT GROUNDS FOR SUMMARY JUDGMENT

The Consumer Advocate has offered sufficient grounds for summary judgment. Summary judgment is rendered when there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law. *Tenn. R. Civ. Pro. 56.03.*

A genuine factual dispute does not exist in this case. A plain reading of the PGA rules reveals that Uncollectible Accounts are not mentioned. The rule states that only gas costs billed are to be included in the PGA and specifically uses the word "billed." As such, it is improper to include Uncollectible Accounts in the PGA rules. Therefore, judgment should be granted in favor of the Consumer Advocate on the merits as a matter of law. The Consumer Advocate maintains that the TRA should find, insofar as Petitioners make any claim that the current rule allows for inclusion of Uncollectible Accounts, such a claim fails as a matter of law.

A genuine factual dispute does not exist in this case. The Petitioners' request is inconsistent with a plain reading of the PGA Rules. The rule states (as detailed in the ACA portion) that recovery of gas costs occurs whenever accounts are "billed", not "collected" as misinterpreted by the applicants. Since recovery of gas costs occur when "billed", it is improper to include uncollectible accounts in the PGA rules. Therefore, judgment should be granted in our favor (CAPD) on the merits as a matter of law.

As shown in the Consumer Advocate's Memorandum in Support of its Motion for Summary Judgment, Petitioner's request for a declaratory order to be granted would be contrary to the current rules and would constitute a change of long standing TRA policy.

The Consumer Advocate maintains that the Petitioners are already allowed to recover uncollectibles through the rate-making process in base rates. A mechanism is already in place to provide relief concerning Uncollectible Accounts expense to the Petitioners. The relief Petitioners seek requires a rule modification, which cannot be accomplished through a declaratory order.

In addition, the case law on summary judgment sets forth that the burden is on the nonmoving party to set forth specific facts establishing that there is a genuine issue that needs to be resolved by the trier of fact and hearing is necessary. *Byrd v. Hall*, 847 S.W. 2d 208, 215 (1993). The court states as follows:

> When the party seeking summary judgment makes a properly supported motion, <u>the burden shifts to the nonmoving party to set forth specific facts</u>, not legal conclusions, by using affidavits or the discovery materials listed in Rule 56.03, <u>establishing that there is a genuine issue that needs to be resolved by the trier of fact and that a trial is necessary</u>.

Therefore, the Consumer Advocate has adequately fulfilled its burden of proof concerning their motion for summary judgment and has presented adequate grounds for same.

B. THE CONSUMER ADVOCATE'S MOTION FOR SUMMARY JUDGMENT SHOULD NOT BE DENIED BECAUSE A CONCISE STATEMENT OF UNDISPUTED MATERIAL FACT WAS NOT FILED

The TRA should not deny the Consumer Advocate's Motion for Summary Judgment merely because a concise statement of undisputed material fact was not filed. The TRA does not require a concise statement of undisputed material fact under Tenn. R. Civ. Pro. 56.03. In Docket No. 01-00704, the TRA held that they have not adopted T.R.C.P. 56.03 as part of its practice and procedural rules. Furthermore, in the Order dated March 31, 2003, the TRA stated that it is not bound by the rules of evidence applicable in a court and conducts contested case hearings according to its own rules and the Tennessee Uniform Administrative Procedures Act.[1] (*See* Exhibit B). The TRA held that they would not strictly enforce Rule 56.03 to reject motions for summary judgment. Therefore, the motion for summary judgment should not be denied.

C. IT IS NOT NECESSARY TO NEGATE AN ESSENTIAL ELEMENT OF THE PETITIONERS' CLAIM IN ORDER TO DEFEAT PETITIONERS' CLAIM WHEN FILING A MOTION FOR SUMMARY JUDGMENT.

Petitioners are incorrect in stating that it is necessary to negate an essential element of Petitioners' claim in order to defeat their claim. When the nonmoving party with the burden of proof has not supported its case, the moving party need only inform the trial court of its basis for its motion and identify those portions of the materials before the court that the moving party believes demonstrate the absence of a genuine issue of material fact.[2] The moving party is not required to support its claim with affidavits negating the elements of the opponents' cause of

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[1] Order, March 31, 2003, TRA Docket 01-00704, *United Cities Gas Company, ATMOS Incentive Account (IPA) Audit*, p. 20.

[2] Warren Freedman, Summary Judgment and Other Preclusive Devices (1989), p. 3.

action.[3] Petitioners have misstated the law concerning adjudications of motions of summary judgment.

D. THERE IS NO NEED TO COMPLETE DISCOVERY BEFORE GRANTING SUMMARY JUDGMENT

Discovery need not be complete in order for a court to grant summary judgment. In this case, the Consumer Advocate's summary judgment addresses issues of geninue fact, matters of law and administrative procedure. Information relevant to these issues is already part of the public record. The outstanding discovery in this case revolves around technical and accounting issues and does not relate to the Consumer Advocate's motion for summary judgment. Accordingly, there is no need to wait for discovery to determine whether summary judgment is appropriate.

E. IT IS NOT APPROPRIATE FOR THE PETITIONERS TO REQUEST A CHANGE IN THE RULE THROUGH A DECLARATORY RULING

Through a declaratory ruling, the TRA may and should interpret its rules. However, the PGA rules clearly indicate that uncollectible accounts are not to be passed through the PGA which Petitioners have admitted. As the Petitioners seek a change in the rules, it would be inappropriate for the TRA to actually modify the rule through a declaratory order. "Rule" is defined in Tenn.Code. Ann. § 4-5-102(10) which expressly excludes declaratory orders issued pursuant to § 4-5-223 from the definition.[4] Therefore, it would be inappropriate for the TRA to

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3 Id.

4 Tenn. Code. Ann. § 4-5-102(10): "..."Rule" includes the amendment or repeal of a prior rule, but does not include: (A) Statements concerning only the internal management of state government and not affecting private rights, privileges or procedures available to the public; (B) Declaratory orders issued pursuant to § 4-5-223;..." Tenn. Code. Ann. § 65-2-101(3) does not expressly adopt or exclude a declaratory order from the definition of "Rule".

grant the relief that the Petitioners are seeking in this docket through a declaratory ruling. A rulemaking proceeding would be the proper venue for effectuating the permanent change Petitioners are seeking to the PGA rules.[5]

F. THE PLAIN READING OF THE RULES DOES NOT ALLOW FOR RECOVERY OF THE UNCOLLECTIBLE ACCOUNTS EXPENSE

The PGA rules provide for a framework of specifically designed components that define and calculate costs of gas delivery to customers and the amounts that a gas company is allowed to bill under the PGA rules. There are various components used in the PGA rules. These components are defined and clearly established in the rules.

Among these components is the "Gas Charge Adjustment" which is defined in Rule 1220-4-7-01(4) as:

> . . . the per unit amount <u>billed</u> by the Company to its customers solely for Gas Costs. The Gas Cost Adjustment shall be separately stated for firm customers and for non-firm customers. (emphasis added).

As previously stated, the Gas Charge Adjustment is the component of the PGA formula which measures the monetary amount billed and/or charged by the company to the customers. The rule states that the Gas Charge Adjustment shall consist of revenues "billed." Under the Petitioners' suggested "interpretation," the Gas Charge Adjustment would need to be changed to no longer include billed accounts.

Moreover, the Petitioners' interpretation would also alter the Actual Cost Adjustment (ACA) portion of the PGA rules. Rule 1220-4-7-.03 (1)(c)(2) states that the ACA shall be:

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[5] The Consumer Advocate, however, does not mean to indicate that the TRA should necessarily commit resources to a rulemaking on this issue.

> . . . the difference between (1) revenues **billed** customers by means of the Gas Charge Adjustment and (2) the cost of gas invoiced the Company by Suppliers plus margin loss (if allowed by order of the Commission in another docket) as reflected in the Deferred Gas Cost account . . (emphasis added)

The ACA uses the language "billed" and not "collected." The ACA further supports the position that Uncollectible Accounts expense is not part of the PGA.

Although the Petitioners claim they could have included the bad debt portion of the gas costs in the ACA without a TRA ruling on the issue (Affidavit of Archie Hickerson, Petitioners Response in Opposition to the Consumer Advocate's Motion for Summary Judgment, Exhibit #2 p. 12, line 20-21), they realized that since the PGA rules do not refer to bad debt or Uncollectible Accounts they needed to seek the TRA's permission to do this. Unfortunately, they are incorrectly seeking that permission through the use of a declaratory order. This is an indication that the Petitioners do not believe that Uncollectible Accounts fall under the PGA rules. This further supports the position that the PGA rules were never intended to be used to include the Uncollectible Accounts expense.

It is undisputed that in each of the Petitioners' last respective rate cases, a percentage of the rate was designed to recover losses due to Uncollectible Accounts. This percentage was based on an average of the losses for a three year period.[6] This method has been used in each of the Petitioners' latest respective rate cases and has been the long-standing method and policy of the TRA to allow for the recovery of Uncollectible Accounts expense. The PGA was not intended to be the method to allow recovery of Uncollectible Accounts. *See* Exhibit A, Affidavit

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[6] Exhibits 2, 3 & 4 of CAPD's Memoradum in Support of Motion for Summary Judgment, October 1, 2003

of Daniel W. McCormac.

G. DOCKET NO. 01-00802 IS NOT PRECEDENT FOR ACCEPTING THE PETITIONERS' REQUEST SINCE IT WAS BASED ON EXTRAORDINARY CIRCUMSTANCES, IT WAS A TEMPORARY MEASURE AND SHOULD NOT BE THE POLICY OF THE TRA

In the Order in Docket No. 01-00802, the TRA stated:

> This measure should not be understood, however, to reflect the ongoing policy of the Authority, but is adopted for this one instance only in response to the extraordinary circumstances surrounding the winter of 2000-2001. (Emphasis added)

Even considering the extreme circumstances of the winter of 2000-2001, the TRA stated that the deferral decision was an exception in extreme times and not to be construed as a change in long standing policy.[7] Taken from the correct perspective, Docket No. 01-00802 sets precedent in direct opposition to the Petitioners' claims. These "extraordinary circumstances" in that docket are the exception that proves the rule.

It should be noted that the Petitioners are seeking inclusion of uncollectibles in the PGA on a permanent basis.[8] If the PGA rules were to include Uncollectible Accounts expense, it would have been included for the past 13 years since the inception of the PGA rules. Categorizing Uncollectible Accounts expense as gas costs is improper. Petitioners are attempting to circumvent the long-standing policy of the TRA for the past 13 years and alter the actual application of the PGA rules.

Petitioners have mistakenly interpreted Docket No. 01-00802. The Petitioners admit that

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7 Order, January 29, 2002. TRA Docket 01-00802, Application of ATMOS ENERGY, INC., PIEDMONT NATURAL GAS COMPANY, INC. and the CHATTANOOGA GAS COMPANY for Approval of Deferred Accounting, p. 5.

8 Petitioners Response in Opposition to Motion for Summary Judgment, October 27, 2003, p. 4.

it has not been the practice to allow for the recovery of uncollectible gas costs through the PGA (p. 6 of the Response in Opposition to Motion for Summary Judgment, October 27, 2003). The Order read in its entirety unquestionably indicates that the TRA's decision relates to extraordinary circumstances and warns that such leave is not to be the ongoing policy of the TRA. Despite the clear differences between the dockets, the Petitioner states (p. 4 of their response) that in "Docket 01-00802, the TRA interpreted the law to allow the recovery that the Petitioners are currently seeking in this Docket."

Specifically in that docket, the TRA opted to grant a temporary waiver especially since they had requested that the Petitioners do everything they could to prevent customers from being turned off including taking all possible measures to accommodate consumers and making payment arrangements. Once the year waiver was concluded, the TRA did not allow the company to continue the practice. In this docket, the Petitioners seek to change a long standing policy of the TRA and alter the PGA rules without evidence of extraordinary circumstances. Petitioners misinterpret Docket 01-00802 as "clear precedent" when in fact the undisputed differences between Docket No. 01-00802 and the present docket dictate denial of the Petitioners' claims.

H. PGA RULES DO NOT DIRECTLY OR IMPLIEDLY STATE THAT THE UNCOLLECTIBLE ACCOUNTS EXPENSE IS RECOVERABLE THROUGH THE PGA RULES

The PGA rules does not use any language allowing a gas company to recover uncollectibles account expense through the PGA. As such, it would be inappropriate to exaggerate the intent of the rule or insert language concerning inclusion of the uncollectibles in the PGA. Merely because the Petitioners claim that Uncollectible Accounts expense is comprised of uncollectible gas costs does not mean it should be included in the PGA rules. In 1986, the Commission considered the intent as the primary issue in the 1986 rulemaking proceeding (Affidavit of Archie Hickerson, Petitioners Response in Opposition to the Consumer Advocate's Motion for Summary Judgment, Exhibit #2 p. 9, line 9-11). The Commission was specific about what was to be included in the PGA rules and did not specifically state nor intend to include Uncollectible Accounts expense because the TRA never mentioned it in the PGA rules and actual practice has not included Uncollectible Accounts expense. Uncollectibles have been a part of the base rates and they continue to remain in base rate as has been the case over the course of the past 13 years. The gas companies have bore the risk of Uncollectible Accounts expense for the past 13 years and it would be improper to shift that burden to the consumers of the State of Tennessee at this juncture.

I. A RULE-MAKING PROCEEDING WOULD BE THE APPROPRIATE MECHANISM FOR THE RELIEF PETITIONERS ARE SEEKING

A declaratory order is not the proper tool to alter rules. The Petitioners have stated "[t]he Petitioners are therefore requesting a change in the practice regarding Gas Costs recovery, which the TRA has previously determined is permitted under the current PGA." (p. 7 of the Response in Opposition to Motion for Summary Judgment). The Petitioners acknowledge that they are seeking a change in the current practice. Furthermore, the Petitioners are clearly seeking a rule change. As such, a permanent change in the practice would require a change to the PGA rules. Hence, a rulemaking is the appropriate forum to explore such a change. The Petitioners mischaracterize the prior decision of the TRA in Docket No. 01-00802 to be the same as the relief they are seeking here. The TRA clearly set forth that they would allow the companies to include uncollectibles as a one-time event and this was not to be the recurring or ongoing policy of the TRA to allow inclusion of uncollectibles. The Petitioners are now seeking to carry that docket forward in perpetuity.

The original rule, when adopted in 1970, was changed upon a petition filed by the Petitioners in 1986 for a rulemaking. As Petitioners stated, the original rule when adopted in 1970 did not "work well" and the gas industry sought a revision. (Affidavit of Archie Hickerson, Petitioners Response in Opposition to the Consumer Advocate's Motion for Summary Judgment, Exhibit #2 p. 5). The gas industry petitioned the TRA for a rulemaking proceeding in January 1986 to revise the PGA rules. The Petitioners saw fit to petition the TRA for a rulemaking because of changes in the natural gas industry. (Affidavit of Archie Hickerson, Petitioners Response in Opposition to the Consumer Advocate's Motion for Summary Judgment, Exhibit #2 p. 6, line 16-20) This further supports the position that when Petitioners found that changes were needed to the PGA, they obtained relief via a rulemaking. As such, it is only proper that the relief Petitioners are seeking is of the same caliber and hence, warrants the petitioning to the TRA for a rulemaking proceeding for revisions to the PGA rules.

A declaratory ruling is proper when a party requests a clarification of the applicability of a rule or statute.[9] The Petitioners are not seeking clarification but amendment/alteration of the

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[9] Tenn. Code. Ann. § 4-5-223.

> "Any affected person may petition an agency for a declaratory order as to the validity or applicability of a statute, rule or order within the primary jurisdiction of the agency. . . ."

PGA rules. The Petitioners are seeking an alternative interpretation of the PGA rules that if adopted by the TRA would permanently alter the PGA rules.

Petitioners are seeking to redefine the formula components of the PGA rules that form the basis of the PGA mechanism. A declaratory order is an inappropriate instrument to alter or amend rules. The TRA has the authority to issue declaratory orders as to the applicability and interpretation of rules. Nevertheless, in situations in which there is the possibility that rules would be altered, the proper procedure for rulemaking is set out in the Uniform Administrative Procedures Act and in the procedure of the TRA as codified at Tennessee Code Annotated § 4-5-201, *et seq* & § 65-2-101, *et seq*. It is this same statute that clearly sets out the petitioners' privilige of seeking a declaratory order as subordinate to the rulemaking process. The petition presently before the TRA is limited in scope to determining the "validity or applicability" of a rule that was previously promulgated.

As stated in the Memorandum in Support of Summary Judgment filed by the Consumer Advocate, the Tennessee Court of Appeals has ruled that when the alteration or introduction of a rule is a change in policy and far reaching, as in this case, that rulemaking is the preferred mechanism. The Tennessee Court of Appeals has adopted this preference in *Tennessee Cable Assn. v. Tennessee Public Service Commission*, 844 S.W. 2d 151 (Tenn. Ct. App. 1992). This decision adopted a test to determine whether a rulemaking procedure is needed.[10] If it appears that the administrative agency's determination may equate to many or most of the following circumstances, then a rulemaking procedure is warranted:

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[10] *Tennessee Cable Assn. v. Tennessee Public Service Commission*, 844 S.W. 2d 151, (Tenn. Ct. App. 1992).

> (1) is intended to have wide coverage encompassing a large segment of the regulated or general public, rather than an individual or a narrow select group; (2) is intended to be applied generally and uniformly to all similarly situated persons; (3) is designed to operate only in future cases, that is, prospectively; (4) prescribes a legal standard or directive that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authorization; (5) reflects an administrative policy that (i) was not previously expressed in any official and explicit agency determination, adjudication or rule, or (ii) constitutes a material and significant change from a clear, past agency position on the identical subject matter; and (6) reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy. *Tennessee Cable*, at 162.

A ruling to allow inclusion of Uncollectible Accounts in the PGA would be a change in the current policy, would be binding on all gas companies, would affect a large field of regulation, and would alter the plain language of the current PGA rules. Therefore, a declaratory ruling is inappropriate. The proper mechanism for the change the Petitioners seek is a rulemaking proceeding.[11] Therefore, the TRA should grant summary judgment in favor of the Consumer Advocate.

CONCLUSION

There are no genuine issues of material fact in this case. The Consumer Advocate maintains that the relief the Petitioners request is an alteration/amendment of the current PGA rules. A rule-making proceeding is necessary to alter the PGA rules to provide the Petitioners with the relief they request under Tennessee law. As a matter of law, summary judgment should

[11] Again, the Consumer Advocate does not intend to suggest that a rulemaking proceeding is justifed. Clearly the change advocated by the Petitioners is inappropiate as concerns the pertinent legal and policy issues.

be granted in favor of the Consumer Advocate. Based on the foregoing, we respectfully request that the TRA grant the Motion for Summary Judgment on behalf of Tennessee consumers.

RESPECTFULLY SUBMITTED,

Shilina B. Chatterjee

SHILINA B. CHATTERJEE, B.P.R. #20689
Assistant Attorney General
(615) 532-3382

by Vance Broemel

Vance Broemel

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Dated: November 3, 2003

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via facsimile and/or hand delivery on November 3, 2003.

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EXHIBIT A

IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:

PETITION OF CHATTANOOGA GAS CO., NASHVILLE GAS CO., A DIVISION OF PIEDMONT NATURAL GAS CO., INC. AND UNITED CITIES GAS COMPANY, A DIVISION OF ATMOS ENERGY CORP. FOR A DECLARATORY RULING REGARDING THE COLLECTIBILITY OF THE GAS COST PORTION OF UNCOLLECTIBLE ACCOUNTS UNDER THE PURCHASE GAS ADJUSTMENT ("PGA") RULES.)))))))))))))	DOCKET NO. 03-00209

AFFIDAVIT OF DANIEL W. McCORMAC IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

I, Daniel W. McCormac, being first duly sworn make oath as follows:

Q. Would you state your name for the record, please?

A. My name is Daniel W. McCormac.

Q. By whom are you employed, Mr. McCormac and what is your position?

A. I am employed by the Attorney General's Office as Coordinator of Analysts for the Consumer Advocate & Protection Division.

Q. Are you over 18 years old?

A. Yes.

Q. What is the basis for your knowledge of the information contained in this affidavit?

A. This affidavit is based on my personal knowledge and my review of pertinent sources of information supplied by the applicants or in prior rate case dockets.

Q. What is your educational background and what degrees and licenses do you hold?

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

Q. What is your experience in the field of ratemaking and regulatory accounting?

A. I have 27 years of experience in the field of utility ratemaking and regulatory accounting including two and one-half years with the Certified Public Accounting firm of Wilson, Work, Fossett & Greer as the supervisor in the utility consulting segment. I served sixteen years with the Tennessee Public Service Commission, including one year as Technical Assistant to the Commissioners. I have served seven years with the Office of the Attorney General and two years as Chief of Energy and Water at the Tennessee Regulatory Authority (TRA). While employed by the Commission and the Attorney General's Office, I supervised the preparation of many utility rate cases and earnings reviews. As part of these investigations, we developed financial exhibits to present to the Commission or TRA. These investigations supplied evidence to the TRA to enable it to set just and reasonable rates for utility services. In addition, I participated in various special studies and helped in other cases in which I did not testify.

As the Technical Assistant to the Commissioners and later as the Chief of Energy and Water, I observed or participated in hearings and analyzed the issues in each case from a technical perspective. I provided the Directors with expert assistance in evaluating and interpreting the financial evidence in the record. I also provided and checked calculations based on that evidence.

My duties with the Consumer Advocate & Protection Division (CAPD) are similar, but also include the review of various tariffs filed before the TRA. I assist in the decision making process as to whether the terms and conditions of the numerous filings are just and reasonable or whether additional evidence is needed to support the filings. When significant consumer interests appear to be in jeopardy, we investigate further and provide expert testimony before the TRA when needed.

Q. What expertise do you have related to the natural gas industry?

A. Since 1976 I have been involved in auditing gas companies, reviewing testimony, tariffs and exhibits, negotiating rates, and preparing testimony and exhibits relating to various revenue, expense, and rate base issues of all major Tennessee gas distribution companies. I have prepared testimony in every major case involving a gas utility since my employment with the Attorney General's office in 1994.

Q. What is your assignment in this docket?

A. I reviewed the petition and assisted in the determination of whether the petition is warranted.

Q. What were the conclusions from the Consumer Advocate's analysis?

A. We conclude that the petition should be denied.

Q. What are the primary reasons for this conclusion?

A.
1. The clear and unambiguous wording of the Purchased Gas Adjustment (PGA) rule clearly shows that the intent of the rule is to assure the proper "billing" of all prudently incurred gas costs.
2. Historical practice supports the current interpretation of the PGA rule that utilities are allowed to "bill" all prudently incurred gas costs.
3. Changing the rule or the interpretation of the rule would eliminate or reduce the companies' incentive to provide good service and properly manage Uncollectible Accounts expense.
4. Changing the rule would provide companies a rate increase (or decrease) based solely on increases or decreases in Uncollectible Accounts expense. This would not necessarily produce just and reasonable rates.

Q. How long has the Tennessee Regulatory Authority and its predecessor, the Tennessee Public Service Commission (TPSC), been regulating natural gas

companies in Tennessee?

A. The TRA and its predecessor have regulated natural gas companies for at least 50 years.

Q. Did the regulatory agencies have a PGA rule prior to June 5, 1970?

A. No, the first PGA rule was approved by order on June 5, 1970 in Docket G-4557-70-1.

Q. Why did the TPSC adopt a PGA rule?

A. The TPSC adopted the PGA rule to improve the administrative process by which just and reasonable utility rates are set in Tennessee. That administrative process is a rate case, which is the normal procedure to determine a utility's just and reasonable rates.

Q. Before the PGA rule was implemented, how were gas rates set?

A. Before the PGA rule, a gas utility's rate case included a determination of what the utility would pay for its natural gas supplies in the future. In the 1970s the price of natural gas rapidly increased and became unstable. Each time the natural gas price increased significantly, the natural gas utilities would file a rate case to increase the authorized rate so consumers could be billed to cover the increased costs of natural gas. This created a situation where rate cases were "pancaked" on top of each other, meaning that before one rate case was concluded, another one would be filed. The regulatory agency decided to adopt the PGA rule as a means of avoiding this series of rate cases caused by the utilities inability to bill consumers for the major fluctuation of natural gas prices. At the same time the PGA was not regarded as a departure from the just and reasonable principle which guides the determination of a utility's rates.

Q. Why was the PGA not a departure from the "just and reasonable principle" which determines a utility's rates?

A. The PGA was consistent with the "just and reasonable principle" because the PGA allowed us to avoid the burden of numerous rate cases caused by one single issue – the expense of purchased gas – or the sum of all bills that gas suppliers render to the gas utility. The bills themselves were accessible in PGA and ACA audits. The PGA allowed rates to stay in sync with the utilities' gas costs and these changes were accepted by consumers as a legitimate cost. In addition, wholesale gas prices at that time were set by the Federal Power Commission, so the local utilities had no control over the price of gas.

Q. In your opinion, what are the petitioners in this docket seeking?

A. In my opinion the petitioners are asking the Tennessee Regulatory Authority to treat the Uncollectible Accounts expense account as if it were a gas cost, even through the Uncollectible Accounts expense is just one of many utility revenue or expense accounts which rise and fall over time. Examples include Forfeited Discounts revenue, labor costs, interest expense, and cost of equity.

Q. What is your opinion of their goal?

A. In my opinion their goal is arbitrary. There is no good reason why Uncollectible Accounts expense should be determined and collected outside of a rate case while changes in revenues, manpower expenses, or debt costs are not.

Q. What is the current accounting practice followed by the companies to record Uncollectible Accounts expense?

A. It is standard practice to estimate the amount of Uncollectible Accounts expense related to the current period's billings. This expense is recorded along with all other operating expenses associated with the current period. A more detailed description of the accounting process will be presented later.

Q1. Would you explain how the clear and unambiguous wording of the PGA rule clearly shows that the intent of the rule is to assure the proper "billing" of all prudently incurred gas costs?

A. The rule states at 1220-4--7-.03 (1) "The PGA shall consist of three major components: (a) the Gas Charge Adjustment; (b) the Refund Adjustment and (c) the Actual Cost Adjustment (ACA)." The "Gas Charge Adjustment" is defined at 1220-4--7-.01 (4) as "the per unit amount **billed** by the Company to its customers solely for Gas Costs." The Gas Charge Adjustment is computed by dividing the adjustment dollars by "Total Sales" or "Total volumes **billed** . . ." (1220-4--7-.03 (1) (a) 3. (viii)).

The ACA factor is defined at 1220-4--7-.03 (1) (c) (2) as "the difference between (1) revenues **billed** customers by means of the Gas Charge Adjustment and (2) the cost of gas . . ."

Furthermore, 1220-4--7-.04 clearly spells out the appropriate accounting to be followed to account for gas costs. Gas costs are expensed (or debited) to the "Natural Gas Purchases" account as "volumes are sold or **billed** to customers."

In addition, the NARUC Uniform System of Accounts requires gas costs to be recorded as Gas Supply Expenses in Account Numbers 800-813. The petitioners in this docket want to redefine a portion of a "Customer Accounts Expense" (Account Number 904 - Uncollectible Accounts) as a "gas cost." This would not only violate the PGA rules, but would violate NARUC's Accounting Requirements. There is no allowance in the rule for any adjustment for cost changes after those costs are billed.

Q. What is the stated intent of the rule?

A. "These Purchased Gas Adjustment (PGA) Rules are intended to permit the company to recover, in timely fashion, the total cost of gas purchased for delivery to its customers and to assure that the Company does not over-collect or under-collect **Gas Costs** from its customers."

Q. In your opinion, what is the intent of the PGA rule?

A. The rule is intended to allow gas distribution companies to keep gross profits stable. This is accomplished by preventing the under collection or over collection of **gas costs**.

Q. Was the PGA rule designed to allow Companies to recover changes in Uncollectible Accounts expense?

A. No.

Q. Would you please describe Uncollectible Accounts expense and explain how this expense is different from gas costs?

A. Yes. According to the "Uniform System of Accounts (USOA) for Class A and B Gas

Utilities" as published and prescribed by the National Association of Regulatory Utility Commissioners (NARUC), Uncollectible Accounts expenses are included in the group of accounts called "Customer Accounts Expenses". "Customer Accounts Expenses" are described beginning on page 226 of the NARUC USOA and include the following accounts:

901. Supervision.

902. Meter Reading Expenses.

903. Customer Records and Collection Expenses.

904. Uncollectible Accounts.

905. Miscellaneous Customer Accounts Expenses.

The description of account 904. Uncollectible Accounts reads:

> "This account shall be charged with amounts sufficient to provide for losses from uncollectible utility revenues. Concurrent credits shall be made to account 144, Accumulated Provision for Uncollectible Accounts-Cr. Losses from uncollectible accounts shall be charged to account 144."

It is significant to note that the description refers to "uncollectible utility **revenues**" rather than "expenses" or "gas costs."

Q. Why is this significant?

A. Because "base rates" are designed in a rate case to produce a certain level of **revenues**. Those revenues are designed to cover all just and reasonable operating expenses of the company, **including** "Account No. 904 - Uncollectible Accounts" expense and a reasonable level of anticipated profits to provide a return on the company's investments. Once rates are designed and approved to cover certain costs, and those rates are billed to consumers as **revenues**, these costs are considered to be recovered.

Q. Please explain the "base rate" component of a customer's bill.

A. The most relevant factor in setting rates for any gas company is the base rate. This rate is the gross profit margin for the company. The base rate or gross profit represents the difference between the total charges billed to consumers and the actual cost of gas. The base rate and other service charges should cover all just and reasonable operating expenses (other than gas costs), and taxes with sufficient residual to allow an adequate return on the Company's rate base.

In essence, a customer's bill is comprised of two components, 1) the gross profit or base rate charge, and 2) the gas cost component. The PGA rules were designed to allow companies to **bill** the appropriate cost of gas in the **gas rate component** of the rate. However, once billed, the total bill becomes **revenue** to the company.

Q. Is it a fact that some of the bills are never paid?

A. Yes.

Q. How are these unpaid bills treated for ratemaking purposes?

A. "Account 904 - Uncollectible Accounts" expense is an ordinary cost of conducting business and is included along with other "Customer Accounts Expenses" in setting the base rate in a rate case. During a rate case, all controllable expenses are examined closely to assure the reasonableness of the expense levels. There is no detailed separation in the accounts to divide Uncollectible Accounts into gas and other. Such a separation can only be estimated.

Q. How are gas costs treated for ratemaking purposes?

A. Gas costs are treated totally different from other operating expenses when developing rates. The PGA rules were designed to allow the gas cost component of the company's rates to be adjusted to keep up with the rapidly changing cost of gas. As gas costs rise, the gas cost **billing** component increases. As gas costs go down, the gas cost **billing** component decreases.

Q. What does "recover" mean?

A. The context of the rule clearly shows that the intended meaning of "recover" refers to the authorization to bill consumers for the costs. "Recover" is defined in the description of the Actual Cost Account in Rule 1220-4--7-.03 (1)(c) 2: "The ACA shall be the difference between (I) **revenues billed** customers by means of the Gas Charge Adjustment and (2) the cost of gas invoiced the Company by Suppliers plus margin loss (if allowed by order of the Commission in another docket) as reflected in the Deferred Gas Cost account."

Therefore, the utilities "recover" the "Actual Cost" when the consumers are **billed** the "Actual Cost." The "Actual Cost" account allows the utilities to bill 100% of the gas costs, not 101%.

Q. The petitioners in this docket want to redefine a portion of a "Customer Accounts Expense" (Account Number 904 - Uncollectible Accounts) as a "gas cost." Why would this violate the PGA rules and NARUC's Accounting Requirements?

A. Once rates are designed and approved to cover certain costs, and those rates are **billed** to consumers as **revenues**, for accounting purposes these costs are considered to be recovered. Once the costs are **billed** to consumers, the costs have been recovered through the **billed revenues**. The **billed** revenues are recorded in the appropriate revenue account such as account No. 480 - Residential Sales. The **billed** amounts are also recorded in balance sheet account No. 142 -

Customer Accounts Receivable as an asset. However, once billed as Revenues and recorded as Accounts Receivable, there is no further accounting for the components of revenues billed and recorded in the Customer Accounts Receivable balance. Those billed revenues become an asset.

If any part of the Accounts Receivable are expected to become uncollectible, utilities have the right to estimate that portion and record it in Account No. 904 - Uncollectible Accounts expense. The utilities want to reclassify a portion of this Uncollectible Accounts expense back into gas cost so these costs can be billed a second time. The PGA authorizes "recovery," "collection," or "billing" of gas costs one time only. Nothing in the rule allows the same gas costs to be billed a second time.

The petitioners are asking for permission to separate the Uncollectible Accounts expense into gas costs and other costs. There is no such separation in the accounting system because revenues are not expenses.

In addition, the utilities are trying to ignore normal accrual accounting. Accrual accounting means that when revenues are billed, they become revenues. In fact, revenues are sometimes estimated and recorded as revenues even before they are billed. The utilities are saying that revenues are not revenues when they are billed, but become revenues only when the bills are paid. This would be a cash basis of accounting. But even under cash basis accounting, there is no distinction in the revenue accounts for gas revenues and other revenues.

Q. How does the USOA define revenues?

A. The USOA defines Residential Sales revenue as "...the net **billing** for gas supplied for residential or domestic purposes." Again, once **billed**, costs are recovered or offset by **revenues**.

Q2. Would you explain how historical practice supports the current interpretation of the current rule that utilities are allowed to "bill" all prudently incurred gas costs?

A. The petition attempts to change the historical interpretation of the PGA rule. The PGA rules were designed to allow companies to "recover" gas costs by "billing" those costs to consumers. The PGA rules have been interpreted this way consistently since implementation in 1970. Unpaid bills are called "Uncollectible Accounts" expense and have been recovered through the base rate portion of revenues as part of the authorized gross profit margin established in a rate case.

Q. Have companies ever been allowed to recover extraordinary Uncollectible Accounts expense through the PGA?

A. Yes. In Docket No. 01-00802 the TRA chose to allow a "one-time-only" exception to include Uncollectible Accounts expense associated with gas costs in the PGA accounts.

Q. Are the circumstances surrounding this case different from those in Docket No. 01-00802?

A. Yes.

Q. What were some of the unprecedented circumstances surrounding the one-time-only allowance?

A. In January of 2001, the cost of gas spiked to all time highs. This caused a significant and unanticipated hardship on consumers. Page 2 of the order in Docket No. 01-00802 states:

> The prospect of excessive disconnects was of great concern to the TRA as expressed at the TRA's conference on February 6, 2001. In

> response to the TRA's concerns the companies made every effort to extend payment plans and offer budget billing. In doing so, the companies adopted a policy of not conducting "business as usual" including not disconnecting customers in accordance with tariff provisions.

The order further states that "each of the companies experienced an unprecedented increase in the level" of bad-debt expenses in Tennessee. "The magnitude of the uncollectible accounts experienced by the Applicants during the 2000-2001 winter heating season and thereafter is far in excess of the amounts currently allowed for uncollectible account expenses in the respective tariffs."

Continuing on pages 4 and 5 of the order:

> "Although the Directors recognized that the three companies were not themselves responsible for the unusual increases in wholesale gas costs that occurred late in 2000, the Directors expressed concern that high gas bills might be causing an abnormally large number of residential customers to have gas service disconnected, including customers whose payment history had previously been good. The Directors noted, and the company representatives acknowledged, that each of the three companies had recently disconnected a much higher than normal number of customers for non-payment of customers' gas bills. The company representatives described a number of unusual measures each company had taken to alleviate the burden of high gas bills, including extended payment periods, delayed disconnection, and the opportunity to enter into average payment plans at any time. <u>The Directors asked the companies not to treat the situation in February 2001 as normal, to take unusual measures to avoid the harsh effects of high bills</u>, and to be compassionate toward their residential customers who were facing unusual circumstances." (Emphasis added)
>
> **"This measure should not be understood, however, to reflect the ongoing policy of the Authority, but is adopted for this <u>one instance only</u> in response to the extraordinary circumstances surrounding the winter of 2000-2001."** [Emphasis added]

In summary, the order clearly indicates the highly unusual circumstances surrounding the decision that allowed the companies to recover the extraordinary costs on a one-time-only basis. It is clear that the companies suspended "business as usual" practices in response to the TRA's concerns about the welfare of the consumers. The modified petition that was filed by the gas industry in 2001 was ultimately approved. But that petition was presented as an exception to the rule. The current petition requests the TRA to change the rule or interpretation of the rule as a permanent change. A "one-time-only" exception was allowed as a good-faith attempt to deal with the extraordinary circumstances of 2001. This good-faith exception should not be used as a precedent to change an interpretation that has endured for 33 years. We should learn from this experience and resist the temptation to remove incentives and accountability from the ratemaking process.

Q3. Would you explain why changing the rule or the interpretation of the rule would eliminate or reduce the companies' incentive to provide good service and properly manage Uncollectible Accounts expense?

A. Under the PGA rule's current interpretation, distribution companies are allowed to charge rates designed to recover all just and reasonable costs associated with delivering gas to consumers and billing and collecting the approved rates. A rate case examines the cost of serving consumers and sets rates that are designed to allow the companies to recover prudent costs through the base rates or gross profit component of the bill. The formal rate case proceeding is a more thorough investigative process in which all elements of the cost of service are examined to assure that those costs are prudent.

The costs recovered through the gross profit or base rate portion of the bill are entirely separate from the PGA or gas cost component of the bill. The gross profit covers reasonable expenses including NARUC's expense account No. 904

"Uncollectible Accounts." Account No. 904 contains the estimated expense associated with "losses from uncollectible utility revenues." Reasonable expenses in NARUC account No. 903 - "Customer Records and Collection Expenses" are also included in the development of just and reasonable rates that are set as the result of a rate case. Account No. 903 includes expenses associated with billing and collecting revenues. Both accounts 903 and 904 are in the "Customer Accounts Expenses" section of the USOA.

Just and reasonable rates should be examined and set in the context of a rate case, not by changing the interpretation of a rule. When rates are set in a rate case, they are based on the proper matching of all revenues, expenses, and investments of the company. If companies are protected from most of the risks associated with Uncollectible Accounts expense, the incentive to control those expenses will be reduced. In fact, the utilities may have an incentive to take actions that would increase Uncollectible Accounts expense.

Q. How could the utilities have an incentive to allow Uncollectible Accounts expense to rise?

A. Whenever cost recovery is automatic, the incentive to control that cost is reduced. Since the utilities' request would make the recovery of most of the Uncollectible Accounts expense automatic, there would be less incentive to properly manage that expense.

To carry the illustration further, a utility could lay off employees and reduce customer service and collection efforts. Since 100% of those savings would be retained by the utility, this would improve earnings. So the utility would have an incentive to **reduce** customer service. A resulting consequence could be an

increase in Uncollectible Accounts expense.

The utilities control Customer Records and Collection Expenses, and these expenses have a bearing on Uncollectible Accounts expense. The utilities must manage or "weigh" the costs saved by laying off people against the possible consequences of those actions on Uncollectible Accounts expense. For example, during the winter of 2000-2001, some of the petitioners did not have sufficient employees to follow the established disconnection and connection policies. As a result of the shortage of employees, some consumers who were not paying the gas bills were allowed to continue to take gas even through the summer of 2001. This quite likely contributed to the increased levels of Uncollectible Accounts expense in 2001.

If utilities are allowed to pass most of the resulting increase in Uncollectible Accounts expense on to consumers, the utilities could have an incentive to provide less customer service even if that allows Uncollectible Accounts expense to rise.

The petitioners have stated that the potential loss of the gross profit portion of Accounts Receivable provides enough of an incentive to collect those accounts. However, the utilities have an incentive to make sales even when there is only a slight chance that the bills will be collectible. Assume 10 highly questionable accounts are allowed to take gas **after** it becomes known that collection of their existing accounts may be in doubt. Disconnecting those 10 customers would cause immediate extra expenses associated with reading the meters, turning off the gas, issuing final bills, etc. In addition, the "gross profit" portion of the bills would stop immediately upon disconnection of the service. By allowing those 10 customers to continue taking gas, the utility will generate even more revenue while saving costs!

Even if 9 of those 10 accounts are subsequently "written off," the utility has still gained the profit made on the one sale that was ultimately collected. If the 10 accounts were not allowed to take the gas, there would have been no accounts to write off. Thus, the utility has not "lost" anything because the risky sales should have not been made.

Meanwhile the other paying customers would be paying the gas costs for the 9 bad accounts. Again, this proposed new scheme provides potentially damaging and costly incentives whereby the consumers are asked to bear the risks and the utilities only stand to gain.

Q4. If the utilities are allowed to recover Uncollectible Accounts expenses automatically, could this cause rates to become unjust and unreasonable?

A. Yes. The petitioners' request takes a single operating expense, Uncollectible Accounts expense, and compares it to the level of Uncollectible Accounts expense that existed in the most recent rate case. If the current expense is greater, the company would be able to increase rates to recover the increase. If the current expense is lower, the company would be able to reduce rates to refund the savings. The petitioners produced no evidence to show that a rate change is needed. The utilities are only claiming that one expense, Account No. 904 - Uncollectible Accounts, may change subsequent to the last general rate case.

Q. Does this support the need for a rate change?

A. No. While Uncollectible Accounts expense may change, other expenses also change. For example, interest expense on short term debt has declined by 50% or more in the last few years. Other expenses have saved these utilities millions of dollars. The petitioners are focusing only on one portion of the cost of service that will provide the opportunity to reduce risks, incentives and accountability while ignoring some major expenses that have declined in recent years. Perhaps the Petitioners could use some of these savings to offset any increase in Uncollectible Accounts expense instead of trying to increase rates to consumers.

Atmos and Chattanooga Gas have also reduced levels of employment in Tennessee. Chattanooga Gas has reduced service employees from 37 in 1996 to 30 in 2003. Atmos has reduced customer service expenses from $303,479 in 1995 to $36,764 in 2002.

The petitioners will likely argue that Uncollectible Accounts expense varies with gas costs. While this may be true, Forfeited Discounts revenues need to be examined closely because these appear to vary with the cost of gas. For example, if a customer gets a gas bill that is comprised of $30 for service and $70 for gas, the total bill is $100. The 5% late charge on a $100 bill would be $5. If the total bill goes up to $140 due to a higher cost of gas, the 5% late charge would be $7. It is quite possible that the extra $2 late charge associated with the higher cost of gas could offset a large portion of any increase in Uncollectible Accounts expense.

Exhibit A shows that Forfeited Discounts revenues normally exceed Uncollectible Accounts expense. Chattanooga's last rate case included .20% of revenues for Uncollectible Accounts expense, and the Forfeited Discount revenue was estimated to be .68% of revenues. In the 2003 Nashville Gas rate case, Uncollectible Accounts expense was assumed to be .45% of total revenues, however the Forfeited Discount revenue was estimated to be .74% of revenues. Similarly, the latest Atmos rate case assumed .12% of revenues for Uncollectible Accounts expense, but the Forfeited Discount revenue was estimated to be .43% of revenues. If the utilities want a rate increase to adjust for increases in Uncollectible Accounts, the utilities should also be willing to give a rate **reduction** to reflect increases in Forfeited Discounts revenue.

Incentive plans are not designed to be all reward without any risks. If utilities want incentives, the incentives need to be balanced with risks and rewards. The petitioners want to remove the sticks and eat the carrots.

Approving the petitioner's proposed changes would continue to shift expenses from the review of the TRA and remove the incentive to control costs. If the TRA allows the process of transferring more and more costs into the "automatic recovery" territory, this may ultimately lead to all costs being flushed through the PGA. If all costs were in the PGA today, it is possible that we would be reducing rates instead of increasing rates. As stated earlier, several major costs have declined since the most recent rate cases for two of the petitioners. In addition, the petitioners are collectively receiving millions of dollars per year in "incentive payments" over and above actual gas costs. Furthermore, if all ratemaking risks are removed, the cost of capital would certainly decline dramatically. If these utilities want the opportunity to earn 8%, 9%, 10% or more on equity, there needs to be some risk involved. The 9% return needs to be **earned** not **given** to the investors! The petitioners have the right to **bill** reasonable costs to consumers, but consumers should not have to take the money to the bank and fill out the deposit ticket for the management of these utilities.

The current PGA mechanism is difficult enough to enforce. Almost all ACA audit reports reveal errors in the recording or billing of the gas costs. For example, the latest Nashville Gas audit report in Docket 03-00317 shows $103,000 of errors in accounting for the cost of gas. Adding yet another automatic recovery mechanism that requires estimates of the separation of the accounts receivable into the theoretical sources of those accounts would add another source of potential error. The current process is cumbersome and error prone. Allowing another layer of automatic cost recovery will only further complicate the process.

Q. How can electric power cost be considered as "gas costs"?

A. The "matching concept" is an integral part of generally accepted accounting and ratemaking principles. The matching concept encourages the proper treatment of certain costs in such a way as to match the costs with the associated revenues that cover those costs. Certain costs can be either expensed or capitalized depending on the circumstances.

For example, interest costs are normally considered an expense. However, there are several exceptions to the general rule that allow interest to be deferred or capitalized for future recovery. Interest costs that are incurred on construction work in progress, such as a liquefied natural gas (LNG) facility, may be capitalized as a part of the cost of the LNG facility. This deferred interest is then recovered over the useful life of the facility while the facility is being used to produce gas that is sold to consumers.

The capitalization of electric power costs also puts the LNG produced locally on a more equal par with imported LNG. Chattanooga Gas Company and Atmos Energy have imported LNG into Tennessee to be vaporized and sold to consumers. The imported LNG certainly included the power or fuel costs required to liquefy that gas.

Q. Is Nashville Gas now able to "recover" the capitalized electric costs?

A. Yes. By allowing Nashville Gas to capitalize or defer the previously expensed electric power costs, these costs are now **billed** to consumers as the LNG is produced and sold. The power costs are recovered when **billed** as LNG gas costs. If the electric power costs were expensed as incurred and included in the normal business expenses, these costs would have been added to the base rate and would have been recovered as **billed**. Either way, the electric power cost would have been recovered when they were **billed**. Any unpaid bills produce another operating expense called Uncollectible Accounts expense. Uncollectible Accounts expense is a different operating expense as previously discussed, and is recovered as a normal cost of conducting business in the gross profits that are set in a rate case. The TRA has already approved 100% of all gas costs, including some electric power costs, to be billed to consumers through the ACA mechanism of the PGA. The petitioners are now seeking permanent approval to re-label Uncollectible Accounts as "gas costs." This would allow over 100% of gas costs to be billed to consumers.

Q. Why are Uncollectible Accounts expenses different from power costs?

A. One major difference is controllability of the costs. The primary reason for the adoption and subsequent modification of the PGA rules was to allow utilities to recover costs which were uncontrollable. Gas is normally purchased at market prices. Since the utilities can not control this price, the PGA allows these costs to be passed through and billed to consumers.

Another major difference is that the power costs actually become a part of the cost of LNG. Uncollectible Accounts expenses are not, and never have been, a part of the cost of gas.

Q. Would you please summarize your testimony?

A. In summary it appears that the applicants are attempting to introduce a new "interpretation" to a long standing rule to provide a multi-faceted financial gain. The mantra of "only collecting our gas cost" **<u>is inaccurate</u>**. Petitioners are attempting to:

1. short-circuit the normal rate making procedure;
2. receive an automatic recovery of "Uncollectible Accounts" expense through an automatic pass-through mechanism;
3. provide more and more automatic recovery of expenses through a pass-through mechanism;
4. provide a speedup in expense recovery which reduces the proper incentives for good management of expenses;
5. provide a subsidy for reducing service quality through continued reductions of service personnel;
6. provide an opportunity for less regulatory oversight responsibility and accountability;

Q. What is your recommendation?

A. The petition should be denied.

Further Affiant saith not.

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

Sworn and subscribed before
me this 3rd day of November, 2003

NOTARY PUBLIC

My commission expires: 9/22/07

EMILY KNIGHT
NOTARY PUBLIC AT LARGE
DAVIDSON COUNTY, TENN.

My Commission Expires SEPT. 22, 2007

Exhibit A
To Affidavit of Daniel W. McCormac

TRA #97-00982
CA Exhibit
Schedule 14

Chattanooga Gas Company
Revenue Conversion Factor
For the 12 Months Ending September 30, 1998

Line No		Amount	Balance
1	Operating Revenues		1 000000
2	Forfeited Discounts	0 006837	0 006837
3	Balance		1 006837
4	Uncollectible Ratio	0 001952	0.001965
5	Balance		1 004872
6	State Excise Tax	0 060000	0 060292
7	Balance		0 944579
8	Federal Income Tax	0 350000	0 330603
9	Balance		0 613977
10	Revenue Conversion Factor (Line 1 / Line 9)		1 628727

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03-00313
CA Exhibit
Schedule 11

Nashville Gas Company
Revenue Conversion Factor
For the 12 Months Ending October 31, 2004

Line No		Amount		Balance
1	Operating Revenues			1.000000
2	Add. Forfeited Discounts	0.007435	A/	0.007435
3	Balance			1.007435
4	Uncollectible Ratio	0.004534	B/	0.004568
5	Balance			1.002867
6	State Excise Tax	0.060000	C/	0 060172
7	Balance			0.942695
8	Federal Income Tax	0.350000	C/	0.329943
9	Balance			0 612752
10	Revenue Conversion Factor (1 / Line 9)			1.631982

A/ Filing Guidelines Item 25, P. 42
B/ Filing Guidelines Item 25, P 47 adjusted to include all uncollectibles ($2,132,710 / $470,411,854)
C/ Statutory rate

95-02258
CA Exhibit
Schedule 11

Atmos

United Cities Gas Company
Revenue Conversion Factor
For the 12 Months Ending November 30, 1996

Line No		Amount	Balance
1	Operating Revenues		1 000000
2	Forfeited Discounts	0 004266	0 004266
3	Balance		1.004266
4	Uncollectible Ratio	0 001237	0 001242
5	Balance		1.003024
6	State Excise Tax	0 060000	0.060181
7	Balance		0.942842
8	Federal Income Tax	0.350000	0 329995
9	Balance		0 612847
10	Revenue Conversion Factor (Line 1 / Line 9)		1.631727

EXHIBIT B

BEFORE THE TENNESSEE REGULATORY AUTHORITY

AT NASHVILLE, TENNESSEE

March 31, 2003

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

ORDER ON MOTIONS FOR SUMMARY JUDGMENT

This matter is before the Hearing Officer, duly appointed by the Directors of the Tennessee Regulatory Authority (the "Authority" or "TRA"), upon motions for summary judgment filed by the Energy and Water Division of the Authority ("Authority Staff") and the Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate"). The motions for summary judgment seek to dismiss the claims of United Cities Gas Company ("United Cities," or the "Company" or "UCG") that it has properly accounted for negotiated transportation contracts and the NORA contract in its performance-based ratemaking ("PBR") mechanism. Upon review of the record in this proceeding, including the Authority Staff's Audit Report, the affidavits filed by the parties and the responses to discovery requests, the Hearing Officer denies both motions for summary judgment.

Background

United Cities' PBR Mechanism

On January 20, 1995, United Cities Gas Company ("United Cities") filed an application with the Tennessee Public Service Commission ("TPSC") proposing that instead of reviewing United Cities' performance after-the-fact by way of a prudency review,[1] as had been traditionally done, the TPSC review its performance on an ongoing basis. United Cities requested that it be authorized to conduct a two-year experiment whereby the TPSC would determine whether the Company was performing reasonably in managing and acquiring its gas supply by measuring United Cities' performance against pre-defined benchmarks that would act as surrogates for the market price of gas. The proposal was premised on United Cities' contention that under a performance-based proposal, the Company would become more accountable to customers for its management and acquisition of gas supplies.

The TPSC convened a hearing at which evidence was presented by United Cities and the Consumer Advocate. The TPSC issued an order approving the proposal with modifications on May 12, 1995. In approving United Cities' proposal, the TPSC adopted, among others, the following modifications:

1. United Cities would be limited to a maximum of $25,000 per month on gains and losses for all of the approved PGA mechanisms.

2. The Gas Procurement Mechanism would be modified to include a 2% reasonableness zone that applies to both sides of the market. The Company would share equally with its customers all gas costs savings below 98% of the market and would also bear a share of the costs in excess of 102% of the market. In regard to the other mechanisms, 90% of all gains or losses would go to the consumers and 10% would go to the Company.

3. The Company would be required to contract with an independent consulting firm to review this mechanism and report to the TPSC annually during the two-year experimental period. This review would be for the purpose of informing the TPSC if the proper incentives were in place and whether modifications should be made to the program.

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[1] Under the Purchased Gas Adjustment (PGA) Rules (TRA Rule Section 1220-4-7-.05) an audit of the prudence of gas purchases applies to any gas company with operating revenues of $2,500,000 or more. The Rule states that a qualified consultant, hired by the TRA, is to evaluate and report annually to the TRA on the prudence of all gas costs which were incurred by the gas company during the previous year.

4. The TPSC would again review this matter in two (2) years to consider any further adjustments and whether the program should be made permanent.[2]

On November 7, 1995, the TPSC approved the selection of the independent consultant, Frank H. Creamer of Andersen Consulting. On February 2, 1996, the consultant filed his first report with the TPSC, recommending certain modifications to the PBR mechanism for the second year. After the consultant's report was filed, the TPSC received pre-filed testimony from United Cities and the Consumer Advocate and conducted a hearing on the matter on March 5, 1996. During the hearing, the TPSC took administrative notice of the consultant's report but did not permit the Consumer Advocate to cross-examine the consultant. On May 3, 1996, the TPSC issued an order modifying the PBR mechanism in accordance with the consultant's report.

On June 27, 1996, the Consumer Advocate filed a petition for review of the May 3, 1996 Order in the Tennessee Court of Appeals. The Consumer Advocate argued before the Court that it was denied due process when, during the hearing giving rise to the May 3, 1996 Order, the TPSC took official notice of Frank Creamer's consulting report without permitting the Consumer Advocate to effectively challenge the report. On March 5, 1997, the Court of Appeals issued an Order vacating the TPSC's Order of May 3, 1996, upon finding that the TPSC had violated the Consumer Advocate's due process rights by denying the Consumer Advocate access to all evidence considered by the TPSC and by failing to afford the Consumer Advocate an opportunity to impeach the same by cross-examination. Because the TPSC was dissolved by act of the Tennessee General

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[2] *In Re: Application of United Cities Gas Company to Establish an Experimental Performance-Based Ratemaking Mechanism*, Docket No. 95-01134 Order (Untitled) pp. 4-5 (May 12, 1995).

Assembly on June 30, 1996, the Court of Appeals remanded the case to the Tennessee Regulatory Authority for further proceedings.[3]

On February 28, 1997, the consultant filed his second report containing a review of the company's performance during the second year of the mechanism and a recommendation favoring the implementation of a permanent performance-based ratemaking ("PBR") mechanism. Following the entry of the Court of Appeals' Order, United Cities filed a petition on March 31, 1997, requesting the Authority to adopt the 1996 and 1997 reports of the consultant, Frank Creamer, and to permanently approve the mechanism. The Consumer Advocate opposed United Cities' petition, and on May 20, 1997, the Authority convened a contested case in TRA Docket No. 97-01364.

The Authority bifurcated the case to consider the issues arising from the remand by the Court of Appeals (Phase One) separate from the issues arising from United Cities' petition seeking approval of a permanent performance-based rate making mechanism (Phase Two). The Phase One and Phase Two hearings took place on March 26, 27, and 31, 1998.

In Phase One, the Authority considered the issues associated with the Court of Appeals' remand of the 1996 proceeding, including the 1996 consultant's report and whether the mechanism should continue for a second year. In Phase Two, the Authority addressed the issues raised in United Cities' 1997 petition, including a review of the 1997 consultant's report and a determination as to whether the mechanism should continue on a permanent basis. The Authority issued its Final Order on Phase One and its Final Order

[3] *Tennessee Consumer Advocate v. Tennessee Regulatory Authority and United Cities Gas Company,* Court of Appeals, Middle District, No. 01A01-9606-BC-00286, March 5, 1997, page 7.

Phase Two on January 14, 1999, and April 16, 1999, respectively. The determinations of the Authority in the Phase One order which are relevant to this docket include:

(1) retaining the NYMEX index as one of the basket of indices used to establish the benchmark for the price of natural gas in the ratemaking mechanism;

(2) excluding the NORA contract from the PBR plan because that contract predated the creation of the plan; and

(3) adjusting the lower end of the deadband around the benchmark price to 97.7% for the second year of the plan - a level that is 1% below the level that existed prior to the creation of the PBR plan. (The Authority did not adjust the high end level of deadband which remained at 102%.) The determinations in the Phase Two order relevant to this docket include:

(1) approving United Cities' PBR plan to be a permanent plan effective April 1, 1999;

(2) increasing the earnings cap per year on overall gains and losses from $300,000 to $1.25 million annually beginning April 1, 1999. The rationale provided for this increase was to

> provide the Company with the necessary incentives to continue to become more aggressive by assuming additional risk in the purchasing of natural gas and in managing its firm transportation capacity on the upstream pipelines.[4]

<u>The TRA's 2002 Audit Report</u>

The Company's Incentive Plan Account filing for the year ended March 31, 2001, was received by the TRA Energy and Water Division on August 7, 2001. The Energy

[4] *In Re: Application of United Cities Gas Company to Establish an Experimental Performance-Based Ratemaking Mechanism*, Docket No. 97-01364, Final Order on Phase Two, p. 23 (August 16, 1999).

and Water Division completed its audit of that filing on March 22, 2002. On March 28, 2002, the Energy and Water Division issued its preliminary audit findings to the Company, and on April 5, 2002, the Company responded thereto. The Audit Report was modified to include the Company's responses and was filed in this docket on April 10, 2002. This matter was convened by the Authority to hear issues arising out of the Audit Report.

In portions of the Audit Report relevant to this matter, the Authority Staff stated as follows:

> As part of this mechanism, the Company also reported an additional \$1,254,424 in "procurement savings," \$201,893 resulting from the NORA contract and \$1,052,531 resulting from negotiated transportation contracts. United Cities retained 50% of these alleged savings, for a total of \$627,212. We disagree that the calculations presented by the Company represent "savings" under the terms of the Incentive Plan. The Company's incentive plan defines savings/(losses) as those total commodity costs that fall outside the deadband. The deadband is a range surrounding the benchmark, within which no sharing takes place. The benchmark is a calculation based on approved market indexes. Any savings to be shared between the Company and the ratepayer must be below "market," as defined by the plan. Therefore, we are recommending audit adjustments to eliminate these "savings" from the Incentive Plan Account (IPA).(p.5)

Upon determining that United Cities could not claim savings resulting from the negotiated transportation contracts, the Authority Staff calculated an over-recovery of \$526,265 in the Gas Procurement Incentive Mechanism. The Authority Staff stated further:

> This finding represents a deviation from the terms of United Cities' Incentive Plan tariff. The \$526,265 in savings is 50 percent of what the Company refers to as "Tennessee Negotiated Rate Savings." The savings represent "avoided costs" resulting from negotiated transportation contracts that the Company entered into with various pipelines. These avoided costs are calculated by comparing the transportation rates negotiated in the contract to the maximum pipeline tariff rates approved by the Federal Energy Regulatory Commission ("FERC").

> The Gas Procurement Incentive Mechanism section of the Company's tariff states that it is the savings associated with its commodity cost of gas that is available for sharing. The commodity cost of gas is compared to a "benchmark." If the total monthly commodity cost of gas falls below 97.7% of the benchmark amount, then the resultant savings will be shared 50/50 with the customers. The benchmark is the mathematical product of the actual purchase quantities and the appropriate price index.
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> . . .
>
> For each type of purchase, the benchmark is clearly defined. Some purchases allow an adjustment of the indexes; however, nowhere in the tariff is there mention of sharing savings associated with transportation discounts. The only mention of transportation costs is in conjunction with the definition of the appropriate index for city gate purchases. A city gate purchase is one where the Company buys local gas and avoids the full pipeline costs of transporting the gas from the Gulf of Mexico to Tennessee. However, the pipeline purchases that United Cities was able to negotiate lower transportation rates for were not city gate purchases.
>
> . . .
>
> Including savings associated with transportation rates in the Incentive Plan would require a revision of the Incentive Plan. If the Company decides to take that approach, a problem would arise in establishing a benchmark with which to compare negotiated rates. The definition of Gas Procurement savings in the current tariff is a discount below "market" prices. The tariff establishes indexes as a proxy for the commodity "market." Since there is no known "market" price for transportation rates (other than the rate paid by United Cities Gas), there is no way to know if the maximum FERC approved tariff rates are appropriate proxies. Without a valid benchmark, savings (if any) cannot be quantified. (pp. 10-11)

United Cities provided its Response which was paraphrased in the Audit Report as follows:

> UCG respectfully disagrees with Staff Finding #2 that UCG over-recovered under the Gas Procurement Incentive Mechanism. UCG believes that the PBR mechanism, as documented in the Final Order on Phase II in Docket No. 97-01364 ("Phase II Order") provides for savings associated with transportation discounts and that Staff's current position is contrary to that order. Furthermore, UCG believes that Staff's current position is inconsistent with the prior discussion it had with UCG on the treatment of transportation discounts as savings under the PBR mechanism and that Staff had failed to object to UCG's quarterly reports, which reported these transportation discounts as savings, within 180 days of filing as required by the tariff.

In January 2001, UCG requested a meeting with Staff to provide notice of its renegotiated transportation contracts that went into effect in November of 2000. On January 31, 2001, Staff met with UCG to discuss the treatment within the PBR framework of the avoided costs resulting from the renegotiated transportation contracts on the Tennessee Gas pipeline, East Tennessee Natural Gas pipeline, and the Columbia Gulf pipeline. Attached as Exhibit 1 is a copy of the meeting agenda and the summary sheets reflecting how these savings would be treated under the PBR mechanism. UCG discussed in detail with Staff the reporting methods they intended to follow in regard to inclusion of these avoided costs in its quarterly reports. At no time during or immediately following this meeting did Staff indicate that UCG was incorrect in its treatment of these avoided costs as savings under the PBR mechanism or in UCG's method of reporting.

The quarterly reports for October through December 2000 and January through March 2001 were filed pursuant to the guidelines of the tariff on March 1, 2001 and May 31, 2001, respectively. The Authority failed to provide any written notification to UCG of any exceptions within 180 days of the filing of those reports. Accordingly, pursuant to the tariff (Sheet No. 45.6) UCG's incentive plan account is deemed in compliance with the provisions of the PBR. Accordingly, UCG booked as income its share of benefits earned under the PBR program. This income has been recognized by the Company since November 2000.

Even if the Authority determines that the Staff may now raise exceptions to the previously filed quarterly reports, although no exceptions were made within 180 days of filing those reports, Staff's current conclusion that transportation discounts should not be included in the PBR plan is categorically incorrect. Both the initial PBR plan and the permanent PBR plan covered the entire associated commodity cost of purchasing, delivering and storing of gas to the end consumer. In the Phase II Order, the Authority specifically identified transportation costs as a component in its definition of the total cost of gas:

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

Phase II Order, Footnote 46, p.18.

. . .

> The negotiated transportation discounts were a direct result of the incentives presented by the PBR. In the final Order on Phase Two the Authority found that the cap should be increased to $1.25 million to provide the Company with the necessary incentives to become more aggressive. Staff met with UCG on two occasions to discuss the treatment of transportation discounts. During those meetings, UCG specifically identified to Staff that "city gate purchases" included both raw commodity costs and transportation costs necessarily incurred for the delivery of the commodity to the city gate. Attached, as Exhibit is an invoice from Woodward Marketing, LLC dated December 29, 2000, which illustrates that the total invoice amount charged to UCG for city gate purchases includes transportation costs.
>
> As noted above, UCG also disagrees with the Staff's conclusion that including savings associated with transportation rates would require a revision of the Incentive Plan. Furthermore, UCG disagrees with the conclusion that a problem exists in establishing a benchmark of performance against which to compare the negotiated transportation rates. The absence of published benchmarks providing comparative analysis on discounted transportation rates should not preclude the Staff from including transportation discounts in the PBR mechanism. . . . When transportation contracts are renegotiated, the benefit derived from the new contract is easily quantifiable – it is based on the prior period costs, which in this case were the maximum FERC rates. In calculating the benefit to the ratepayers and UCG, the first contract renewal would be compared to the prior period rate, the undiscounted, published FERC rate. This approach is inward looking, and measures UCG's performance against itself. This approach would be consistent with a prudency audit, if one were to be performed. It should be noted that under the PBR sharing formula, the ratepayer receives the first 2.3% of the discount and one-half of any discount greater than 2.3%. (pp. 11-14)

The Audit Report also contained an exception based on United Cities' treatment of the NORA contract. As a result, the Authority Staff calculated an over-recovery of $100,947 in the Gas Procurement Incentive Mechanism. The Authority Staff explained the reason for this exception in the following manner:

> The NORA contract was initially excluded from United Cities' Incentive Plan in Docket No. 97-01364. The primary reason for the exclusion was that it pre-dated the plan and did not require any additional effort by the Company to generate savings. But the Authority's Phase One Order (January 14,1999) stated that if, when the contract was renewed or

> renegotiated, the Company was still operating under its Incentive Plan, the contract could be considered for inclusion. A new NORA contract was entered into on April 19, 2000, with an effective date of November 1, 2000. On September 26, 2000, United Cities filed a petition with the TRA, requesting permission to include the new NORA contract in its Incentive Plan. Since the contract was no longer pre-existing and met the requirements of the Affiliate Rules contained in the Company's Incentive tariff, the Authority approved the Company's request at its June 12, 2001 Conference.
>
> The Company's calculation of the "savings" related to the NORA contract does not conform to the terms of its Incentive Plan. As discussed in Finding #2 above, the Gas Procurement section of the Company's tariff specifies that the commodity cost for each purchase will be compared to the appropriate benchmark for that purchase. Then the total commodity cost of all purchases for the month will be compared to total benchmark cost. Only the amount of purchases that falls below 97.7% of the benchmark is available for sharing.
>
> The terms of the current NORA contract call for United Cities to pay the appropriate Inside FERC index each month plus a premium for volumes delivered. Through a data request to the Company, Staff has learned that Inside FERC is the commodity price of the NORA gas and the "premium" is the transportation cost for delivery of the gas from the NORA delivery point to the East Tennessee service area.
>
> The Company did not compare the NORA commodity cost with the average of the three indexes for its monthly spot purchases as specified in the tariff. When questioned in a data request, the Company responded that the comparison with the benchmark showed minimal savings and the savings fell within the deadband each month. Therefore, the Company elected to calculate "savings" based on the transportation cost. The calculation is similar to the one for the transportation discounts, addressed in Finding #2. The premium was compared to the maximum tariff rates allowed by FERC. Then 97.7% of the difference was deemed "savings" by the Company to be shared 50/50 with the customer. This type of calculation is not covered under the current Incentive Plan tariff. Additionally, the Company separated out this calculation from the other calculations, so that it led to shared "savings" each month. The tariff is clear that the "total" commodity costs for the month must fall outside the deadband before sharing of savings or losses will occur. (pp. 17-18)

The Audit Report contains a paraphrase of United Cities' response to the exception as follows:

The Company's response to finding #3 is two part. First, it appears that the Staff has chosen to disallow transportation costs on the same basis as set forth in finding #2. Accordingly, UCG adopts its response to finding #2 in regard to savings resulting from avoided transportation costs.

Secondly, the Staff has objected to the method of calculation by the Company of the cost savings resulting from the NORA contract. The method of calculation for the savings associated with the NORA contract have been well documented beginning with the experimental PBR program. Although the NORA contract was subsequently deleted, the method of the calculation nonetheless remained intact as evidenced in Staff's own Table included in their discussion of Finding #2 that noted the type of purchase that the NORA contract falls under, i.e. citygate purchase. It appears that Staff has failed to adjust the commodity portion for the avoided transportation cost when comparing to the indices benchmark.

On or about September 21, 2001, UCG filed a petition requesting permission to include the new NORA contract in the current PBR. TRA Docket No. 00-00844. This petition included attachments which illustrated the inclusion of the avoided cost savings in the PBR calculation. The PBR calculation set forth in the petition is identical to the PBR calculation set forth in the quarterly reports filed thereafter as well as in the annual report. (p. 18)

Travel of the Case

Following the filing of the Audit Report, United Cities requested an opportunity to address the Directors of the Authority regarding its interpretation of the Authority's orders approving the PBR mechanism and its conduct in including the negotiated transportation contracts and the NORA contract in the PBR mechanism. What began as an opportunity for United Cities to make remarks to the Directors grew into a controversy in which a contested case was convened and the Consumer Advocate was granted intervention.[5] Later the Directors appointed a Hearing Officer to preside over the hearing and render a decision on the merits of United Cities' claim.[6]

[5] *Order Convening A Contested Case Proceeding, Granting Intervention to Consumer Advocate and Appointing A Pre-Hearing Officer* (May 13, 2002).
[6] *Order Appointing A Hearing Officer* (June 28, 2002).

Certain members of the Energy and Water Division have been separated from advisory staff, have been designated as a party and are represented by counsel in this proceeding. The Consumer Advocate has intervened in this proceeding largely in part because of its active role in the formation of United Cities' PBR mechanism and its interpretation of that mechanism which is in agreement with the Authority Staff's position. United Cities has retained the services of Frank H. Creamer, the independent consultant who reviewed and made recommendations for modifications in the original PBR mechanism and testified in the 1998 hearings before the TRA. Mr. Creamer supports the position of United Cities in this proceeding.

This matter was originally set for hearing on May 20, 2002, but was continued by joint motion of the parties. Thereafter, all parties in this proceeding engaged in ongoing settlement negotiations. When it appeared that negotiations had reached an impasse, the parties expressed to the Hearing Officer a desire to proceed with an evidentiary hearing. After the hearing was rescheduled for August 27-28, 2002, the Consumer Advocate and Authority Staff filed their motions for summary judgment. At that point the Hearing Officer established a procedural schedule for discovery and responses to the motions for summary judgment. United Cities initiated discovery to the parties primarily in an attempt to determine the bases for those parties' motions for summary judgment. Following the resolution of several discovery disputes, oral argument on the motions for summary judgment were heard by the Hearing Officer on October 24, 2002. There has been no supplementation to the record since the oral arguments. A Status Conference was held with the parties on March 11, 2003, during which the parties agreed that no further briefing on the motions would be necessary.

The Parties' Motions for Summary Judgment

During the preparation for the hearing, the parties entered into discussions regarding the issues that are central to this proceeding. The parties have agreed to the following issues:

> 1. Whether UCG's inclusion in the PBR of the savings resulting from negotiated discounted transportation contracts is consistent with the Authority's Final Order on Phase Two in Docket 97-01364 (the "Phase Two Order").
>
> 2. How should the savings associated with avoided costs resulting from a negotiated gas supply agreement for requirements from the East Tennessee-NORA Gas Pipeline (the "NORA Contract") be accounted for in the PBR under the terms of the Phase Two Order and the Order in Docket No. 00-00844 authorizing inclusion of the NORA contract in the PBR.

The Authority Staff has moved for summary judgment on both issues. The Consumer Advocate has filed a motion for summary judgment only as to the first issue. The limited discovery conducted in this matter has focused on the factual and legal basis for the motions for summary judgment.

The Consumer Advocate moved for partial summary judgment on the issue of whether United Cities could include in its PBR mechanism the savings resulting from the negotiated transportation discounted contracts. The Consumer Advocate asserts that such inclusion is inconsistent with the Authority's Final Order of Phase II in Docket No. 97-01364. The Consumer Advocate asserts that there is no dispute of material fact and that United Cities' claim that it can include those contracts in the PBR mechanism must be dismissed as a matter of law.

Notwithstanding the Consumer Advocate's assertion that the material facts are undisputed, United Cities argues that all of the facts put forth by the Consumer Advocate are in dispute and therefore the motions for summary judgment must be denied. United Cities also asserts that the motions for summary judgment filed by the Consumer Advocate and the Authority Staff must be denied because neither motion complies with Rule 56.03 of the Tennessee Rules of Civil Procedure. In addition, United Cities has alleged that its plan for including the negotiated transportation contracts was discussed with members of the Energy and Water Division in a meeting before taking the action that was cited as an exception in the Audit Report. After the meeting, United Cities reported its activity in two separate quarterly reports which were not challenged by the Energy and Water Division. Because of these events, United Cities argued that the Authority Staff is estopped from finding exception against United Cities for over-recoveries under the PBR mechanism. Quite simply, United Cities responds that

> Because the material facts alleged by the CAD are disputed, and because the Staff failed to allege any undisputed material facts, the CAD and Staff cannot meet the standard for summary judgment under Tennessee law, and both motions for summary judgment must be denied.[7]

Findings and Conclusions

The parties have aptly stated the general law governing the consideration of a motion for summary judgment. Nevertheless, there are additional criteria included in the standard for summary judgment that are applicable to this matter. The seminal case in this area appears to be the Tennessee Supreme Court's decision in *Byrd v. Hall*, 847 S.W.2d 208 (Tenn. 1993). In that case the Court concisely stated the standard for a trial court considering a motion for summary judgment:

> [T]he trial court must take the strongest legitimate view of the evidence in favor of the nonmoving party, allow all reasonable inferences in favor of

[7] *United Cities Gas Company's Memorandum in Response to the Motions for Summary Judgment Filed by the Staff of the Tennessee Regulatory Authority and the Consumer Advocate and Protection Division of the Attorney General's Office*, p. 4 (October 21, 2002).

> that party, and discard all countervailing evidence. Then if there is a dispute as to any material fact or any doubt as to the conclusions to be drawn from that fact, the motion must be denied....The court is simply to overrule the motion where a genuine dispute exists as to any material fact. The phrase "genuine issue" contained in Rule 56.03 refers to genuine factual issues and does not include issues involving legal conclusions to be drawn from the facts. The critical focus is limited to facts deemed "material", which is to say those facts that must be decided in order to resolve the substantive claim or defense at which the motion is directed....Once it is shown by the moving party that there is no genuine issue of material fact, the nonmoving party must then demonstrate, by affidavits or discovery materials, that there is a genuine, material fact dispute to warrant a trial. (Citations omitted)[8]

As required, the Hearing Officer has examined the filings by the parties to determine which facts are material and has considered the arguments of the parties to determine whether there exist any genuine and material factual disputes. To determine which facts are material the Hearing Officer must look to the agreed-upon list of issues in this proceeding. Each issue requires a conclusion that is legal in nature but that is based on a presentation of facts. Examining only the PBR mechanism and the orders that created and modified it will not in this case lead to a full and complete resolution of the issues. Even though this case may ultimately involve an interpretation of the PBR mechanism as a matter of law, there are facts regarding the circumstances surrounding the formation of the PBR mechanism and regarding the conduct of the parties arising from different interpretations of the PBR mechanism.

The Authority Staff and the Consumer Advocate have argued that they are entitled to summary judgment as a matter of law because there are no genuine issues of material facts. However, even in cases where the basic facts are not in dispute, summary

[8] *Byrd v. Hall*, 847 S.W.2d 208, 210-211 (Tenn. 1993).

judgment is not proper where "parties in good faith may disagree nevertheless about the inferences to be drawn from the facts."[9]

In this proceeding, basic facts are in dispute. Notwithstanding the excellent presentation of the history leading up to this controversy and explanation of the PBR mechanism in the Authority Staff's memorandum and the detailed factual assertions of Dr. Steven Brown in his affidavit in support of the Consumer Advocate's motion, United Cities has disputed many basic and material facts through its four affidavits and a detailed response to the material facts as characterized by the Consumer Advocate. In addition, United Cities' position was articulated from the outset in its responses to the Energy and Water Division's Audit Report. Mr. Creamer's affidavit set forth numerous areas in which parties differ over facts and interpretations of facts, most of which are material to the determination of the agreed upon issues. These issues may, in the end, be resolved against United Cities. However, at this point in the proceeding, United Cities has demonstrated that facts material to the resolution of those issues are in dispute. A summary judgment should be granted "only when both the facts and the inferences to be drawn from the facts permit a reasonable person to reach only one conclusion."[10] In this matter, it is clear that a reasonable person could reach more than one conclusion from the facts.

Moreover, United Cities has raised an issue of estoppel claiming that it acted to its detriment in reliance on its interpretation of the actions of TRA staff members. Regarding the January 31, 2001 meeting, United Cities has provided extremely detailed information through the Affidavit of John Hack that if unrefuted would indicate

[9] *Prescott v. Adams*, 627 S.W.2d 134, 139 (Tenn. App. 1981).
[10] *McCann v. Hatchett*, 19 S.W.3d 218, 219 (Tenn. 2000).

acquiescence, if not agreement, on the part of the Energy and Water staff regarding United Cities' interpretation of the PBR mechanism and its plan to include the negotiated transportation contracts therein. Mr. Hack, Director of Gas Supply Planning for Atmos Energy Corporation, explained United Cities' basis for claiming reliance in his Affidavit as follows:

> 9. Sometime around the beginning of January 2001, UCG contacted Mike Horne, then Chief of the TRA Energy and Water Division, to request a meeting between UCG representatives and TRA staff. The purpose of the meeting was to discuss the transportation discounts UCG had recently negotiated and how they would be accounted for under UCG's PBR tariff.
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> 10. The meeting was held on January 31, 2001, at the TRA offices in Nashville. I participated in the meeting. The meeting was fairly lengthy, lasting more than an hour.
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> 11. TRA Chief of Energy and Water Division Mike Horne, and TRA staff members Dave McClanahan and Pat Murphy were present at the meeting.
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> 12. UCG had arranged for several members of its management to attend the meeting, and had asked me and Patti Dathe, Gas Supply Analyst, to travel from the home office of Atmos in Dallas, Texas to attend. Present at the meeting representing UCG were, in addition to Ms. Dathe and myself:
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> > (1) Patricia Childers, then Manager of Rates and Regulatory Affairs;
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> > (2) her supervisor, Attorney Mark Thessin, then Vice-President of Rates and Regulatory affairs;
> >
> > [(3)] Alicia Rye, Rate Analyst; and
> >
> > [(4)] Ms. Rye's supervisor, Bob Cline, Manager of Rate Administration.
>
> 13. At the meeting, UCG representatives provided all of the attendees with packet of information, which included a Meeting Agenda. A copy of the information packet is attached as collective Exhibit 1 to the Affidavit of Patricia Childers.

14. The purpose of the January 31 meeting was to inform the TRA staff that UCG had successfully negotiated discounted rates for a substantial portion of its transportation contracts. At the meeting, UCG informed the TRA staff that UCG, motivated by the PBR provisions allowing UCG to share in savings from avoided costs, had actually begun efforts to negotiate discounted transportation rates in late 1999. UCG informed the TRA staff at the meeting that around October of 1999, UCG was successful in completing negotiated discounts for three of its transportation contracts. The combined totals for these contracts represented a very small portion of UCG's total transportation costs. The second page of the information packet UCG provided to the attendees at the January 31 meeting showed the savings that resulted from those discounted transportation contracts, which totaled $1,160,050 for UCG's 1999-2000 PBR plan year. (Childers Aff. Exhibit 1 at p.2.)

15. At the meeting, UCG informed the TRA staff, that due to an oversight, UCG had neglected to report the savings resulting from the discounted contracts in its annual report for the 1999-2000 PBR plan year. In response to concerns raised by the TRA staff regarding making corrections to the 1999-2000 plan year, which had already been closed, UCG agreed that it would not seek recovery of its share of the $1,160,050 in savings for the 1999-2000 plan year.

16. UCG then told the TRA staff that just a few months earlier, around November of 2000, UCG had successfully completed negotiated discounted rates for the Tennessee Gas Pipeline Company and the East Tennessee Pipeline systems. These newly negotiated discounted contracts represented a significant portion of UCG's total transportation costs as compared to the 1999 discounts. Page 3 of the information packet UCG provided to the attendees at the meeting gave a breakdown of the savings. This sheet listed the maximum FERC rate, the negotiated rate, and the resulting discount for each contract, and computed total monthly and annual savings resulting from those discounts. (Childers Aff. Exhibit 1 at p.2.) UCG explained to the TRA staff that the savings resulting from the discounted transportation contracts UCG had negotiated would be considered "avoided costs" under the PBR tariff, and consequently, UCG would be able to share in those savings under the PBR tariff.

17. At the January 31 meeting, UCG also explained to the TRA staff how those savings would be calculated under the PBR. UCG walked through the fact that the transportation discounts would be calculated by subtracting the negotiated rate from the maximum FERC rate for each particular pipeline. UCG also explained that the monthly discounts for all transportation contracts would be added together to reach a total annual savings, which UCG would then be able to share in according to the percentages outlined in the PBR tariff. (Childers Aff. Exhibit 1.) UCG

> informed the TRA staff at the meeting that they would begin using this calculation in future quarterly reports, which were due in the upcoming months.
>
> 18. The response from the TRA staff at the January 31 meeting was positive. The TRA staff members actively participated in meeting and asked numerous questions. It appeared that the TRA staff agreed with UCG's position that the savings from the negotiated discounts were to be included within the avoided costs provisions of the PBR, and did not object to UCG's proposed method of calculating the savings.[11]

The Authority Staff has not sufficiently refuted the factual details regarding this meeting, and it is obvious from the affidavits of the parties and the narrative content of the Audit Report itself that there is disagreement between the parties not only as to what transpired before, during and after the meeting of January 31, 2001, but also to the significance of those events. Establishing what happened and what understandings could be reasonably carried away from that meeting would be developed primarily through credible witness testimony. Where an issue may be determined in part on the credibility of witnesses, "findings of credibility are for the trier of fact and cannot be made in the context of a motion for summary judgment."[12] Moreover, the dispute between United Cities and the Authority Staff over what the word "reports" means in the context of the requirement that the Energy and Water Division notify United Cities within 180 days of the filing of "reports" lends itself to resolution through the introduction of factual evidence. These factual matters are material to United Cities' claim of estoppel. The Hearing Officer is unable to reject the claim of estoppel as a matter of law.

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[11] Affidavit of John Hack (October 17, 2002) paras. 9-18.
[12] *Winsett v. Orr* (Tenn Ct. App. 1997) 1997 Tenn. App. LEXIS 805.

United Cities has also argued that the motions for summary judgment should be denied because the Authority Staff and the Consumer Advocate did not comply with Rule 56.03 of the Tennessee Rules of Civil Procedure (TRCP) which requires that

> In order to assist the Court in ascertaining whether there are any material facts in dispute, any motion for summary judgment made pursuant to Rule 56 of the Tennessee Rules of Civil Procedure shall be accompanied by a separate concise statement of the material facts as to which the moving party contends there is no genuine issue for trial. Each fact shall be set forth in a separate, numbered paragraph. Each fact shall be supported by a specific citation to the record.

Notwithstanding the Authority's express adoption of certain Tennessee Rules of Civil Procedure for use as part of its practice and procedural rules, the Authority has not adopted TRCP 56.03 in a similar manner. As an administrative agency, the TRA is not bound by the rules of evidence applicable in a court[13] and conducts contested case hearings according to its own rules and the Tennessee Uniform Administrative Procedures Act (Tenn. Code Ann. § 4-5-301 et seq.). The TRA's predecessors, the Railroad & Public Utilities Commission and the Tennessee Public Service Commission have been held on several occasions to be an administrative body and not a "court."[14] Based upon the foregoing, the Hearing Officer is not inclined to enforce strictly Rule 56.03 to reject the motions for summary judgment filed by Authority Staff and the Consumer Advocate. As such, United Cities' request relying on Rule 56.03 for dismissal of the motions for summary judgment is denied.

[13] See Tenn. Code Ann. § 65-2-109(1).

[14] *See In Re: Cumberland Power Co.*, 249 S.W. 818, 147 Tenn. 504 (1923); *GBM Communications v. United Inter-Mountain Telephone Company*, 723 S.W.2d 109 (Tenn. App. 1986).

Based upon the foregoing findings and conclusions,

IT IS HEREBY ORDERED THAT:

1. The Consumer Advocate's Motion for Partial Summary Judgment is denied;

2. The Authority Staff's Motion for Summary Judgment is denied; and

3. A Status Conference is scheduled for Monday, April 7, 2003, following the TRA's Authority Conference to establish a procedural schedule for this matter.

J. Richard Collier

J. Richard Collier, as
Hearing Officer

March 31, 2003

Date