WALLER LANSDEN DORTCH & DAVIS, PLLC

WALLER LANSDEN DORTCH & DAVIS PLLC
THE CHESAPEAKE BUSINESS CENTRE
1616 WESTGATE CIRCLE SUITE 106
BRENTWOOD TENNESSEE 37027-8019
(615) 844 6212

WALLER LANSDEN DORTCH & DAVIS LLP
AFFILIATED WITH THE PROFESSIONAL LIMITED LIABILITY COMPANY
520 SOUTH GRAND AVENUE SUITE 800
LOS ANGELES, CALIFORNIA 90071
(213) 362-3680

NASHVILLE CITY CENTER
511 UNION STREET, SUITE 2700
POST OFFICE BOX 198966
NASHVILLE, TENNESSEE 37219-8966
(615) 244-6380
FAX (615) 244-6804
www wallerlaw com

WALLER LANSDEN DORTCH & DAVIS, PLLC
809 SOUTH MAIN STREET
POST OFFICE BOX 1035
COLUMBIA TENNESSEE 38402 1035
(931) 388 6031

D. Billye Sanders
(615) 850-8951
billye.sanders@wallerlaw.com

August 16, 2004

VIA HAND DELIVERY

Pat Miller, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37219

Re: Petition of Chattanooga Gas Company for Approval of Adjustment of its Rates and Charges and Revised Tariff
Docket Number 04-00034
Rebuttal Testimony of Chattanooga Gas Company

Dear Chairman Miller:

Enclosed you will find the original and fourteen copies of the rebuttal testimony of Chattanooga Gas Company. This filing includes testimony from Steve Lindsey, Mike Morley, Richard Lonn, Dr. Roger A. Morin, Darilyn Jones and Doug Schantz.

Sincerely,

D. Billye Sanders

D. Billye Sanders
Attorney for Chattanooga Gas Company

DBS/hmd
Enclosures

cc: Archie Hickerson
Steve Lindsey
John Ebert, Esq.
Elizabeth Wade, Esq.

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CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of August 2004, a true and correct copy of the enclosed rebuttal testimony was delivered by hand delivery, email, facsimile or U.S. mail postage prepaid to the other Counsel of Record listed below.

D. Billye Sanders

D. Billye Sanders, Esq.

Vance Broemel
Assistant Attorney General
Tim Phillips
Assistant Attorney General
Office of Attorney General
Consumer Advocate and Protection Division
2nd Floor
425 5th Avenue North
Nashville, TN 37243-0491
Timothy.Phillips@state.tn.us
Vance.Broemel@state.tn.us

Mailing address:
P.O. Box 20207
Nashville, TN 37202

David C. Higney, Esq.
Grant, Konvalinka & Harrison, P.C.
633 Chestnut Street, 9th Floor
Chattanooga, TN 37450-0900
423-756-8400 (phone)
423-756-0643 (fx)
dchigney@gkhpc.com

Henry M. Walker, Esq.
Boult Cummings, Conners & Berry, PLC
414 Union Street, Ste 1600
Nashville, TN 37219
615-244-2582 (phone)
615-252-6380 (fax)
hwalker@boultcummings.com

Dale Grimes, Esq.
Bass, Berry & Sims PLC
AmSouth Center
Suite 2700
315 Deaderick Street
Nashville, TN 37238
dgrimes@bassberry.com

BEFORE THE
TENNESSEE REGULATORY AUTHORITY

REBUTTAL TESTIMONY
Of
MICHAEL J. MORLEY

IN RE:
CHATTANOOGA GAS COMPANY
DOCKET NO. 04-00034

Q. Please state your name, position and address.

A. Michael J. Morley, Director, Financial Accounting, AGL Services Company (AGSC). My business address is 10 Peachtree Place, Location 1180, Atlanta, Georgia 30309.

Q. Did you file direct testimony in this proceeding?

A. Yes.

Q. What is the purpose of this rebuttal testimony?

A. The purpose of this testimony is to respond to the direct filed testimonies of Mr. Daniel W. McCormac, CPA, Mr. Michael D. Chrysler and Dr. Steve Brown on behalf of the Consumer Advocate and Protection Division (CAPD) of the Attorney General's Office of Tennessee. I will provide factual evidence that many of the assertions and positions presented by the CAPD are predicated on faulty assumptions and are baseless in fact and principle. Additionally, I will respond to a number of other positions and adjustments proposed by the CAPD.

Q. What are the assertions and positions that are baseless in fact and principle?

A. These assertions and positions, which will be discussed in more detail later in my testimony, are as follows:

1. The assertions by Dr. Brown that AGL Resources Inc.'s (AGLR) reporting of its regulated companies' returns "throw doubt on the accuracy of AGL Resources' financial reporting procedures with respect to the actual profitability of its regulated subsidiaries" (Brown, p. 52) — This opinion is based on his review of a limited number of public documents filed by AGLR or its subsidiaries. I will provide factual evidence in Section I of my testimony that will prove Dr. Brown's opinions on the reporting practices of AGLR are unsubstantiated, irresponsible and cannot be supported.
2. The proposed adjustment by Mr. McCormac and Mr. Chrysler to decrease payroll and payroll related expenses by approximately $345,000 — In addition to the information previously provided by Chattanooga Gas Company (CGC) or (Company) in TRA Minimum Filing Guideline No. 44 and TRA Data Request No. 126, I will provide additional analyses in Section II of my testimony that clearly support the requested increase in payroll expense, with the exception of the Company's proposed reduction in payroll expense and related benefits of approximately $94,000, which will also be discussed in section II of my testimony.
3. The assertions by Mr. McCormac and Dr. Brown that CGC incurred a net loss as a result of Sequent Energy Management's (SEM) management of CGC'S assets — I will provide factual evidence in Section III of my testimony that the "net loss" calculated by Dr. Brown does not exist and cannot be supported. In fact, I will provide evidence that CGC and its

ratepayers benefited by receiving approximately $3.2 million between 2003 and 2004 as a result of SEM's management of CGC's assets.

4. The assertions by Dr. Brown that AGLR is not in compliance with the Public Utility Holding Company Act of 1935 (PUHCA) — I will provide factual evidence in Section IV of my testimony that AGLR is indeed in compliance with PUHCA.
5. The assertions by Dr. Brown that certain components of the capital structure proposed by CGC are "arbitrary" and inconsistent with the components of the capital structure used at Virginia Natural Gas (VNG), a regulated subsidiary of AGLR — I will provide evidence based on fact in Section V of my testimony that the components of CGC's proposed capital structure are not arbitrary and are consistent with those used at VNG, as well as Atlanta Gas Light Company (AGLC), also a regulated subsidiary of AGLR.

Q. Briefly describe the other positions and adjustments proposed by the CAPD that you will address.

A. The CAPD has proposed adjustments and/or taken positions on the following:

1. Uncollectible accounts expense
2. Savings adjustment for improved efficiencies and economies of scale
3. Pending acquisition of NUI
4. Deferred rate case expenses
5. Percentage of short term debt in the proposed capital structure
6. Cost of short-term debt

7. Preferred stock included in the proposed capital structure

All of the above items will be discussed in more detail in Section VI of my testimony.

Q. Do you have any revisions to the revenue requirement filed in your direct testimony?

A. Yes. I will provide adjustments to the initial revenue requirement as follows:

- Payroll and related benefits - discussed in Section II of my testimony
- Bad debt expense – discussed in Section VI of my testimony.
- Other post retirement benefits expense – discussed in Section VII of my testimony.

Q. Are you sponsoring exhibits in connection with your testimony?

A. Yes. The exhibits will be referenced and explained in the applicable section of my testimony.

Q. Were these exhibits and related schedules prepared by you or under your direction and supervision?

A. Yes.

Section I

Q. What is the basis of Dr. Brown's assertion regarding the accuracy of AGLR's financial reporting with respect to ALGR's regulated subsidiaries?

A. Dr. Brown's assertion is based on a review of selected publicly filed information with the Virginia State Commission Corporation (VSCC) and the Securities and Exchange Commission of the United States (SEC).

Q. Are these filings with the VSCC and SEC good sources of financial information that can be used in this case?

A. I believe they are, provided the user of the information understands the purpose of the filings and includes all pertinent information within the filings in his or her analyses. Dr. Brown appears to have designed his assumptions and analyses to fit the end result he was seeking, which is to reduce CGC's proposed revenue requirement as much as possible.

Q. Please explain.

A. Dr Brown reviewed three public fillings with the SEC and VSCC that provided return on equity ratios for CGC and VNG. These filings were as follows:

- SEC Form 8-K filed November 7, 2002 (Dr. Brown's Schedule 11)
- SEC Form 8-K filed November 18, 2003 (Dr. Brown's Schedule 12)
- VNG WNA Annual Report filed with the VSCC July 15, 2003 (Dr. Brown's Schedules 13, 14 and 15)

Based on his review of these filings, Dr. Brown is claiming that the changes in the returns on equity for VNG and CGC are "very inconsistent" and "throws doubt on the accuracy of AGL Resources' financial reporting procedures."

Q. Are the returns on equity for CGC and VNG in those filings inconsistent?

A. No. The returns were and are calculated and reported on a consistent basis from filing to filing While the returns for VNG increased and those for CGC decreased, the fluctuations were not the result of inconsistent return calculations or reporting procedures.

Q. What were the primary factors for the fluctuations in the returns on equity?

A. As Dr. Brown states in his testimony, VNG's return on equity increased from 8.73% for the twelve months ending September 30, 2002 to 10.9% for the twelve months ending May 31, 2003. The primary reason for this increase in equity return for VNG is the WNA program initiated in November of 2002, which is actually stated on page 52, lines 19 and 20 of Dr. Brown's testimony:

"...VNG initiates its WNA program in November 2002..."

The absence of the WNA program for the twelve months ended September 30, 2002, during which VNG experienced unseasonably warm weather, resulted in the lower return on equity for that period. This explanation was clearly stated on page 28 of AGLR's 2002 annual report (provided in TRA Minimum Filing Guideline No. 17) as well as page 13 of AGLR's 8-K filed January 28, 2004, which Dr. Brown states he reviewed in his testimony. Both financial reports provide the following statement, included as Exhibit MJM 1-1, regarding the weather impact at VNG during 2002:

> "$11.3 million decrease in VNG's operating margin, resulting from the impact of warmer-than-normal winter weather of $12.4 million..."

This statement compares the twelve months ending September 30, 2001 (FY 2001) and the twelve months ending December 31, 2002. Taking into consideration the favorable impact of $3.8 million due to colder-than-normal weather in FY 2001, which was also clearly stated in AGLR's 2002 annual report and is included as Exhibit MJM 1-2, VNG's operating margin would have been approximately $8.6 million higher for the twelve months ending September 30, 2002 had the WNA program been in effect during that time period, resulting in a return on equity of approximately 11.38. This pro-forma equity return for VNG for the twelve months ended September 30, 2002 is comparable to the equity returns of 10.9% and 11.38% for the twelve months ending May 31, 2003 (actual) and December 31, 2003 (projected), respectively, when considering all facts and circumstances.

Q. What caused the decrease in CGC's return on equity?

A. CGC's decrease in return on equity is due to an increase in operating expenses, primarily bad debt expense, depreciation expense and AGL Services Company shared service allocations, all of which can be delineated through review of CGC's monthly filings of TRA Form 303.

Q. What other issues did Dr. Brown assert existed in these filings?

A. Dr. Brown appears to take issue with AGLR's inclusion of a footnote stating "actual weather" with reference to VNG's return on equity in the November 2002 8-K but with no reference to weather or the WNA program in the November 2003 8-K or the January 2004 10-K.

Q. Is there merit to this issue?

A No. The inclusion of the "actual weather" footnote was to point out that the return on equity was based on actual results and was not a pro-forma calculation to reflect the impacts of the WNA program.

Q. Why did AGLR feel this was necessary to include?

A Because the WNA had been approved by the VSCC in September 2002 and went into effect November 2002, making it a topic of discussion at the analysts' conference. AGLR wanted to ensure that those attending and reviewing the financial information were clear that the return on equity for VNG did not include any potential impacts of the WNA program.

Q. Was the WNA program referred to in the November 2003 8-K and January 2004 10-K?

A. There is no discussion regarding the WNA program in the November 2003 8-K. However, the January 2004 10-K includes a discussion of the WNA program on page 9, which is included as Exhibit MJM 1-3. Results in both filings include the impact of WNA since the program was in effect during both time periods.

Q. What other claims are made by Dr. Brown regarding the equity returns reported by AGLR?

A. In comparing the financial information contained in the 8-K filed November 2003 to the WNA Annual Report filed July 15, 2003, Dr. Brown provides the following assertion on page 53, lines 17-22:

> "Therefore, the 11.38% return reported to the SEC, an agency whose data is most likely to be accessed by investors, is probably not an "actual" return and is different from the "actual" return reported to the state agency, the VSCC."

Q. Is this statement accurate?

A. His statement is misleading. Given the fact that the 11.38% return reported to the SEC was projected (as stated in the schedule) the return reported to the SEC in this filing will most likely be different than the return reported to the VSCC. Furthermore, the calculated return was based on forward looking statements, for which AGLR provided a cautionary statement, which is included as MJM Exhibit 1-4.

Q. Is the 11.38% return reported to the SEC an "actual" return?

A. The return is "actual" from the standpoint that it was derived using the same method for calculating return on equity when reporting to the VSCC. Since the return was presented in a November 2003 filing, yet calculated for the twelve months ending December 31, 2003, it obviously included projections and assumptions for November and December of 2003.

Q. Based on your responses above, why would Dr. Brown opine that AGLR's financial reporting procedures are inaccurate, as he implies in his testimony?

A. Because Dr Brown's analyses and assumptions are not objective. Rather they are designed to throw doubt on the financial reporting of AGLR, and therefore CGC, in an effort to discount the information provided by CGC in this case. As stated above, Dr. Brown appears to have designed his assumptions and analyses to fit the end result he is seeking, which is to reduce CGC's proposed revenue requirement as much as possible.

Q. Please continue

A. Dr. Brown's assertions regarding the reporting practices of AGLR are confounding. In our current business environment, in which the reporting of financial information is under perhaps more scrutiny than ever due to accounting and financial reporting improprieties and fraud by other companies, for Mr. Brown to imply in a public forum that AGLR has itself engaged in financial reporting improprieties, without a basis in fact, is dangerous and reckless and simply not appropriate.

Q. Are there other issues you would like to address with respect to Dr. Brown's assumptions, analyses and interpretations of the financial information he reviewed?

A. Yes. There other issues that I will address throughout the remainder of my testimony.

Q. Why have you chosen to make the primary focus of your testimony Dr. Brown's interpretation of the financial information reported by AGLR and its subsidiaries?

A. Because Dr. Brown's interpretations provide much of the basis for the CAPD's positions, adjustments and conclusions in this case, and most of his interpretations are not supported by factual evidence.

Section II

Q. Do you agree with the payroll and related benefits adjustments proposed by Mr. McCormac and Mr. Chrysler?

A. No. Mr. McCormac and Mr. Chrysler have based their payroll adjustment on something that occurred almost five years ago in 1999.

Q. What occurred in 1999?

A As part of an overall AGLR initiative to recognize synergies with facilities in close proximity and realize savings by eliminating redundant functionality, the work force at CGC was reduced from 86 to 58 toward the end of 1999.

Q. Was this elimination in work force related to the previous rate case filed by CGC?

A. No. As stated in the previous question, this was an overall AGLR initiative, including AGLC, and would have been implemented regardless of whether or not CGC had new rates put in place the previous year.

Q. What is a full-time equivalent (FTE's)?

A. A full time equivalent is the term used to illustrate the number of personnel required to operate a business, including outsourced positions.

Q. How many (FTE's) are included in the attrition period?

A. There are 55 FTE's included in the attrition period, after the adjustment discussed later in this section of my testimony.

Q. Have the number of FTE's remained consistent from the end of 1999 through end of the attrition period?

A. Yes. When analyzing FTE's, both employees and outsourced positions should be considered. In the CAPD's analysis of work force, only employees of CGC were considered. Attached Exhibit MJM 2-1 is a historical analysis of FTE's, including outsourced positions. This schedule clearly shows that CGC's level of FTE's has remained consistent from 1999 through the attrition period when all positions, including those outsourced, are taken into consideration.

Q. Does Exhibit MJM 2-1 represent required FTE's?

A. No. Exhibit MJM 2-1 represents actual FTE's for the specified time periods and does not include open positions. Additionally, the exhibit does not include AGSC allocated call center FTE's.

Q. What positions were previously outsourced?

A. Beginning in late 1999 through most of 2002, CGC outsourced the majority of its meter reading functions. Based on a study performed in 2002, it was determined that in house meter reading was more efficient and would provide better service to CGC customers. This resulted in an increase in meter readers from 4 at December 2002 to 10 at December 2003.

Q. Are there any adjustments required to the payroll expense provided in your initial testimony?

A. Yes. CGC determined in June 2004 that an open position would not be filled, in effect eliminating the position. Additionally, on May 7, 2004, the union agreement between CGC and its union employees was approved. This new agreement impacted the percent and timing of merit increases for union employees as provided with my initial testimony and exhibits.

Q. What is the amount of this adjustment?

A The adjustment is to decrease payroll expense and related benefits by $93,439. A detailed calculation is provided in Exhibit MJM 2-2.

Section III

Q. What assertions are made by Dr. Brown and Mr. McCormac regarding SEM'S management of CGC's assets?

A. Dr. Brown asserts that SEM's management of CGC's assets do not benefit CGC, but rather result in a loss of $800,000, and Mr. McCormac recommends CGC include $2,360,317 as a credit to base rates "to partially offset costs already billed to consumers."

Q. Do Dr. Brown and Mr. McCormac provide any factual evidence to support their claim?

A No. Dr. Brown's claim is based on a misinterpretation of a line item in AGLR's unredacted SEC Form U-9C-3, and Mr. McCormac's recommendation is based on the assumption that CGC rate payers have incurred incremental or unnecessary fixed costs due to CGC's relationship with SEM.

Q. What is the misinterpretation by Dr. Brown in AGLR's unredacted U-9C-3?

A. Dr. Brown claims that $2.027 million dollars of "gas transmission storage management" costs were direct charged by SEM to CGC. However, the $2.027 million reported on AGLR' s SEC form U-9C-3 for the quarter ended September 30, 2003 was actually an amount CGC shared with its ratepayers through the reduction of stored gas inventory. Interpretation of the treatment of the $2.027 million as sharing rather than a direct charge of costs can be derived from footnote (b) included in the U-9C-3. The footnote is stated below and has been revised to include the name of the "Receiving Company" and the "Serving Company" for purposes of this testimony:

> "The Receiving Company (CGC) makes available idle or underutilized gas transportation and storage capacity for use by the Serving Company (SEM), as agent for the Receiving Company (CGC), in return for which the Serving Company (SEM) pays for costs incurred and shares the profits with the Receiving Company (CGC) in accordance with approval by the appropriate state commissions."

In summary, the above footnote states that CGC makes available to SEM its idle or underutilized gas transportation and storage capacity. In return, SEM pays for any costs incurred in using this gas transportation and storage capacity and shares with CGC any profits made on the use of the gas transportation and storage capacity.

Q. Do you have evidence that the above footnote is referencing a sharing transaction as opposed to a direct charge of costs transaction?

A. Yes. Attached Exhibit 3-1 is Item 3 from AGLR's U-9C-3 for the quarter ended March 31, 2004. This is the Item 3 from other filings that Dr. Brown uses in his testimony to assert that SEM is direct charging CGC for overhead costs. In the last line of the chart in Item 3, the "types of services rendered" by SEM to CGC are "gas transmission and storage management". The amount included in the "direct costs charged" column is \$1.18 million, which represents the amount paid to CGC by SEM in shared profits as filed in the February 2004 Interruptible Margin Credit Rider (IMCR) filing with the TRA. This is clearly proof that amounts included in the U-9C-3 filing as "gas transmission storage management" represent amounts paid by SEM to CGC in shared profits, not direct costs charged from SEM to CGC.

Q. Were the amounts in Item 3 of the March 31, 2004 U-9C-3 redacted as with previous quarters?

A. No. AGLR began providing the information as a public filing since AGLR began disclosing the amounts shared between SEM and its affiliated utilities in AGLR's 10-Q for the quarter ended March 31, 2004.

Q. Did Dr. Brown review the March 31, 2004 U-9C-3?

A. I do not know. Based on Dr. Brown's response to CGC Discovery Request No. 6, Dr. Brown reviewed "SEC Forms U-9C-3 quarterly filings for 2003 and 2004." It is not clear, however, if the dates he refers to are for the quarter ended period or the date filed.

Q. When was the March 31, 2004 U-9C-3 filed?

A. The U-9C-3 was filed with the SEC on May 28, 2004, or about two months prior to the filing of his testimony. Additionally, it was filed June 16, 2004 with the TRA.

Q. What types of costs does SEM charge CGC?

A. SEM charges CGC for two types of transactions:

1. Purchases of stored and flowing natural gas – these transactions are charged at cost and are subject to annual audit by the Tennessee Regulatory Authority Staff.
2. Gas procurement, scheduling and other gas related services – these transactions are charged at cost to CGC by AGSC through a shared services agreement between SEM and AGSC. This shared services agreement is subject to the PUHCA at cost rules. Under the agreement, SEM provides the above services to CGC and bills AGSC for those services at cost. AGSC then bills CGC for the costs.

Q. Where does Dr. Brown purport the $2.027 million in "direct costs" allegedly charged by SEM to CGC was recorded on the books and records of CGC?

A Based on CGC Discovery Request No. 28, "Dr. Brown did not identify the 'loss' as being recorded in accounts on CGC's books and records."

Q. If this amount was not recorded on the books and records of CGC, how can Dr. Brown claim CGC incurred a loss in its dealings with SEM?

A. I do not know. The only way CGC could have incurred a loss associated with the $2.027 million "direct charge" from SEM would be for the transaction to be recorded as an operating expense or increase in deferred gas costs on the books and records of CGC.

Q. Was the $2.027 million recorded on the books and records of CGC?

A. Yes. The $2.027 million was recorded on the books and records of CGC as a reduction in stored gas inventory. Including the $1.2 million shared with CGC ratepayers in 2004, SEM has shared a total of $3.2 million with CGC rate payers over the past two years.

Q. What is the basis of Mr. McCormac's claim that CGC rate payers have incurred incremental unnecessary fixed costs due to CGC's relationship with SEM?

A. Based on Mr. McCormac's "gross profit" example on page 13, lines 11-24 of his testimony and the CAPD's response to CGC Discovery Request No. 33, Mr. McCormac believes there are additional costs incurred by CGC due to its relationship with SEM.

Q. What types of additional costs does Mr. McCormac believe CGC is incurring due to its relationship with SEM?

A. In Mr. McCormac's response to CGC Discovery Request No. 33, he states that the CAPD does "not know what these costs are because CGC has not reported {these} costs." However, in Mr. McCormac's Exhibit CAPD DM-Schedule 14 and his response to CGC Discovery Request No.33, Mr. McCormac refers to "some storage costs such as LNG facilities and associated depreciation, maintenance, taxes and return on investment; reservation fees and demand charges."

Q. Did the CAPD inquire specifically about these costs?

A. No. But even if the CAPD had issued a discovery request seeking information regarding the types and amounts of costs discussed by Mr. McCormac above, the response would be that SEM does not cause CGC to incur additional costs.

Q. Please explain,

A. All costs incurred by CGC are for the benefit of its ratepayers. They are costs incurred to ensure that, on peak demand days of the coldest periods of a given year, CGC has the supply and transportation capacity to serve its ratepayers. In other words, all of CGC's costs included in the cost of service study provided in this case, as well as its storage costs, reservation fees and demand charges would be incurred regardless of its relationship with SEM or any other asset manager.

Q. Do CGC and its ratepayers benefit from CGC's relationship with SEM?

A. Yes. SEM provides sharing of profits from its management of CGC assets that would otherwise remain idle and under utilized at no cost to CGC. These profits are then credited to CGC's ratepayers in accordance with CGC's IMCR tariff provision. Mr. Doug Schantz, President of SEM, elaborates on these benefits in his rebuttal testimony.

Q. What are "idle" or "underutilized" assets?

A. Idle or underutilized assets are terms used to describe unused gas transportation and storage capacity at any given time.

Q. Does this mean CGC has excess capacity?

A. No. While CGC may have idle or underutilized assets most of the year, CGC must contract for and maintain a capacity level that is sufficient to serve its customers during peak demand times, even if this is for a short period of time during a given year. To illustrate, assume you have a child who just started college out of state. You currently have a two bedroom house and now have an extra room and are considering whether or not to move into a one bedroom house. You decide that, while the extra room will not be used for most of the year, your child will need a place to stay when visiting you from college. Therefore, you decide to remain in your two bedroom house to provide you the needed "capacity" when your child visits from college.

Q. Do you agree with Mr. McCormac's proposed adjustment to credit base rates by $2,360,317?

A. No. Based on the facts I have provided, there is no merit to Mr. McCormac's proposed adjustment. The supposed incremental and unnecessary fixed costs referenced by Mr. McCormac simply do not exist.

Section IV

Q. Do you agree with Dr. Brown's assertion that SEM's management of CGC's assets violates PUHCA?

A. No. His allegation is based on the faulty assumption that CGC incurs costs as a result of this arrangement. As I explained in Section III, CGC does not incur any costs.

Q. Is the CAPD's "understanding that PUHCA requires all transactions between affiliates to be billed at cost" accurate?

A. No. There are certain affiliated transactions exempt from the PUHCA "at cost" rules. In fact, Dr. Brown acknowledges this in his testimony. On pages 69-71, he provides excerpts from the PUHCA regulations which define transactions exempt from the "at cost" rules. If there are transactions exempt from the "at cost" rules, then not all affiliated transactions are required to be billed at cost.

Q. Are there transactions between CGC and SEM that are exempt from the PUHCA "at cost" rules?

A. Yes. The sales of stored and flowing gas from SEM to CGC are exempt from the "at cost" rules as provided in Section 13(b), CFR 250.80 and 250.81. Both sections are included on pages 70 and 71 of Dr. Brown's testimony. Section CFR 250.80 exempts the sale of gas in its definition of "goods", in which "natural or manufactured gas" is not included. Additionally, CFR 250.81 exempts the sale of a "similar commodity or service, the sale of which is normally subject to regulation" from the at cost rules under Section 13(b). In this case, SEM's sale of stored and flowing gas to CGC is regulated by the TRA. Although these transactions are exempt under the PUHCA at cost rules, SEM still charges CGC cost for all gas purchases.

Q. Is SEM's management of CGC's assets subject to the "at cost" rules?

A. No. SEM's non-jurisdictional sales are with non-affiliated parties and are therefore exempt from the PUHCA "at cost" rules. Moreover, as discussed previously, CGC does not incur costs associated with SEM's asset management and non-jurisdictional sales activity.

Q. Refer to page 73, Lines 10-24 of Dr. Brown's testimony, he states the following with regard to the benefits of the SEC's at cost rules:

"They cause the holding company's capacity planning to focus on CGC's customer load rather than blending CGC's customer load with all the side-deals aimed at improving the holding company's profit margin."

Do you agree with this statement?

A. I agree that there are benefits to the SEC's "at cost" rules. However, I do not agree with the context of Dr. Brown's statement. This is another example of Dr. Brown making statements and assertions without regard for the underlying facts in an effort to cast doubt on the integrity and business practices of AGLR.

Q. Please explain.

A. The "holding company" does not perform the capacity planning function for CGC. Capacity planning is performed by AGSC in the best interest of the CGC ratepayer and without influence from the holding company or SEM. Furthermore, CGC has only changed its contracts with its interstate pipeline suppliers for firm storage and transportation services once since CGC was purchased by AGLC, which was in 1995, over 5 years prior to the formation of SEM. Therefore, without a history showing such practices, there is no basis for Dr. Brown's statement.

Q. **Did you make an issue of AGLR's compliance with PUHCA in your direct testimony, as Dr. Brown states?**

A. No. The intent of my testimony was to provide the TRA and any interveners with basic information on AGSC, including its purpose and why it is required. In the last rate proceeding by CGC, AGSC did not exist, AGLR was not subject to the PUHCA rules and CGC was owned by and had corporate costs allocated from AGLC.

Q. **Is the excerpt from your testimony provided by Dr. Brown on page 55, lines 21-25 of his testimony an accurate depiction of what you stated?**

A. No. Dr. Brown omitted a key component of my testimony. Below is the actual excerpt from my testimony, including the key component omitted by Dr. Brown:

> ". . . . accordance with the Act, AGLR formed AGL Services Company ("AGSC") to provide shared services to all subsidiaries of AGLR at actual cost.
>
> Q. Is AGLR in compliance with the **above mentioned (emphasis added)** PUHCA requirements?
>
> A. Yes."

This excerpt from my testimony was to provide confirmation that AGLR is in compliance with the PUHCA at cost rules as they relate to the shared service allocations charged from AGSC to AGLR subsidiaries. The manner in which Dr.

Brown included this excerpt leads one to believe that I stated AGLR is in compliance with all PUHCA regulations.

Q. Based on this statement, are you saying that AGLR is not in compliance with all PUHCA regulations?

A. No, not at all. To my knowledge, AGLR is currently in compliance with all PUHCA regulations. I felt it necessary to point out the above excerpt from Dr. Brown's testimony, which is another example of Dr. Brown's lack of objectivity and consistent neglect to provide the entire scope of a supposed issue. Again, he has focused his efforts on casting doubt on the procedures and practices of AGLR in an effort to reduce CGC's revenue requirement as much possible.

Q. Do you have evidence that AGLR is in compliance with the at cost rules as they relate to AGSC shared service allocations to AGLR subsidiaries?

A. Yes. Included in Exhibit MJM 4-1 is an examination report from the SEC's Office of Public Utility Regulation (Staff) dated June 20, 2003. This was the result of an audit-examination conducted by the Staff to determine AGLR's compliance pursuant to the following sections of PUHCA:

- Section 12 and Rule 45(c) require the apportionment of consolidated tax in proportion to each individual subsidiaries' taxable income or separate return tax, but such apportionment shall not exceed the subsidiaries' separate return tax.
- Section 13(b) and Rule 90 are intended to protect investors or consumers by requiring the costs associated with the performance of services to be allocated fairly, equitably and at cost.

- Section 15(f) and Rule 93 require the maintenance of all accounting procedures, correspondence, memorandum, papers, books and other records, as well as such records being subject to periodic, special and other examinations.
- Rule 91 addresses the determination of cost and states that transactions are deemed to be performed at no more than cost if the price does not exceed the fair and equitable allocation of expenses plus reasonable compensation for capital procured through the issuance of capital stock.
- Rule 94 requires the filing of annual report by AGSC by May 1st and on SEC Form U-13-60.

As stated in the SEC's report, AGLR is in compliance with all above sections and rules, with the exception of Rule 45(c). AGLR was required to file a post-effective amendment requesting approval of the amended tax allocation agreement specifically related to the VNG acquisition debt and file relevant tax worksheets with the annual SEC Form U-5S filings. AGLR has made that filing, and the SEC has approved the amended tax allocation agreement.

Q. Did the audit-examination result in any findings by the Staff?

A. Yes. Those findings are included in Exhibit MJM 4-2.

Q. What was the nature of these findings?

A. There were a total of 37 findings, most of which were administrative in nature. Findings that impacted the costs allocated to CGC resulted in a reduction in AGSC shared service costs to CGC of approximately $377,000 for the 36 month period January 2001 – December 2003, or approximately $125,000 per year. This reduction is net of any expenses that would not normally be allowed for regulatory purposes, such as donations and government affairs.

Q. Is the \$8.1-\$8.2 million credit to AGLR as shown in the 2003 U-13-60 the result of "Sequent's dual practice of sharing in the profits from its use of CGC's 'idle' and 'underutilized' assets while at the same time imposing additional direct charges on CGC for Sequent's use of CGC's idle assets", as Dr. Brown opines?

A. Absolutely not. The \$8.1-\$8.2 million credit to AGLR in the 2003 U-13-60 was actually the result of the aforementioned PUHCA audit. One of the findings of the audit was that all AGSC income and /or expenses should be allocated so that AGSC has zero net income. Additionally, the PUHCA Staff recommended any adjustment be made to include the 36 month period January 1, 2001 through December 31, 2003. Therefore, an adjustment was made between AGLR and AGSC in December of 2003 in accordance with this finding, resulting in the \$8.1-\$8.2 million credit for AGLR.

Q. Was the \$8.1-\$8.2 million adjustment referred to above approved by the PUHCA staff?

A. The PUHCA Staff agreed with the adjustment to reduce AGSC net income to zero, but disagreed with charging the entire amount to AGLR. The PUHCA Staff required AGSC to re-allocate the charges from AGLR to all other subsidiaries as to ensure that all affiliates shared the benefit or incurred the costs as a result of this adjustment.

Q. What was the impact of this adjustment to CGC?

A. The impact of this adjustment to CGC is included in the $377,000 PUHCA audit adjustment discussed previously in this testimony.

Q. Has AGLR responded to all findings and recommendations of the PUHCA audit?

A. Yes. Attached as Exhibit MJM 4-3 is a letter from the PUHCA Staff approving AGLR's response. A condition of the letter is that AGSC will re-allocate $4 million in costs to AGLR by May 20, 2004. This adjustment was completed on May 26, 2004 and includes the re-allocation of the $8.1-$8.2 million credit to all AGSC affiliates. The impact of this entry to CGC for regulatory purposes is the above mentioned $377,000 decrease.

Section V

Q. Are the assertions by Dr. Brown that certain components of the capital structure proposed by CGC are "arbitrary" and inconsistent with the components of the capital structure used at VNG true?

A. No. Dr. Brown misinterpreted VNG's applications with the VSCC to issue short-term debt, long-term debt and common stock. The schedules included by VNG in those applications were not an actual or proposed capital structure. Rather, the schedules provide a pro-forma VNG capital structure based on a VNG stand alone entity with the balances of short-term and long-term debt equal to the authorized debt in the financing authority. Dr. Brown failed to include in his testimony that Item No. 4 of the filing requires VNG to provide a schedule showing the "impact on company" if VNG were to issue the maximum short-term and long-term debt authorized by the financing authority, even though this is clearly stated on his Schedule 18, page 1.

Q. What is the definition of pro forma?

A. Pro forma means "as if". In this case, pro forma means the capital structure of VNG "as if" VNG issued the full amount of debt authorized in the financing authority.

Q. Why is the financing authority required?

A. Virginia law requires VNG to apply for authority to issue short-term and long-term debt and common stock to an affiliate.

Q. Is preferred stock of AGLR included in the capital structure of VNG?

A. Yes.

Q. Have you provided evidence to support this?

A. Yes. Included are Exhibits MJM 5-1 and 5-2, which are excerpts from previously filed Minimum Filing Guideline No. 80 and TRA ECON #1 – Data Request No. 2, respectively. These exhibits clearly provide the basis of VNG's current capital structure as approved by the VSCC, which is a hypothetical capital structure based on VNG's previous owner, Consolidated Natural Gas. The hypothetical capital structure is applied to the capital structure of consolidated AGLR, including preferred stock. Notations have been added to these exhibits for emphasis and to show how the calculation of VNG's hypothetical capital structure includes preferred stock.

Q. Is preferred stock included in the capital structure of AGLC?

A. Yes. Preferred stock is included in the capital structure of AGLC.

Q. Is Dr. Brown's assertion that AGLR "has capitalized its operating subsidiary in Virginia with an 18% short-term ratio in two different financing cases" accurate?

A. No. Dr. Brown based his conclusion on his review of VNG's applications with the VSCC to issue short-term debt, long-term debt and common stock. As discussed above, the schedules he relied upon were pro-forma capital structure statements as required by the filing and do not represent the actual capital structure of VNG as approved by the VSCC or as reported by VNG in its Annual Information Filing (AIF) or any other filing before the VSCC that requires the use of VNG's authorized capital structure. The short-term debt ratio included in VNG's capital structure is also included in Exhibits MJM 4-1 and MJM 4-2.

Q. What is the AIF?

A. The AIF is an annual filing made with the VSCC, similar in purpose to the TRA Form 303. The VSCC reviews, in detail, the AIF to insure VNG is not earning over its authorized rate of return.

Q. Was the ratio of short-term debt in the approved capital structure of AGLC calculated in the same manner as the ratio CGC has proposed in this docket?

A. Yes. The same method for calculating the ratio of short-term debt in AGLC's capital structure was used for the calculation of CGC's short-term debt ratio proposed in this docket. The short-term debt ratio for AGLC was approved by the Georgia Public Service Commission in AGLC's last rate case in 2002.

SECTION VI

Q. Do you agree with the CAPD's proposed adjustment to reduce bad debt expense by $615,976?

A. No. While CGC agrees bad debt expense should be reduced in accordance with the TRA's ruling in Docket No. 03-00206, the CAPD based its bad debt adjustment on an incorrect cost of gas amount. Therefore, CGC proposes a reduction in bad debt expense in the amount of $639,865.

Q. Do you agree with Mr. McCormac's position that CGC's proposed adjustment to include savings achieved from the VNG acquisition in CGC's cost of service is a violation of the PUHCA "at cost" rules?

A. No. CGC would continue to be billed by AGSC at cost. The adjustment to include savings achieved from the VNG acquisition in CGC's cost of service is a ratemaking adjustment and would not be recorded on the books and records of CGC as an additional cost allocation from AGSC. Therefore, there would not be a violation of the PUHCA "at cost" rules.

Q. Do you agree with Mr. McCormac's position that Tennessee ratepayers have not received the benefit of lower shared service cost allocations from AGSC as a result of AGLR's acquisition of VNG?

A. No. Tennessee ratepayers have, in fact, received the benefit of lower shared service cost allocations as a result of the VNG acquisition. As was proven in the AGLC rate case in 2002, shared service costs did not increase with the purchase of VNG. Therefore, the same cost structure and level of costs are now allocated over a larger base, providing cost savings of approximately $1,067 million to CGC ratepayers.

Q. Does this mean AGSC costs have not increased since the acquisition of VNG?

A. No. AGSC costs have increased since the acquisition of VNG but not because of the acquisition of VNG. In other words, AGSC would have close to or the same level of costs regardless of whether or not AGLR had acquired VNG.

Q. How have CGC ratepayers benefited from the VNG acquisition?

A. As discussed previously, there is now a larger base for which to allocate AGSC costs, while those same costs have remained relatively stable due to the achievement of improved efficiencies and economies of scale. Allocating stable costs over a larger base results in lower shared service allocations for CGC. Put another way, shared service costs would be approximately $1,067 million higher for CGC ratepayers if AGLR had not purchased VNG. Put in the context of this case, the revenue requirement for CGC would have been approximately $533,000 (50% of the savings already included in the cost of service) higher than CGC's proposed revenue requirement.

Q. Is this request to include cost savings achieved from an acquisition as a rate making adjustment unprecedented?

A. No. In its last rate case, AGLC was authorized to include savings resulting from the VNG acquisition in its regulatory rate of return calculation.

Q. What is the expected impact of the pending NUI acquisition on future costs of CGC?

A. There will be no impact until and unless the acquisition is completed, and NUI is integrated into AGLR's operations. The acquisition remains pending and is subject to the approval of NUI's shareholders, the SEC, the state regulatory agencies of New Jersey, Maryland and Virginia, the expiration of the Hart-Scott-Rodino waiting period and various other closing conditions. Any cost impacts are speculative and will not occur until an unknown date in the future.

Q. Do you agree with Mr. McCormac's removal of deferred rate case expenses from CGC's cost of service and rate base?

A. No. Mr. McCormac's removal of deferred rate case expenses from CGC's cost of service and rate base is based on the CAPD's conclusion that CGC does not require a rate increase, but rather a rate reduction. The direct and rebuttal testimonies and exhibits provided by CGC clearly substantiate that an adjustment to increase revenue is required.

Q. Do you agree with Dr. Brown's 12.9% ratio of short-term debt?

A. No. As previously discussed in section IV of my rebuttal testimony, the short term debt ratio calculated by CGC is not discretionary as Dr. Brown asserts. The method used for calculating the short-term debt ratio proposed by CGC is consistent with AGLR's most recent rate proceeding in 2002 for AGLC.

Q. Do you agree with Dr. Brown's assertion "that CGC has offered in this case a capital structure substantially at odds with the one it is likely to operate on" based on his review of a filing with the SEC?

A. No. The filing with the SEC, Form U-1, reviewed by Dr. Brown is a required filing under PUHCA. Under PUHCA, holding companies and their utility subsidiaries are required to obtain authority from the SEC to issue and sell equity or debt securities to external or affiliated parties. Currently, CGC's short term debt needs are financed through its participation in the utility money pool, which is administered by AGSC. Therefore, CGC is required to obtain authority from the SEC, through the filing of a Form U-1, to participate in the utility money pool.

Q. **How long is the financing authorized?**

A. The financing authority is valid for three years or until issuances of debt or equity securities exceed the amount authorized by the SEC

Q. **Was this the first Form U-1 filed by AGLR?**

A. No. One was filed in 2000, when AGLR first became a registered utility holding company, and CGC requested authority to borrow up to $100 million.

Q. **Did CGC issue debt in its name under the 2000 financing authority?**

A. No. CGC participated in the AGSC administered money pool.

Q. **Does CGC expect to issue debt in its name under the 2004 financing authority?**

A. No. CGC does not expect to issue debt in its name under the 2004 financing authority. CGC will continue to participate in the AGSC money pool.

Q. **Do you agree with Dr. Brown's short-term debt rate of 1.265%?**

A. No. The short-term debt rate proposed by CGC, while not based on the short-term debt rate of AGLR, is a more accurate cost of debt for CGC, as it is based on CGC's estimated costs were it to issue debt in its own name.

Q. **Do you agree with Dr. Brown's categorization of the London Inter Bank Offering Rate (LIBOR) as a "synthetic forward rate".**

A. No. Dr. Brown's reference to LIBOR as "synthetic" is to say that it is an artificial or fake rate. However, LIBOR is one of the most widely used rates in financing today, including the base rate used for AGLR's commercial paper program.

Q. Do you agree with Dr. Brown's position to exclude the preferred stock of AGLR from CGC's capital structure?

A. No As with many other positions presented in his testimony, Dr. Brown's basis for excluding the preferred stock of AGLR from CGC's capital structure does not take into consideration all relevant facts.

Q. Please explain.

A. As provided in CGC's response to TRA ECON #1 — Data Request No. 4, one reason AGLR issued preferred stock as opposed to long-term debt is its favorable treatment by some credit rating agencies In the case of AGLR, issuance of long-term debt instead of preferred stock in 2001 could have adversely impacted AGLR's credit rating. This, of course, would have resulted in a much higher overall cost of debt to CGC and its ratepayers.

Q. Do you agree with Dr. Brown's statement on page 78, lines 13-14 of his testimony "AGL's rates on the preferred stock are high enough to appear unreasonable"?

A. No. While the rates are higher than the long-term debt issued by AGLR subsequent to the preferred stock as well as current long term rates, there are a number of factors to be considered. The preferred stock was issued in 2001, a time at which interest rates were higher than they are today. Additionally, the longer the term of the debt, in this case 40 years, the higher the interest rate. For example, AGLR issued 10 year bonds at 7.125% two months prior to the issuance of the 40 year preferred stock at 8.0%. An additional 87.5 bps is not unreasonable given 30 more years for the term of the preferred stock. There are two other equally important factors that resulted in a higher rate at the time of issuance – the preferred stock is callable in 2006, and the interest payments on the preferred stock can be deferred for 20 consecutive quarters. In summary, given the timing of the issuance (2001), the term of the debt (40 years), the call option (2006) and the option to defer interest payments (20 consecutive quarters), the interest rate on AGLR's preferred stock is reasonable.

Q. Why did AGLR elect to issue such a long term debt instrument?

A. The primary reason was to spread out AGLR's debt service requirements. At the time of the issuance of preferred stock, AGLR had debt service requirements almost each year from 2002 – 2027. Issuance of debt with a debt service requirement during 2002 - 2027 could have resulted in an adverse effect to AGLR's credit ratings.

Q. What about Dr. Brown's assertion that the preferred stock of AGLR is not included in the capital structure of VNG?

A. As discussed in Section IV of my testimony, this is simply not true. The preferred stock of AGLR is included in the capital structure of VNG as well as the capital structure of AGLC.

Q. Is the issuance of preferred stock as a means of financing standard practice in the utility industry?

A. Yes. The following utilities issued preferred stock in May and July 2001, the same time frame as AGLR's most recent issuance of preferred stock (amounts are in millions):

Company	Amount	Interest Rate
Energy East Capital Trust	$325	8.25%
Puget Sound Energy Cap Trust	$200	8.40%
National Rural Utilities Coop	$150	7.625%

SECTION VII

Q. Do you have any additional revisions to the proposed revenue adjustment provided in your direct testimony?

A. Yes. CGC is reducing its other post retirement benefits expense by $108,779. The decrease is the result of changes in actuarial estimates. Additionally, AGLR amended its health and welfare plan effective July 1, 2004, discontinuing prescription drug benefits for retirees age 65 and over after January 1, 2006. This plan amendment was the result of the Medicare Prescription Drug Improvement and Modernization Act of 2003, which was signed into law December 8, 2003, and which resulted in Medicare offering prescription drug coverage beginning January 1, 2006 to all Medicare-eligible retirees. This plan amendment also had an impact on the expense reduction.

Q. What is the impact of the revisions discussed in your rebuttal testimony on CGC's proposed revenue adjustment?

A The net impact of the adjustments to bad debt, payroll and related benefits and other post retirement benefits is to reduce CGC's revenue deficiency from $4.6 million to

$3.7 million. Exhibits MJM 7-1 – MJM 7-8 provide the updated revenue requirement, cost of service and rate base after the revisions discussed in this testimony.

Q. Have you included a summary of the differences between the cases of CGC and the CAPD?

A. Yes. Included in Exhibit MJM 8-1 is a summary of the differences in the proposed capital structures of CGC and the CAPD as well as a reconciliation of the required revenue increase proposed by CGC and the revenue reduction proposed by the CAPD. Additionally, Exhibit MJM 8-2 provides the differences in the proposed capital structures of CGC and the CAPD by debt and equity component.

Q. Does this conclude your testimony?

A. Yes

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INTEREST EXPENSE AND PREFERRED STOCK DIVIDENDS

Dollars in millions	Calendar 2002	Fiscal 2001	Fiscal 2000
Total interest expense and preferred stock dividends	$ 86.0	$ 97.4	$ 57.7
Average debt outstanding[1]	$1,411.9	$1,376.1	$819.4
Average rate	6.1%	7.1%	7.0%

[1] Includes subsidiaries' obligated mandatorily redeemable preferred securities in calendar 2002, fiscal 2001 and fiscal 2000

The decrease in interest expense of $11.4 million for calendar 2002 as compared to fiscal 2001 was a result of lower interest rates on commercial paper and the effect of favorable fixed to floating interest rate swaps, which was offset by slightly higher average debt balances due to increases in working capital needs

The increase of $39.7 million for fiscal 2001 as compared to fiscal 2000 consisted of $12.7 million resulting from the issuance of $300.0 million of 7.125% senior notes, $24.1 million under the commercial paper program for short-term financing needs, and $4.4 million in preferred dividends related to the issuance of $150.0 million of 8.0% subsidiaries' obligated mandatorily redeemable preferred securities

The increase in average debt outstanding of $556.7 million for fiscal 2001 as compared to fiscal 2000 was primarily due to the acquisition of VNG and increases in working capital needs

DISTRIBUTION OPERATIONS

In millions	Calendar 2002	Fiscal 2001	Fiscal 2000
Operating revenues	$844.1	$914.3	$525.1
Cost of sales	267.4	321.9	57.8
Operating margin	576.7	592.4	467.3
Operation and maintenance expenses	255.3	268.0	229.4
Depreciation and amortization	82.0	90.4	71.0
Taxes other than income	25.2	28.5	23.4
Total operating expenses	362.5	386.9	323.8
Operating income	214.2	205.5	143.5
Other income	10.2	7.7	7.3
EBIT	$224.4	$213.2	$150.8

The increase in EBIT of $11.2 million for calendar 2002 as compared to fiscal 2001 was due to

- decreases in operating margin of $15.7 million
  - $11.3 million decrease in VNG's operating margin, due primarily to warmer-than-normal winter weather of $12.4 million, offset by an increase of $1.1 million in operating margin due to an increase in customer growth and the effect of an experimental WNA program that went into effect for the billing cycle beginning November 2002
  - $3.1 million decrease at AGLC
    - $6.7 million decrease in AGLC's operating margin due to the PBR settlement with the GPSC
    - $11.0 million increase in AGLC's PRP rider revenues which includes a $2.7 million adjustment for recovery of prior-year program expenses, this program recovers operating and capital program expenditures incurred in prior periods
    - $2.7 million decrease in AGLC's cost of sales due to a one-time positive adjustment in fiscal 2001 related to inventory costs for natural gas stored underground
    - $4.3 million decrease resulting from a decline in AGLC customers, which is primarily a result of customers who do not have the ability to pay Marketers and the statutory right of customers to disconnect on a seasonal basis without penalty
    - $0.4 million decrease in other revenues
  - $1.2 million decrease in CGC's operating margin due to lower use per customer
- decreases in operating expenses of $24.4 million
  - $4.2 million decrease in operating and maintenance expenses due primarily to reductions in payroll and contract costs as a result of aggressive implementation of cost efficiencies
  - $6.0 million decrease in bad debt expenses primarily due to higher-than-normal bad debt in fiscal 2001 as a result of colder-than-normal weather and higher-than-normal gas prices
  - $5.2 million decrease from a reduction in goodwill amortization, as a result of the adoption of SFAS 142
  - $3.1 million decrease in depreciation expense due to a $5.6 million decline in average depreciation rates from 3.0% to 2.6% as a result of AGLC's PBR settlement offset by an increase in depreciation expenses of $3.3 million due to property, plant and equipment additions and other factors
  - $2.7 million decrease in taxes other than income taxes as a result of a change in Virginia state law that replaced the gross receipts tax with a state income tax
  - $2.5 million decrease in benefit cost due to integration of VNG into AGL Resources' benefit plans and benefit plan amendments
  - $0.7 million decrease in all other operating expenses
- $2.5 million increase in other income from higher carrying charges on natural gas stored underground on behalf of AGLC's Marketers due to higher inventory balances

2002 compared to fiscal 2001 The increase in EBIT of $11.2 million for 2002 compared to fiscal 2001 was primarily due to decreases in operating expenses of $24.4 million, which were partially offset by decreases in operating margin of $12.7 million.

Operating margin decreased $12.7 million primarily due to

- $11.3 million decrease in VNG's operating margin, resulting from the impact of warmer-than-normal winter weather of $12.4 million, partially offset by a $1.1 million increase in customers and the positive impact of an experimental WNA program that went into effect for the billing cycle beginning November 2002.
- CGC's operating margin decreased $1.2 million primarily due to lower use per customer.
- $0.1 million decrease in AGLC's operating margin, primarily due to a $6.7 decrease in AGLC rates as a result of the PBR settlement with the GPSC, a decrease of $4.3 million as a result of a decline in number of customers due to fewer end-use customers connecting to our system. Additional decreases to AGLC margin were a 2001 $2.7 million one-time adjustment to cost of sales as a result of inventory cost for natural gas stored underground. These decreases were offset by an $11.0 million increase in AGLC's PRP rider revenues, resulting from recovery of prior-year program expenses, and an increase in carrying costs charged to marketers for gas stored underground which contributed an additional $3.0 million.

Operating expenses decreased $24.4 million primarily due to

- $12.7 million decrease in operating and maintenance expenses related to reductions in payroll and contract costs as a result of implementing cost efficiencies
- $6.0 million decrease in bad debt expenses as a result of higher-than-normal bad debt expense in fiscal 2001 as a result of colder-than-normal weather and higher-than-normal gas prices, resulting in higher customer bills during the 2001 heating season
- $5.2 million decrease in goodwill amortization from 2001 as a result of the adoption of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets" (SFAS 142), effective October 1, 2001.
- Depreciation expense decreased $3 0 million in 2002 as compared to fiscal 2001, due to a decrease of $5.6 million caused by a decline in average depreciation rates (from 3.0% to 2.6%) as a result of AGLC's PBR settlement with the GPSC effective May 1, 2002, partially offset by an increase in depreciation expenses of $3.3 million due to higher property, plant and equipment balances.

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The increase in EBIT of $62.4 million for fiscal 2001 as compared to fiscal 2000 was due to

- $40 6 million increase in contributions from VNG, acquired by AGL Resources effective October 1, 2000, primarily due to $116 3 million of operating margin including $3 8 million due to colder-than-normal weather, offset by $75 7 million of operating expenses
- $8 9 million increase in AGLC's operating margin as a result of increased base rate revenue due to additional recovery under the GPSC rider associated with the PRP and residential customer growth, partially offset by a decrease in small commercial growth
- $12 7 million decrease in AGLC's and CGC's operating expenses due primarily to lower corporate overhead allocations

WHOLESALE SERVICES

The following table reflects the adoption of EITF 02-03, which requires energy-trading entities to present gains and losses from energy marketing activities on a net basis Wholesale services was established during fiscal 2001 and had no results in fiscal 2000

In millions	Calendar 2002	Fiscal 2001	Fiscal 2000
Operating revenues	$23 0	$11 6	$—
Cost of sales	0.3	0.2	—
Operating margin	22.7	11.4	—
Operation and maintenance expenses	13 2	6 1	—
Depreciation and amortization	—	—	—
Taxes other than income	0 4	—	—
Total operating expenses	13 6	6.1	—
Operating income	9.1	5 3	—
Other income	—	(2 2)	—
EBIT	$ 9 1	$ 3 1	$—

The increase in EBIT of $6 0 million for calendar 2002 as compared to fiscal 2001 was due to the following

- $11 3 million increase in operating margin primarily as a result of increased weather volatility from warmer-than-normal weather in the Northeast, two hurricanes during the late summer, colder weather in November and December and an overall increase in volumes sold These weather-related events caused interruption in the supply/demand equilibrium between the affected production and market areas resulting in wide locational pricing disparities Sequent used access to contracted assets and its expertise in logistics to maximize the profit opportunity by flowing gas on the most economical path available Additionally, operating margin was positively impacted by peaking services that were not offered in prior years Physical gas sales volumes increased from 0 1 billion cubic feet/day in fiscal 2001 to 1 4 billion cubic feet/day in calendar 2002
- $2 2 million increase in other income primarily due to a prior-year write-off of the investment in Etowah LNG of $2 6 million resulting from a termination of the joint venture partnership, which was formed in fiscal 1998
- $7 5 million increase in operating expenses primarily attributable to the addition of personnel to support growth in the business and a full year of operating expenses

The increase in EBIT of $3 1 million for fiscal 2001 as compared to fiscal 2000 was due to the following

- $11 4 million increase in operating margin due to the startup of the marketing and risk management business
- $6 1 million increase in operating expenses related to the startup of the marketing and risk management business
- $2 2 million decrease in other income due to the write-off of the investment in Etowah LNG of $2 6 million resulting from the termination of the joint venture partnership, which was formed in fiscal 1998

The energy marketing contracts that are utilized by Sequent in its energy marketing and risk management activities are recorded on a mark-to-market basis The tables below illustrate the change in the net fair value of the energy-trading contracts during calendar 2002, as well as provide details of the net fair value of contracts outstanding as of December 31, 2002.

In millions	Calendar 2002
Net fair value of contracts outstanding at beginning of period	$ 2.9
Contracts realized or otherwise settled during period	(4.9)
Net fair value of net claims against counterparties	—
Change in net fair value of contracts	8 8
Net fair value of new contracts entered into during period	—
Change in fair value attributed to changes in valuation techniques and assumptions	—
Net fair value of contracts outstanding at end of period	$ 6 8

Distribution Operations

Distribution operations includes the results of operations and financial condition of our three natural gas local distribution utility companies: Atlanta Gas Light Company (AGLC), Virginia Natural Gas, Inc. (VNG) and Chattanooga Gas Company (CGC). Distribution operations' revenues contributed 95.1% of our consolidated revenues for 2003, 97.1% for 2002, 96.8% for the transition period and 97 2% for fiscal 2001. Each utility operates subject to regulations provided by the state regulatory agencies in its service territories.

- **AGLC** is a natural gas local distribution utility with distribution systems and related facilities throughout Georgia. AGLC has approximately 6 billion cubic feet, or Bcf, of LNG storage capacity in three LNG plants to supplement the supply of natural gas during peak usage periods. Pursuant to the Georgia Natural Gas Competition and Deregulation Act, AGLC is designated as an "electing distribution company," which means that AGLC is required to offer LNG peaking services to marketers at rates and on terms approved by the Georgia Public Service Commission (GPSC).

  Performance-Based Rates AGLC operates under a three-year performance-based rate (PBR) plan that became effective May 1, 2002, with an allowed return on equity of 11%. The PBR plan also establishes an earnings band based on a return on equity of 10% to 12%, with three-quarters of any earnings above a 12% return on equity shared with Georgia customers and one-quarter retained by AGLC.

  In the last year of the PBR plan (May 2004 – April 2005), the GPSC staff and AGLC will review the operation of the plan and review AGLC's revenue requirement to determine whether base rates should be reset upon the initial plan's expiration. The GPSC will then determine whether the plan should be discontinued, extended or otherwise modified. As part of any hearing procedure, AGLC will file a cost of service study in accordance with the GPSC's minimum filing requirements as well as supporting testimony. AGLC plans to file the required cost of service study in 2004, the precise timing of which is subject to discussions with the GPSC staff.

  Straight-Fixed-Variable Rates AGLC's revenue is recognized under a straight-fixed-variable rate design, where AGLC charges rates to its customers based primarily on a fixed charge. This minimizes the seasonality of both revenues and expenses since the fixed charge is not volumetric and therefore not directly weather dependent Weather indirectly influences the number of customers that have active accounts during the heating season, and this has a seasonal impact on AGLC's revenues, since generally more customers will be connected in periods of colder weather than in periods of warmer weather

- **VNG** is a natural gas local distribution utility with distribution systems and related facilities serving the region of southeastern Virginia. VNG owns and operates approximately 155 miles of a separate high-pressure pipeline that provides delivery of gas to customers under firm transportation agreements within the state of Virginia. VNG also has approximately five million gallons of propane storage capacity in its two propane facilities to supplement the supply of natural gas during peak usage periods

  Weather normalization adjustment On September 27, 2002, the Virginia State Corporation Commission (VSCC) approved a weather normalization adjustment (WNA) program as a two-year experiment involving the use of special rates The WNA program's purpose is to reduce the effect of weather on customer bills by reducing bills when winter weather is colder than normal and increasing bills when winter weather is warmer than normal Under the terms of the program, if VNG requests to continue the WNA program after the two-year experiment, it is required to file a fully adjusted cost of service study along with the same schedules as would be required for a general rate case. It is possible the VSCC may require a general rate case prior to extending the WNA program. VNG plans to request an extension of the WNA program in 2004.

- **CGC** is a natural gas local distribution utility with distribution systems and related facilities serving the Chattanooga and Cleveland areas of Tennessee. CGC has approximately 1.2 Bcf of LNG storage capacity in its LNG plant. Included in the base rates charged by CGC is a WNA factor that allows for revenue to be recognized based on a weather normalization factor derived from average temperatures over a 30-year period, which offsets the impact of unusually cold or warm weather on our operating income

  On January 26, 2004, CGC filed a request for a total rate increase of $4.5 million with the Tennessee Regulatory Authority (TRA), as rates have not increased since 1995 If approved, new rates would be effective March 1, 2004, subject to a TRA suspension for hearing The rate plan was filed to cover CGC's rising cost of providing natural gas to its customers.

EX-99.2 4 dex992.htm DISTRIBUTION OPERATIONS

2003 Analyst/Investor Conference

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Forward-Looking Statements

These presentations contain forward-looking statements Company management cautions readers that the assumptions, which form the basis for the forward-looking statements, include many factors that are beyond company management's ability to control or estimate precisely Those factors include, but are not limited to, the following changes in industrial, commercial, and residential growth in the company's service territories and those of the company's subsidiaries, changes in price and demand for natural gas and related products, impact of changes in state and federal legislation and regulation, including various orders of the state public service commissions and the Federal Energy Regulatory Commission, on the gas and electric industries and on the company, including the impact of Atlanta Gas Light Company's performance based rate plan, effects and uncertainties of deregulation and competition, particularly in markets where prices and providers historically have been regulated, unknown risks related to nonregulated businesses, and unknown issues such as the stability of certificated marketers, impact of Georgia's Natural Gas Consumers' Relief Act of 2002, concentration of credit risk in certificated marketers and the company's wholesale services segment's counterparties, excess network capacity and demand/growth for dark fiber in metro network areas of AGL Networks' customers, AGL Networks' introduction and market acceptance of new technologies and products, as well as the adoption of new networking standards, ability of AGL Networks to produce sufficient capital to fund its business, ability to negotiate new contracts with telecommunications providers for the provision of AGL Networks' dark-fiber services, industry consolidation, performance of equity and bond markets and the impact on pension fund costs, impact of acquisitions and divestitures, changes in accounting policies and practices issued periodically by accounting standard-setting bodies, direct or indirect effects on the company's business, financial condition or liquidity resulting from a change in the company's credit ratings or the credit ratings of the company's competitors or counterparties, interest rate fluctuations, financial market conditions, and general economic conditions, uncertainties about environmental issues and the related impact of such issues, impact of changes in weather upon the temperature-sensitive portions of the company's business, and other risks described in the company's documents on file with the Securities and Exchange Commission

Chattanooga Gas Company
Historical Analysis of FTE's
Attrition Period Ending June 30, 2005

Docket No. 04-00034
Rebuttal Testimony
Exhibit - MJM 2-1

	(A) Qtr 4 2000	(A) Qtr 4 2001	(A) Qtr 4 2002	(A) August 2003	Attrition Period
Employees of CGC	53	52	47	55	55
(B) Outsourced Positions	6	6	6	-	-
Total FTE's	59	58	53	55	55

(A) Source - Direct Testimony of Michael Chrysler, Exhibit MDC EL 2

(B) Outsourced positions based on meter reader FTE's during the fourth quarter of 1998 less employed meter readers of CGC, both provided in MDC EL 2

	Qtr 4 2000	Qtr 4 2001	Qtr 4 2002	August 2003	Attrition Period
Meter Reader FTE's Q4 1998	10	10	10	10	10
Meter Reader Employees of CGC	4	4	4	10	10
Outsourced Meter Readers	6	6	6	-	-

Docket No. 04-00034
Rebuttal Testimony
Exhibit - MJM 2-2

Chattanooga Gas Company
Adjustment for Payroll and Related Benefits
Attrition Period Ending June 30, 2005

			As Filed 6/30/2005	New Union Contract & Position Elimination		
Job Code	**Title**	**Class**	**Attrition Period Adj. Earnings**	**Attrition Period Adj. Earnings**	**Adjustment Required**	**% Variance**
8771	Position Eliminated	Salary	62,204.25	-	62,204.25	
C162	Union contract finalized	Hourly	36,285.38	35,839.67	445.71	-1.2%
C205	Union contract finalized	Hourly	275,705.35	272,311.69	3,393.66	-1.2%
C230	Union contract finalized	Hourly	713,315.18	704,383.72	8,931.46	-1.3%
C261	Union contract finalized	Hourly	60,118.43	59,365.10	753.33	-1.3%
C262	Union contract finalized	Hourly	80,978.02	80,122.45	855.57	-1.1%
C425	Union contract finalized	Hourly	333,276.65	329,087.53	4,189.12	-1.3%
C439	Union contract finalized	Hourly	106,988.32	106,348.33	639.99	-0.6%
C703	Union contract finalized	Hourly	43,989.50	43,460.32	529.18	-1.2%
	All Other Payroll	Various	1,258,723.91	1,258,723.91	-	0.0%
	Total		**2,971,585.00**	**2,889,642.72**	**81,942**	-3.2%

	Impact of payroll taxes			
(A)	Payroll tax rate used in attrition period	7.65%		
	Payroll tax rate applied to adjustment	6,268.58	6,269	Taxes Other than Income
(B)	Attrition Period RSP Expense	73,172.00	1,307	Admin and General
(B)	Attrition Period Health Insurance Expense	326,349.00	5,828	Admin and General
(B)	Attrition Period Benefit Deductions	(106,753.00)	(1,906)	Admin and General
	Impact of payroll expense adjustment, including benefits		**93,439**	
	Benefits Adjustment - Sum of **(B)**		**5,228**	

Note In CGC's initial cost of service, the merit increase for union employees was forecasted for May of 2004 and 2005 Based on the approved union agreement, merit increases will take place October of 2004 and 2005

(A) TRA MFG No 43, schedule 43-5, page 5 of 9
(B) TRA MFG No 43, schedule 43-2, page 1 of 6 - The adjustments for benefits were derived by dividing the amount included in the attrition period by 56 (FTE's in initial attrition period estimate)

(a) The following acronyms are used in Item 1: RHC – registered holding company, IHC – intermediate holding company
(b) AGL Resources and AGLI are not reporting companies but are included in this Item 1 because they hold securities, directly or indirectly, in the gas-related companies as indicated.
(c) SEM is an asset optimization, producer services, and wholesale marketing and risk management subsidiary.
(d) Through September 2003, Southeastern LNG, Inc. owned and operated a fleet of liquefied natural gas tankers. Southeastern LNG, Inc. sold its entire fleet of tankers in October 2003 and currently has no active operations.
(e) GNG currently owns a non-controlling 70% financial interest in SouthStar and Piedmont Natural Gas Company, Inc. ("Piedmont") owns the remaining 30%. Our 70% interest is non-controlling because all significant management decisions require approval by both owners. On March 29, 2004, AGL Resources executed an amended and restated partnership agreement with Piedmont. This amended and restated partnership agreement calls for SouthStar's future earnings starting in 2004 to be allocated 75% to GNG and 25% to Piedmont. In addition, the partners executed a services agreement, which provides that AGL Services Company will provide and administer accounting, treasury, internal audit, human resources and information technology functions.
(f) SouthStar is the largest retail marketer of natural gas in Georgia with a market share of approximately 37% and operates under the trade name Georgia Natural Gas.
(g) Formed to construct a propane air facility in the VNG service area to serve VNG's peaking needs.
(h) AGL Peaking Services, Inc. ("AGL Peaking") owns property formerly designated for a liquefied natural gas peaking facility, but has no active operations.

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ITEM 2 - ISSUANCES AND RENEWALS OF SECURITIES AND CAPITAL CONTRIBUTIONS

There were no reportable issuances of securities or capital contributions made by the reporting entities during the quarter ended March 31, 2004.

ITEM 3 - ASSOCIATE TRANSACTIONS

Part I - Transactions Performed by Reporting Companies on Behalf of Associate Companies for the Quarter Ended March 31, 2004 (in thousands)

Reporting Company Rendering Services	Associate Company Receiving Services (a)	Types of Services Rendered	Direct Costs Charged (b)	Indirect Costs Charged (b)	Cost of Capital (b)	Total Amount Billed (b)
SEM	Atlanta Gas Light Company	Gas procurement, scheduling and other	$ 67	--	--	$ 67
SEM	Virginia Natural Gas, Inc.	Gas procurement, scheduling and other	58	--	--	58
SEM	Chattanooga Gas Company	Gas procurement, scheduling and other	44	--	--	44
SEM	Atlanta Gas Light Company	Gas Transmission Storage Management	529	--	--	529
SEM	Chattanooga Gas Company	Gas Transmission Storage Management	1,180	--	--	1,180

(a) All services are being provided at cost and are being billed (with the exception of certain direct billings) through AGL Services Company ("AGSC"). As per Rules 80 and 81, energy purchases are not reported hereunder.
(b) The Receiving Company makes available idle or underutilized gas transportation and storage capacity for use by the

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Serving Company, as agent for the Receiving Company, in return for which the Serving Company pays for costs incurred and shares the profits with the Receiving Company in accordance with approval by the appropriate state commissions.

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Part II - Transactions Performed by Associate Companies on Behalf of Reporting Companies for the Quarter Ended March 31, 2004 (in thousands)

Associate Company Rendering Services	Reporting Company Receiving Services	Types of Services Rendered	Direct Costs Charged	Indirect Costs Charged	Cost of Capital	Total Amount Billed
AGSC	SEM	Support (c)	$ 626	$ 1,254	$ 21	$ 1,901
AGSC	Southeastern LNG, Inc	Support (d)	1	2	--	3
AGSC	Pivotal Energy Services, Inc	Support (d)	9	--	--	9
AGSC	GNG	Support (e)	128	475	30	633
AGSC	Pivotal Propane of Virginia, Inc	Support (d)	9	--	--	9
AGSC	AGL Peaking	Support (d)	--	2	--	2

(c) Sequent receives support services (i e accounting, information services, human resources, payroll, etc.) from AGSC which are billed pursuant to a standard at-cost service agreement with AGSC Detailed information with respect to transactions under the agreement is not provided in this report but will be provided by Form U-13-60

(d) Southeastern LNG, Inc.; Pivotal Energy Services, Inc.; Pivotal Propane of Virginia, Inc.; and AGL Peaking Services receive support services from AGSC Detailed information with respect to these transactions is not provided in this report but will be provided by Form U-13-60

(e) GNG receives support services (i e. accounting, legal, risk management, etc) from AGSC which are billed pursuant to a standard at-cost service agreement with AGSC Detailed information with respect to transactions under the agreement is not provided in this report but will be provided by Form U-13-60.

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ITEM 4 - SUMMARY OF AGGREGATE INVESTMENT

Investments in energy-related companies (in thousands):

Total consolidated capitalization of AGL Resources as of March 31, 2004 (1)	$2,105,295		Line 1
Total capitalization multiplied by 15% (Line 1 multiplied by 0 15)	315,794		Line 2
Greater of $50 million or line 2		$315,794	Line 3
Total current aggregate investment (categorized by major line of energy-related business)			
Total current aggregate investment		-	Line 4
Difference between the greater of $50 million or 15% of capitalization and the total aggregate investment of the registered holding company system (line 3 less line 4)		$315,794	Line 5

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
PUBLIC UTILITY REGULATION

June 20, 2003

Mr. Richard O'Brien
Executive Vice President
and Chief Financial Officer
AGL Resources, Inc.
817 West Peachtree Street NW
Atlanta, Georgia 30308

Subject: Examination of AGL Resources, Inc. ("AGLR" or "Parent"), AGL Services Company ("AGSC" or "AGL Services") and certain non-utility subsidiaries

Dear Mr O'Brien :

The Office of Public Utility Regulation ("Examination Staff") within the Division of Investment Management, has completed an audit-examination of the books, records, accounts, billing procedures, and methods of allocation of AGSC, the service company subsidiary of AGLR, a registered holding company under the Public Utility Holding Company Act of 1935 ("Act") The audit was conducted pursuant to sections 13(b), 15(f) and Rules 90, 91, 93, and 94 of the Act. The Audit Staff examined specific issues involving the Parent and certain non-regulated subsidiaries which were incurring losses. AGL Peaking Services, Inc , Georgia Natural Gas Company, AGL Networks, LLC, Customer Care Services Company, AGL Energy Wise Services, Inc , Retired MainLLC, AGLR, AGL Capital Corp., AGL Capital Trust, AGL Capital Trust II, and Others. The Audit Staff also examined the AGLR tax allocation agreement and procedures to determine compliance with the requirements of section 12 and rule 45(c) of the Act.

The examination included a review of the overall accounting system of AGSC, types of services rendered by AGSC to associate companies, at cost requirements for service transactions by AGSC, internal controls for monitoring such services, and the methods of allocation for costs associated with such services The audit also included an evaluation of AGSC accounting systems for capturing its costs, and compliance with the Uniform System of Accounts for Mutual and Subsidiary Service Companies, 17 C F.R. Section 256 ("USA" or System of Accounts"). The Audit Staff reviewed selected audit reports produced by AGLR's Internal Audit Department ("IAD") The Audit Staff examined certain financial and operational information of the Parent, and of the certain non-utility subsidiaries The Examination Staff also examined a number of financial based issues related to the AGLR System to test internal and external controls and to insure that AGLR is in compliance with generally accepted accounting principles.

Based on our review of the examination workpapers of the Advanced Data Request Audit Scope Items in the letters dated October 17, 2002, our supplemental letter of January 10, 2003 and additional items added during the field examination, as excepted in the attached Findings and Actions Required, we have concluded that AGSC is in compliance with sections 13(b), 15(f) and Rules 90, 91, 93 and 94 of the Act The AGLR System is in compliance with Rule 45(c) of the Act except as noted in the Findings and Actions Required. All Findings and Actions Required related to our examination are enclosed. Any findings on allocations, corporate goverance, and internal policies and procedures is to be applied for similar items in all subsequent years. Any finding on allocations, corporate governance, and internal policies and procedures is to be applied for similar items in all subsequent years.

Concerning the Findings and Actions Required, please submit a response letter addressing each examination finding discussed in the attachment on or before July 28, 2003.

We would like to express our appreciation to the accounting staff of AGSC and expecially Brian Little for his cooperation throughout the examination. All questions concerning the audit should be directed to my attention at (202) 942-0543 or David E. Marsh at (202) 942-0558.

Sincerely,

RPWa

Robert P. Wason
Chief Financial Analyst

cc: Brian Little, Assistant Controller

Attachment

Findings and Actions Required

Finding 1 (Item 1)

The Commission's examination program of registered holding company systems ("RHC") under The Public Utility Holding Company Act of 1935 ("PUHCA") centers around three major issues

(1) do all three of the functional components of a registered holding company, holding company, utility and non-utility, operate under positive financial performance goals, (2) what is the purpose of the corporate and/or legal entities formed by the RHC and the propriety of corporate governance, and (3) how effective are the RHCs internal controls and how far down the chain of companies within the RHC umbrella do they reach

Financial performance under the above standards is a measure of profitability, not as a requirement of PUHCA but an objective of each RHC that acts to protect investors and consumers by not becoming a detriment to their protective standards Corporate structure and governance looks at the extensiveness of management knowledge of the business functions of the RHCs and communication and coordination of RHC policy throughout the system Internal controls and procedures is a required principle under PUHCA that mandates (Sections 13, 14 and 15) full and complete financial statement reporting and consolidation combined with the identification of all affiliate transactions between the companies that control the RHC

We asked that AGLR provide a full and complete explanation for each of the following questions

(a) What internal controls are in place at AGLR that enables executive management to know that all expense, financial, acquisition and corporate structure transactions have been accounted for, recorded and/or disclosed to books and records and are done so at the proper corporate level within the RHC?

(b) What internal controls are in place that monitors the use of proceeds of any AGLR equity investment and the leveraging of or commitment to any other funds in non-utility businesses?

(c) What internal and external controls are in place that identifies and reports (i) any off the balance sheet financings or investments and (ii) the formation of any corporate or business entities formed to hold, control or own any type of investment, asset or liability?

We asked that AGLR provide flow-charts, organization charts, chain-of-command structure, executive review procedures, investment threshold level approval procedures or any other type of quality oversight procedures that are in place and designed to identify the controls that are in place as to the above three questions We also asked that AGLR specifically identify problems they either foresee or know have existed from their efforts to achieve the above levels of control

(a) In order for the CEO and CFO of AGLR to certify the financial statements for the 3rd Quarter 2002 10-Q filing under Section 302 of the Sarbanes-Oxley Act of 2002, the Company performed an internal review of its internal control structure to ensure that the internal controls were free of material weaknesses In doing so, the Company conducted many interviews, documented processes, and performed certain tests of controls AGLR provided the Examination Staff with a document that represents their internal report that summarizes the procedures performed and the related findings The study utilized the COSO (Committee of Sponsoring Organizations) Framework (this was a report of the Treadway Commission published in 1992 on internal control and is the generally accepted model used by accountants in financial statement audits and by internal auditors) to evaluate AGLR system of internal control over financial reporting An outside accounting firm, Moore Colson, the Internal Audit Department, and the Controller's Group all had a part in conducting the assessment No material weaknesses in internal control were found, but there were several recommendations for improvement

(b) The company provided a copy of a memo (entitled "Understanding of the Treasury Cycle" by Barry A Brostoff) written on the Treasury Cycle to answer this question This memo included information on the borrowing of cash, investing of cash, investments, derivative financial transactions and compliance with loan covenants, including appropriate flowcharts A commercial paper program was established and replaced the two existing lines of credit

The Cash Manager is responsible for aggregating all information regarding the cash disbursements and receipts and determines the net cash position for the following day If cash is needed, the Cash Manager will initiate a draw form commercial paper The Treaurer or his secretary must approve the transaction A worksheet calculating the principal outstanding , and the effective interest rate is compiled on a worksheet and forwarded to financial accounting on a monthly basis for booking to the general ledger

If there is excess cash, the Cash Manager will initiate a short-term investment The investment must be approved in the same way as a borrowing The accounting is also the same For equity investments such as Southstar and US Propane, the Cash Manger receives communication at the time monies are needed or are going to be wired back to AGL Services

The only subsidiary that makes use of derivative instruments is Sequent and AGL Capital Corporation Deloitte and Touche was contracted to design appropriate controls for commodity trading activities

The Cash Manger also maintains worksheets to track debt to total capitalization ratio to ensure compliance with covenents set by the commercial paper program

(c) An entity can only be created by the General Counsel with the approval of the Board of Directors and CEO The Financial Accounting Group stays informed of any arising legal entities and would determine whether or not to consolidate the entity based on US GAAP Financial Accounting stays aware of these formations via CFO communication, corroboration with internal audit (who reviews the Board minutes), corroboration with the tax department (who must set up tax id's for each entity), advise of external auditors, review by internal audit, etc

The following meetings occur on a monthly basis to ensure management is aware that all expense, financial, acquisition and corporate structure transactions have been properly accounted for, recorded and/or disclosed to books and records in accordance with United States Generally Accepted Accounting Principles

- Earnings meetings between the Controller's organization, Senior Management and business unit heads during the month-end closing process The purpose of these meetings is to discuss preliminary earnings for the month, variances against budget and forecast, and any accounting issues to be resolved during the month or a subsequent accounting period

- Monthly business review meetings conducted by the Chief Executive Office, Chief Financial Officer and the Executive Vice President Distribution and Pipeline Operations with each of their direct reports, as well as representatives from the Controller's organization These meetings are similar to the above earnings meetings, however, they occur after the books and records have been closed and actual financial results are reviewed as compared to budget and forecast Additionally, these meetings discuss on-going strategies and issues and also focus on capital expenditures

- Disclosure Committee meetings, which occur in connection with the Company's SEC filings The Disclosure Committee was formally organized and formal processes documented in accordance with the requirements of Sarbanes/ Oxley However, prior to Sarbanes/ Oxley, the Company followed similar procedures, but not in such a structured and formalized process The Disclosure Committee procedures related to the Company's filing of its September 30, 2002 SEC Form 10Q were provided Checklists were also provided for Form 8-K, annual proxy statement and Form 10-K The checklists break down the different parts or items of each form, what action is required to complete that part, who is responsible and the status These checklists are to ensure that all items of the forma are prepared completely and accurately AGSC has recently developed a "35 Act Process and Timeline", which includes the Form U5SU-13-60, U-9C-3 and 35-CERT and the responsible party for each of the various parts of the forms

Action Required:

The Examination Staff recommends that the checklists designed for the forms of PUHCA, including Form U-13-60, Form U5S and Form U-9C-3 be included in the formal charter and procedures of the Disclosure Committee. The checklists help ensure that all parts of forms are properly prepared and reviewed.

Finding 2 (Item 2)

The Examination Staff asked for information on any energy related contracts that have resulted in losses in 2001 and 2002 Sequent Energy Management (Sequent), a wholly owned subsidiary of AGLR, is the only subsidiary, which enters into energy trading contracts None of these energy trading contracts are of the nature of a structured transaction and thus no losses have occurred on such transactions As for energy trading contracts related to storage and transportation, these contracts have been marked-to-market on a monthly basis in accordance with GAAP, which could result in unrealized gains and losses However, current procedures and processes to account for these storage and transportation contracts do not enable Sequent to determine whether these contracts result in a net loss on a total basis

Action Required:

The Examination Staff would like a further explanation on what is meant by structured contracts and how it is determined that losses have not occurred on them.

<u>Finding 3 (Item 9)</u>

The Examination Staff asked AGLR to clarify the organizational structure, utility interests, and non-utility interests of the AGLR System, provide a listing of entities in the AGLR System that are 10% to 50% owned as defined under sections 2(a)(8) and 2(a)(17) of the Act We asked that AGLR identify any of these subsidiaries have not been reported in the AGLR 2001 Form U5S Item 1 Finally, we asked if any subsidiary (as defined under the Act) has not been reported in Item 1, and to provide a legal analysis as to why not

AGL Resources Response

<u>1</u> AGL Resources states that SouthStar Energy Services, LLC, Georgia Natural Gas Services (GNG), a subsidiary of AGL Resources, Inc , owns 50% of this joint venture A subsidiary of Dynegy Inc is a 20% owner and a subsidiary of Piedmont Natural Gas Company is a 30% owner Results of SouthStar Energy Services, LLC are reported on GNG's income statement as other income

2 US Propane, LP, US Propane, LLC, and Heritage Propane Partners, L P
AGL Energy Corporation, a subsidiary of AGL Investments, Inc and a second-level subsidiary of AGL Resources Inc , owns a 22 36% member interest in US Propane, LLC, a partnership with subsidiaries of TECO Energy, Inc , Piedmont Natural Gas Company, and Atmos Energy Corporation US Propane, LLC, holds a 1% general partnership interest in US Propane, LP AGL Propane Services, Inc , a subsidiary of AGL Investments, Inc and a second-level subsidiary of AGL Resources Inc , owns a 22 36% limited partnership interest in US Propane, LP US Propane, LP owns approximately 29% of the limited partnership interests in Heritage Propane Partners, L P AGL Propane Services, Inc , as presented, includes AGL Propane Services, Inc and AGL Energy Corporation Results of Heritage Propane Partners, L P are reported on AGL Propane Services, Inc 's income statement as other income

3 In addition, AGL Resources provided us with a "White Paper" prepared at year-end with respect to FASB Interpretation No 46, "Consolidation of Variable Interest Entities," and why this Interpretation does not apply to its equity interest in US Propane and SouthStar AGL Resources states that it will not have any disclosure requirements as of January 31, 2003 nor will we need to consolidate US Propane or SouthStar effective for periods beginning after June 15, 2003 The following information is quoted from the "White Paper"

"Essentially, FIN #46 tries to address the issue of when a company should consolidate an entity ARB 51 requires companies to consolidate entities in which the company has a majority voting interest FIN #46 takes it a step further to determine if in the absence of majority voting interests a company has controlling financial interests, which should result in consolidation I have based my conclusion on the following FIN #46 requirements

1 The equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, which is provided through other interests (so called "variable interests") that will absorb some or all of the expected losses of the entity

Currently, I believe US Propane and SouthStar have sufficient equity investment to finance its activities I was concerned about the capital contribution agreements for SouthStar where each partner is required to contribute additional capital to pay SouthStar invoices from vendors affiliated with the owners However, since there has been no activity during 2002 with respect to this agreement, and SouthStar's equity as of November 2002 was $77 5 million consisting of $90 6 million in contributions from partners plus accumulated EBT of $58 7 less $69 million in partner distributions and $2 7 of OCI, the evidence supports that SouthStar's existing equity is sufficient to finance its activities Additionally, since SouthStar has made partner distributions of $69 million of which $49 million occurred during 2002, I do not believe that the partners will need to provide subordinated financial support

2 The equity investors lack one or more of the following essential characteristics of a controlling financial interest

a The direct or indirect ability to make decisions about the entity's activities through voting rights or similar rights

b The obligation to absorb the expected losses of the entity if they occur, which makes it possible for the entity to finance its activities

c The right to receive the expected residual returns of the entity if they occur, which is the compensation for the risk of absorbing the expected losses

Conclusion

All of the above three criteria apply to our investment in SouthStar, therefore, we do not lack one or more the above There is one section within FIN #46, which states that the equity investors as a group would lack the above three characteristics is the following two criteria were met

1 The voting rights of some investors are not proportional to their obligations to absorb the losses of the entity, to receive the expected residual returns of the entity or both; AND

2 Substantially, all of the entity's activities either involve or are conducted on behalf an investor that has disproportionately few voting rights

Clearly, #1 applied to our interest (50% interest for equity in earnings but equal voting rights) However, #2 does not apply

Therefore, the overall conclusion is that FIN #46 does not apply and we would continue to apply the requirements of ARB 51, which requires companies to consolidate entities in which the company has a majority voting interest "

AGL Resources Public Disclosure

1 AGL Resources' Form 10-K filed for the calendar year ended December 31, 2002 states that, "on January 24, 2003, AGL Resources announced that its wholly-owned subsidiary had reached an agreement to purchase the Dynegy Holdings Inc 20% ownership interest of SouthStar The purchase was completed March 11, 2003 At closing, AGL Resources' subsidiary owned a noncontrolling 70% financial interest in SouthStar, with Piedmont Natural Gas Company owning the remaining 30% Although at closing AGL Resources owns 70% of SouthStar, it does not have a controlling interest as most matters of significance require the unanimous vote of each Owner's representative to the governing board of SouthStar The remaining Owners of SouthStar are parties to a capital contribution agreement that requires each Owner to contribute additional capital to SouthStar to pay invoices for goods and services received from any vendor that is affiliated with an Owner whenever funds are not otherwise available to pay those invoices The capital contributions to pay affiliated vendor invoices are repaid as funds become available, but repayment is subordinated to SouthStar's revolving line of credit with financial institutions There was no activity related to the capital contribution agreement during calendar 2002 "

Examination Review and Analysis

1 This review was to clarify the organizational structure of AGL Resources system of statutory subsidiaries, direct or indirect that are 10% to 50% owned, and to identify those entities, if any of these subsidiaries have not been reported in the AGL 2001 Form U5S Item 1 Examination Staff has addressed this issue in IER 10 of this examination

2 In addition, AGL Resources stated that FASB Interpretation No 46, "Consolidation of Variable Interest Entities" (FIN 46) does not apply to its subsidiaries SouthStar Energy Services LLC ("SouthStar") and US Propane, LP, therefore, these subsidiaries are accounted for using the equity method With regard to SouthStar, Examination Staff believes that because AGL Resources' subsidiary recently acquired Dynegy Holdings Inc 's 20% interest in SouthStar, additional information is required

Action Required

1. With regard to SouthStar, provide the agreement that documents how profits or losses generated by SouthStar are allocated. Please state whether this document or agreement was amended upon acquisition of Dynegy Holdings Inc.'s 20% interest in SouthStar. In addition, describe the amount of profit/losses SouthStar assumed prior to March 11, 2003

and how much of the profit/losses SouthStar assumes after acquiring Dynegy Holdings Inc.'s 20% interest in SouthStar.

2. On March 11, 2003, AGL Resources' subsidiary acquired Dynegy Holdings Inc.'s 20% interest in SouthStar. Prior to this date, AGL Resources' subsidiary owned 50% of SouthStar; and Piedmont Natural Gas Company owned 30% in SouthStar; and Dynegy Holdings Inc. owned the 20% of SouthStar (collectively the Owners). Describe what activities SouthStar was involved in for each of its Owners before and after the additional 20% interest was purchased. The Examination Staff suggest AGLR provide this information in a chart for the two different time periods.

Finding 4 (Item 10)

The Examination Staff asked for an organization chart (in a tabular format) of the AGLR system This table was to include all affiliates of the registered holding company system in existence as of September 30, 2002 We asked for the names of any affiliate, organized, dissolved or sold in 2002 For each affiliate, we asked for the following

(a) Name of company and acronym used in accounting code block (indented to show degree of remoteness from registrant)
(b) Country or state of organization (include date of incorporation)
(c) Type of business (i e intermediate holding company, gas or electric utility, non-utility, FUCO, EWG, ETC, service company, special purpose entities or inactive)
(d) Nature of business (description of any non-utility affiliate company)
(e) Indicate whether is wholly or partially controlled by the registrant (including percentage of voting securities held)
(f) Cite under what authority the affiliate was formed

Definitions For purpose of this question, affiliate means registered holding company, intermediate holding company, subsidiary company, gas utility company, electric utility company, exempt telecommunication company, exempt wholesale generator, and exempt foreign utility company, special purpose entities in the form of corporations, partnerships, limited liability companies and trusts Subsidiary company as defined in the Act is in Section 2(a)(8)

Note because the requested information is as of September 30, 2002, Examination Staff reviewed both Forms U5S for the year ended September 30, 2001 and December 31, 2002

Required Reporting under Form U5S, Item 1 System Companies and Investments

1 Instructions to Item 1 of Form U5S require a registered holding company to disclose inactive companies and partnerships "list the parent holding company and all statutory subsidiaries, direct or indirect, including inactive and nonutility companies and inactive companies should also be indicated by an asterisk (*) and a footnote " With regards to partnerships disclosure, "noncorporate subsidiaries, such as a trust or partnership, should be identified by a footnote, stating the form of organization and the form of equity investment, the amount of which should be included in the tabulation as though it were common stock "

2 In addition, there has been considerable misunderstanding with the term "subsidiary company," as used in practice by the accounting profession and the term "subsidiary company" as defined in the Act of 1935 In practice, when a corporation acquires a voting interest of more than 50 percent in another corporation,

the investor is referred to as the parent and the investee as the subsidiary[1] Section 2(a)(8)(A) of the Act of 1935 defines a "subsidiary company" (also know as "statutory subsidiary") of a specified holding company means "any company 10 percent or more of the outstanding voting securities of which are directly or indirectly owned, controlled, or held with power to vote, by such holding company (or by a company that is a subsidiary of such holding company by virtue of this clause or clause (B), unless the Commission, as hereinafter provided, by order declares such company not to be a subsidiary company of such holding company "

3 Instructions to Item 1(6) of Form U5S require disclosure of common stock investments, or equivalent, and the investments, if any, (i) in other equity securities, (ii) in unsecured debt and (iii) in secured debt These three categories should be summarized, in aggregate amount on additional lines under the company name shown on Item 1 of Form U5S "The description will include the principal amount, interest of dividend rate, and maturity date, and distinguish between the amount owned within the system and those otherwise outstanding "

AGLR Responses

1 AGLR responded to IER 10 with a corporate chart (DR 1-10 Attachment 1 of IER 10) of its system companies This corporate chart provides information about the company name and acronym, country or state of organization, type of business, nature of business, percentage of voting securities held, and under what authority the affiliate was formed Further, AGLR responded to a series of questions in additional examination request (AER 1) In addition, AGLR filed with the Commission a registration statement on Form U5B on January 8, 2001, and its annual report on Form U5S for the year ended September 30, 2001 and December 31, 2002 [2]

Examination Staff Review and Analysis

1 Examination Staff reviewed and analyzed the information provided in the examination responses and what has been filed with the Commission under the annual report on Form U5S for the fiscal year ended September 31, 2001 and calendar year ended December 31, 2002 This review and analysis is for compliance with the required information by Form U5S, Item 1 System Companies and Investments, and Item 5 Investments in Securities of Nonsystem Companies Based on information on Items 5 of the U5Ss, AGLR indicated that it has no investments in securities of nonsystem companies to report for the year ended September 30, 2001 and calendar year ended December 31, 2002

2 The corporate chart provided in response to the initial examination response (IER 10), omitted the entities such as Tes, Inc (inactive), Atlanta Gas Light Services, Inc (inactive), Georgia Natural Gas Services, Inc , Heritage Propane Partners, L P , Political Action Committee, Inc , Cumberland Gas Pipeline Company, and Pinnacle LNG, Inc (inactive) AGLR explained in paragraph below, as to why these types of entities were omitted in preparing the Company's September 30, 2001 annual report on the U5S Examination Staff became aware of the existence of these entities in a Schedule 4 14 of Form 10-K, as discussed in paragraph (4) below

3 AER 1(2) Form U5S, Item 1 for the year ended September 30, 2001, the word "Management" was excluded in error for Sequent Energy, LP, and the actual legal name is Sequent Energy Management, LP, however, the error is corrected in the Form U5S filed on May 1, 2003 See also IER 25, this explains as to why there were no financial statements provided for Sequent Energy, LP

[1] Source Kieso Donald e, Weygandt Jerry J and Warried Terry D Intermediate Accounting 11e, pg 851, Publisher (March 2003) by John Wiley and Sons, Inc

[2] AGL Resources publicly announced in its Form 8-K filed September 21, 2001 that changed its fiscal year-end from September 30 to a calendar year-end December 31, effective on the date of this 8-K filing

4 AER 1(1) requested an explanation as to why certain subsidiaries of AGLR were reported in the annual report on Form 10-K, in Schedule 4 14 Subsidiaries (period Sep 30, 2001), but not reported in Item 1 of AGLR's annual report on Form U5S for the same period AGLR's response states that the Schedule 4 14 was a schedule included as part of Exhibit 10 10, "Credit Agreement dated October 4, 2001, by and between AGLR , AGL Capital Corporation, as Borrower, and the Lenders (the "Credit Agreement") This Schedule 4 14 of the Credit Agreement required that all subsidiaries of the AGLR be listed whether they were considered to be significant or not or whether the subsidiaries were operationally and/or financially active Further, states that in preparing the Company's September 30, 2001 Form U5S, only those subsidiaries which were operationally and financially active were included within the filing The companies referenced by the Examination Staff (i e , Atlanta Gas Light Services, Inc , Cumberland Gas Pipeline Company, Georgia Natural Gas Services, Inc TES, Inc , Political Action Committee, Inc , and Heritage Propane Partners, L P) while still legal subsidiaries of AGLR were not operationally active, did not have any financial activity during the year ended September 30, 2001, and did not have any assets or liabilities as of September 30, 2001 Therefore, these subsidiaries were not included within the Company's Form U5S filing for the year ended September 30, 2001 AGLR stated that Heritage Propane Partners, L P ("Heritage") is not a subsidiary of AGLR, but is a limited partnership, which markets propane through a nationwide retail distribution network AGLR through ownership of limited partnership (LP) and limited liability company (LLC) interests has partnership interests in Heritage Examination Staff reviewed the most recent AGLR's U5S filed (May 1, 2003) The review indicated that, except for Cumberland Gas Pipeline Company, these entities are now publicly disclosed in Item 1 of the U5S for the year ended December 31, 2002 However, it does not explain why AGLR in the context of the initial examination response omitted certain inactive and noncorporate subsidiaries, such as partnerships

5 AER 1(3) Examination Staff requested an explanation as to why the footnotes identifying the owners were omitted for subsidiaries of more than one system company in Item 1 of Form U5S for the year ended September 30, 2001 For example, footnotes were omitted for the following subsidiaries SouthStar Energy Services LLC (33% voting power), US Propane, LP (25% and 1% voting power), and US Propane, LLC (25% of voting power) AGLR states that they erroneously omitted the explanations from the footnotes, but will include the required Item 1 footnotes in future Form U5S filings Examination Staff reviewed indicated the required footnotes for SouthStar Energy Services, LLC, US Propane, LP and US Propane, LLC are now included in Item 1 of Form U5S filed May 1, 2003 In the interim, the owners of the above are as follows

(a) SouthStar Energy Services LLC (SouthStar) is a joint venture in which a wholly-owned subsidiary of AGLR (Georgia Natural Gas Company or GNGC) is a 50% owner, a subsidiary of Dynegy Holdings, Inc is a 20% owner, and a subsidiary of Piedmont Natural Gas Company is a 30% owner Although AGLR owns 50% of SouthStar, it does not have a controlling interest as most matters of significance require the unanimous vote of each of the owners It should be noted that on January 24, 2003, AGLR announced that GNGC had reached an agreement to purchase the Dynegy Holdings, Inc 20% ownership interest in SouthStar This transaction was closed in March 2003, and was subject to a number of approvals, including clearance by the Georgia Public Service Commission Upon closing, GNGC now owns a non-controlling 70% financial ownership interest in SouthStar It still does not have a controlling interest as most matters of significance still required the unanimous vote of each of the owners

(b) AGLR owns 22 36% of the limited partnership (US Propane LP) and 22 36% of the limited liability company (US Propane) that serves as US Propane's general partner The other limited partners are subsidiaries of TECO Energy, Inc , Piedmont Natural Gas Company and Atmos Energy Corporation These other companies are also owners of US Propane's general partner US Propane owns all the general partnership interests directly or indirectly and approximately 29% or 4,641,282 common units of the limited partnership interests in Heritage Propane Partners, L P (NYSE HPG)

6 AER 1(5) With respect to those companies requiring a footnote, AGLR states that it did not include the type of business information because based on the Company's reading of the instructions to Form U5S that such information was not required However, such information will be included in future Form U5S filings AGLR has disclosed the type of business in Item 1 of Form filed May 1, 2003 In addition, the

companies that required a footnote in Form U5S for the year ended September 30, 2001, now the footnote is included in the Form U5S filed May 1 2003

7 AER 1(4) The Examination Staff requested an explanation as to why AGLR omitted the required disclosure of common stock investments, or equivalent, and the investments, if any, (i) in other equity securities, (ii) in unsecured debt and (iii) in secured debt in Item 1 of the Form U5S for the year ended September 30, 2001 (see Instruction to Item 1(6) of the Form U5S) AGLR states that they erroneously omitted the disclosures due to a lack of understanding of the requirements, but will include the required disclosures in future Form U5S filings However, AGLR has not yet provided this disclosure in its Form U5S filed on May 1, 2003

8 AER 1(6) Examination Staff recommended that AGLR provide the Examination Staff with its current internal controls and procedures for preparing and reviewing the SEC filings, specifically the filings under the Public Utility Holding Company Act of 1935, as amended ("PUHCA" or "Act") The report should explain the type of review(s) performed on the PUHCA forms, and the Company's internal control structure for PUHCA reporting How do you assure that all subsidiaries (as defined in the Act) in the AGLR System are being reported in the Form U5S?

(a) Examination response states that AGLR has been in the process of creating formal policies and procedures for preparing and reviewing filings under PUHCA AGLR provided us its current policy and procedure ("35 Act Process and Timeline") with respect to preparing and reviewing the PUHCA filings The procedure outline the timeline and responsibilities for preparation and review and incorporates individuals from the Chief Financial Officer, Controller, Corporate Secretary, Legal, Financial Reporting and Financial Accounting organizations as well as members of the Disclosure Committee who review the Company's SEC 1933 and 1934 Act filings For more information on the Disclosure Committee, please see the Company's response to IER-1

(b) AGLR stated that it has also worked closely with in-house and outside counsel to understand the reporting requirements under PUHCA When AGLR was in the process of becoming a registered holding company under PUHCA, reporting requirements were obtained from outside counsel, which are entitled "Ongoing 1935 Act Reporting Requirements " Additionally, AGLR has presented training to key individuals within the Company as to what events trigger filing requirements under PUHCA This training was conducted by the AGLR's Internal Audit organization and by outside counsel AGLR provided us with copies of the training materials presented by outside counsel ("Filing Triggers Under the Public Utility Holding Company Act of 1935") and by Internal Audit ("Internal Process of Activity Requiring SEC Approval" and "Internal Process After SEC Approves Transaction" flowcharts)

(c) Lastly, to ensure the AGLR files its SEC filings (1933, 1934 and 1935 Act) on a timely basis, the filings are incorporated into a common calendar, "Controllers Calendar", which is accessible by all individuals within the Controller's organization This calendar in conjunction with the above discussed items are controls to ensure that AGLR's PUHCA as well as the Form U5S filings are complete, accurate and incorporate all subsidiaries

Action Required

1. AGLR in the context of the examination response, stated that "in preparing the Company's September 30, 2001 Form U5S, only those subsidiaries which were operationally and financially active were included within the filing." Further, AGLR stated that the companies referenced by the Examination Staff (i.e., Atlanta Gas Light Services, Inc.; Cumberland Gas Pipeline Company; Georgia Natural Gas Services, Inc. TES, Inc.; Political Action Committee, Inc.; and Heritage Propane Partners, L.P.) while still legal subsidiaries of AGLR were not operationally active, did not have any financial activity during the year ended September 30, 2001, and did not have any assets or liabilities as of September 30, 2001. Therefore, these subsidiaries were not included within the Company's Form U5S filing for the year ended September 30, 2001.

AGLR stated that Heritage Propane Partners, L.P. ("Heritage") is not a subsidiary of AGLR, but is a limited partnership. Instructions to Item 1 of Form U5S require a registered holding company to disclose inactive companies and partnerships "list the parent holding company and all statutory subsidiaries, direct or indirect, including...inactive and nonutility companies ... and inactive companies should also be indicated by an asterisk (*) and a footnote." With regards to partnerships disclosure, "noncorporate subsidiaries, such as a trust or partnership, should be identified by a footnote, stating the form of organization and the form of equity investment, the amount of which should be included in the tabulation as though it were common stock."

In addition, Section 2(a)(8)(A) of the Act of 1935 defines a "subsidiary company" (also know as "statutory subsidiary") of a specified holding company means "any company 10 percent or more of the outstanding voting securities of which are directly or indirectly owned, controlled, or held with power to vote, by such holding company (or by a company that is a subsidiary of such holding company by virtue of this clause or clause (B), unless the Commission, as hereinafter provided, by order declares such company not to be a subsidiary company of such holding company."

The Examination Staff reviewed AGLR's U5S and revealed that, except for Cumberland Gas Pipeline Company, these entities were all publicly disclosed in Item 1 of the U5S for the year ended December 31, 2002, but not included in the U5S for the year ended September 30, 2001, nor in the context of the examination response to IER 10. Examination Staff concludes that AGLR needs to provide us with a written representation to confirm the disclosure of all statutory subsidiaries, including inactive and noncorporate subsidiaries, such as partnerships and trust in its future filing on Form U5S, and made the proper footnotes as required by Form U5S. The noncorporate subsidiaries should be listed with the corporate subsidiaries in Item 1 and should be identified by a footnote, stating the form of organization and the form of equity investment, the amount of which shall be included in the tabulation as though it were common stock.

2. Even though AGLR under the Securities Exchange Act of 1934, disclosed the inactive and noncorporate subsidiaries in its Form 10-K, AGLR did not report this information, under the Act of 1935, in its Form U5S for the same period. Further, it failed to disclose those inactive and noncorporate subsidiaries in the context of the examination response (IER 10). AGLR need to provide the Examination Staff with an explanation as to why those entities were not listed in the examination response (DR 1-10 Attachment 1 to IER 10) with its statutory subsidiaries.

3. The footnotes identifying the owners for subsidiaries of more than one system company in Item 1 of Form U5S were omitted for the year ended September 30, 2001. However, AGLR states that it erroneously omitted the explanations from the footnotes, but will include the required Item 1 footnotes in future Form U5S filings. Examination Staff reviewed the 2002 Form U5S and disclosed that footnotes are included for the subsidiaries identified by the Examination Staff. In addition, Examination Staff recommends that AGLR needs to ensure that in preparing this form the required footnotes are included.

4. AGLR omitted the required disclosure of common stock investments, or equivalent, and the investments, if any, (i) in other equity securities, (ii) in unsecured debt and (iii) in secured debt in Item 1 of the Form U5S for the year ended September 30, 2001. AGLR states that it erroneously omitted the disclosures due to a lack of understanding of the requirements, but will include the required disclosures in future Form U5S filings. However, AGLR has not yet provided this disclosure in its Form U5S filed on May 1, 2003.

5. Examination Staff recognizes that AGLR is in the process of creating formal policies and procedures for preparing and reviewing filings under PUHCA. The current policy and procedures, "35 Act Process and Timeline" displays a detail process for reviewing each item of the Forms under the Act of 1935. It also listed the responsible party and a schedule for filing this forms. In addition, AGL Resources stated that it has also worked closely with in-house and outside counsel to

understand the reporting requirements ("Ongoing 1935 Act Reporting Requirements") under PUHCA.

Examination Staff recommends that AGLR needs to review its policies and procedures for Item 1 System Companies and Investments and 10 Financial Statements of Form U5S. Specifically for the required disclosure of (a) inactive entities (b) noncorporate subsidiaries, such as a trust or partnership, (c) required footnotes, (d) investments in the form of equity securities, unsecured debt and secured debt within the registered holding company system or system companies listed in Item 1 of Form U5S. In addition, for Item 10 Financial Statements of Form U5S, be sure the following items are specifically included: (a) all the required consolidating financial statements for majority-owned subsidiary companies, including those subsidiaries that are combined for reporting and consolidation purpose; (b) elimination entries for the consolidating financial statements; and (c) proper format, i.e. the word "consolidated" should appear on consolidated financial statements.

<u>Finding 5 (Item 12)</u>

The Examination Staff asked for a listing of all costs and describe how the AGLR System allocates any costs related to lobbying and/or consulting of federal and state regulators and/or political issues We asked for the details by item and amount for the years 2001 and 2002

Two lists of the costs related to lobbying and/or consulting of federal and state regulators and/or political issues was provided The first list covers 2001, the second covers January 2002 through October 2002

It was stated that these expenses are recorded to FERC account 426 5, Other Deductions, which falls below the line and are not allocated or charged to the AGLR system companies These expenses, incurred by AGL Services, were recorded by AGL Services on its books as other income and expense, which the company states is not included within the pool of costs to be allocated or charged back to any subsidiary of AGLR The service company under the Act must allocate out all of its costs The Uniform System of Accounts ("USA") in Instruction 01-3 General Structure of accounting system states in part (c) that "All disbursements and expenses of the service company for service performed for associate companies are recoverable from such companies" Since AGL Services has determined that these costs are not to be allocated, these costs should be charged to the Parent company and expensed on its books

Action Required

Costs for lobbying and/or consulting of federal and state regulators and/or political issues should be allocated to the Parent company since the service company must allocate out all of its costs.

<u>Finding 6 (Item 14)</u>

The Examination Staff asked if AGL Services owns or operates the building in which AGL Services employees work or is the building owned by a utility company? We also asked under which method is floor space allocated to associate companies and to provide the allocation of floor space by associate company for the years 2000 and 2001

The examination response states that AGL Services Company (AGSC) employees work in one of three buildings in Atlanta, Georgia One facility is owned by AGSC and is located at 1219 and 1251 Caroline Street ("Caroline Facility") The other AGSC facility consists of two leased floors in the Biltmore building ("Biltmore Facility") located at 817 West Peachtree Street The allocation methodology for both the Caroline facility and the Biltmore facility takes the square footage used by a department multiplied by a standard rate to determine the monthly charges The increase in floor space from 2000 to 2001 is due to the transfer of departments to or from AGSC when AGSC was formed in connection with AGLR Inc becoming a registered holding company

Additionally, the amount of usable or occupied space increased from 2000 to 2001 The allocation of floor space by affiliate for the years 2000 and 2001 is as follows

2000

Company		Square Footage (Annual)
Atlanta Gas Light Company	AGLC	874,422
Sequent Energy Management	SEQT	18,887
AGL Resources Inc.	AGLR	1,410,324

2001

Company		Square Footage (Annual)
Atlanta Gas Light Company	AGLC	523,013
Sequent Energy Management	SEQT	46,426
AGL Resources Inc.	AGLR	412,266
AGL Services Company	AGSC	1,759,219

Examination Staff believes that the allocation methodology based on the square footage used by a department multiplied by a standard rate to determine the monthly charges for both the Caroline Facility and the Biltmore Facility needs some clarification

Action Required:

AGSC needs to clarify in a dollar amount, how much of the floor space was charged to the Parent for the year 2000 and 2001.

Finding 7 (Items 16,17,18,19 and 20)

Items 16, 17, 18, 19 and 20 concerned the execution and implementation of AGLR's Tax Allocation Agreement ("Agreement"), among AGLR and its subsidiaries ("Members") Item 16 requested copies of AGLR's IRS Form 1120 for the tax year ending September 30, 2001 Item 17 requested copies of the Agreement Item 18 requested copies of the worksheets supporting the allocation of taxes under the Agreement Item 19 requested information concerning the timing of rule 45(c)(5) payments to loss position Members Finally, Item 20 requested information concerning AGLR's retention of the tax benefits associated with AGLR's merger related debt

AGLR(consolidated) reported taxable income of $80,384,742 and a total tax of $28,134,660 for the tax year ending September 30, 2001 Credits were redirected properly to the Member generating the benefit

After prepayments and credits, AGLR reported an overpayment of $2,173,766 Under the Agreement, the allocation ratio was calculated by relating the taxable income of each Member to the consolidated taxable income The worksheets verified that no Member incurred a tax liability greater than its separate return tax liability The worksheets used to allocate the tax liability/benefit agreed to the amounts on the tax return Rule 45(c)(5) payments to loss position Members are made quarterly and settled finally through the system money pool With one exception, discussed below, AGLR's tax allocation methodologies comport with rule 45(c)

By order dated October 5, 2000 (HCAR No 27243) ("Order"), among other things, the Commission approved AGLR's acquisition of Virginia Natural Gas, Inc ("VNG"), while reserving jurisdiction over AGLR's proposed Agreement In particular, the Commission did not act on a provision in the Agreement that would allow AGL to retain the tax benefits associated with debt incurred in connection with the VNG acquisition ("Acquisition Debt") The supporting worksheets indicate that AGLR had expenses of $96,912,352 for the tax year ending September 30, 2001, which included $43,239,958 of non-allocable Acquisition Debt producing an AGLR tax expense of $15,133,985 The remaining AGLR expenses of $53,672,394 were allocated properly to the other Members Without the benefit of a Commission order under rule 45(a), the proposed allocation of the Acquisition Debt tax benefits is impermissible

Action Required

1. AGLR should file a post-effective amendment in the Order (filed as 70-9907 dated June 4, 2003) requesting approval of an amended version of the Agreement that includes a provision to allocate Acquisition Debt benefits to the parent. The amended agreement should define Acquisition Debt. Acquisition Debt should be measured by the net amount of short-term debt used initially for the bridge financing phase of the acquisition that was finally converted to permanent financing. Currently, the Examination Staff is aware of the issuance of approximately $660 million of commercial paper on October 6, 2000 to finance the acquisition of VNG (2001 Annual Report, Note 4). It is not clear how much, if any, of this debt was paid down prior to any permanent financing arrangements. Please provide the Examination Staff with the interim details that will substantiate the actual amount of Acquisition Debt, as soon as they are available;

2. AGLR should include in each future U-5S filing, Exhibit D, the supporting worksheets for the relevant Form 1120 filing and the first page of the Form 1120;

3. AGLR should separately include in each future U-5S filing, Exhibit D, a statement showing the treatment of Acquisition Debt for the tax year and remaining amounts of Acquisition Debt. The worksheets should also show the allocation of the Parent company benefit to the other companies in the AGLR System.

4. The tax worksheets did not include the fuels credits. Future worksheets should reflect these credits.

Finding 8 (Item 21)

The Examination Staff asked about AGSC time reporting procedures We asked the company to highlight any documentation, including the AGSC employee handbook, and guidance given to employees and the approval process for time reporting In addition, we asked for a copy of time sheets for the periods December 2001 and August 2002 for the following officers of AGLR and AGL Services Paula G Rasput, Susan A McLaughlin, Richard T O'Brien, Kevin P Madden, Richard J Duszynski, Melanie M Platt, and Paul R Shlanta Finally, the Examination Staff asked the company to provide an accounts payable list for 2002 of the expense reports paid for ach of these individuals

The AGSC time recording process is designed to capture the time spent by service company employees on activities for the affiliates Each service company employee is required to record the amount of time spent providing services (time keeping procedures specify "even the highest levels of executive management within AGL Services will need to track time ") to each of the AGLR Systems companies and on certain projects on a timesheet that is approved by the employees' supervisor or by another senior officer for senior officers The procedures did not appear to include any explanation on the importance of proper charging of time, including the importance of PUHCA The time captured on the time sheets is then entered into the On-line Time Entry System (OTIS) and AGSC accounting systems A ratio of the total number of service hours performed by the respective AGSC department for each AGLR System company divided by the total number of service hours performed by the AGSC department for all AGLR System companies is calculated This ratio is then used to calculate and charge back the service company's costs associated with the employees' provision of service (time) to the AGLR System companies For example, if a department such as accounting, spends 20% of it's labor hours providing services to Chattanooga Gas Company (CGC) in a given month, then CGC will be charged 20% of the department's operating expenses net of direct charges

The Examination Staff analyzed the timesheets of the AGLR and AGSC common officers for six weeks in November-December 2001 and four weeks in July-August 2002 For the ten-week period, the amount of time allocated to utility functions per executive officer ranged from a high of 94% to a low of 67 2%, with an average for all of the officers of 86 2%, assuming a 94% allocation of AGSC service costs to utility operations

The Examination Staff asked for the audit trail to document the amounts of senior officers charged to various companies in the System This information was provided for Paula Rosput, Richard T O'Brien, Melanie Platt, Kevin Madden, Susan A McLaughlin and Paul Shlanta As we have discussed under various items in this Examination, it is difficult to track the specific individual's time, since all of the employees in a department are combined to calculate monthly the ratio of costs charged to each subsidiary The bottom line summary for these executive officers showed that very little costs are allocated directly or indirectly to the Parent company This confirms the statistics shown in the last paragraph In addition, in Item 61 which covers the Department Analysis of Salaries – Account 920, we calculated that only 0 8% of executive salaries were charged to the Parent Since we cannot tell specifically what the executives are working on by looking at their timesheets, we believe for the percentages calculated (and the fact that the Parent is not included in the allocation of other corporate governance costs) that it appears likely the executives do not see much of their function as parent company related

AGL Services personnel undertook an analysis to see how executive's time would be charged if an alternative method was used The alternative method takes a person's direct time within each department and charges affiliate companies based on the percentage of time spent working for an affiliate and the actual payroll for the applicable employee Any non-payroll related costs specifically related to an affiliate were direct assigned to such affiliate There were some variances between the costs allocated between the two methods in terms of the amounts going to utility companies and non-utility companies In either case, very little costs were charged to the parent company This appears to run afoul of our position that a fair amount of corporate governance costs should be charged to the parent company, and a fair amount of senior executive's time should be spent on corporate governance issues

In the area of expense reports, it appears, from our sample, that these are in pretty good shape There did not appear to be any large unusual items and the meals/entertainment costs seemed had documentation as to who the meal was with and the business purpose In addition, internal audit has an ongoing audit to review the expense reports on a regular basis See Item 35 for more information on expense reports The charging/allocation of the costs is a more difficult problem Again, the issue is costs are comingled by department and then allocated, and as stated very little of the costs are allocated to the Parent

Action Required:

The Examination Staff recommends that an allocation method be adopted to allocate a fair and equitable percentage of executive officer's salary and expenses to the Parent company.

Finding 9 (Item 25)

The Examination Staff asked whether AGLR presented the financial statements for each subsidiary (including 3rd, 4th, etc level subsidiaries) for which it has a greater than 50% investment in the Form U5S

AGLR examination response stated that the consolidating financial statements presented in the 2001 Form U5S included the financial statements for all AGL Resources, subsidiaries The following entities were combined for reporting

- AGL Investments, Inc as presented, includes the balance for Georgia Energy Company, an inactive entity
- Sequent Energy Management, LP, as presented, consists of Sequent Energy Management, LP, Sequent Holdings, LLC, Sequent Energy Marketing, LP, Sequent, LLC, Southeastern LNG, Inc , and Pivotal Energy Services, Inc
- AGL Propane Services, Inc , as presented, includes AGL Propane Services, Inc and AGL Energy Corporation
- AGL Macon Holdings, Inc, Utilipro International, Inc , and Utilipro Canada Company were not included because there were no income statements or balance sheets for those entities

During the field examination, the Examination Staff verbally requested financial statements for subsidiaries that were combined or in a group for the purpose of preparing consolidated financial statements AGLR stated that many of the entities listed in Item 1 of the September 30, 2001 Form U5S were created for organizational purposes The financial statements presented in Item 10 of Form U5S were prepared from an organizations perspective, according to the way AGLR manages its business AGLR's examination response disclosed the following

Sequent Energy Management, LP as presented per Item 10 of Form U5S includes the financial statements of the following entities

- Sequent Energy Management, LP
- Sequent Energy Services
- Sequent Holdings, LLC
- Sequent Energy Marketing, LP
- Pivotal Energy Services, Inc
- Southeastern LNG, Inc
- Eliminations between the above listed entities

AGL Propane Services, Inc as presented in Item 10 of Form U5S includes the financial statements of AGL Propane Services, Inc and AGL Energy Corporation

In addition, AGLR provided a listing of the entities included in the financial statements of Energy Investments – Other Examination Staff noted that the entities listed for Energy Investments were those entities listed in Exhibit F 1e in the U5S However, Georgia Energy Company did not include its financial statements, because AGL Investments, Inc , as presented, includes the balance sheet for Georgia Energy Company (discussed above)

Further, AGLR states that the statements are reconciled to AGLR's consolidating statements and used to prepare and support AGLR fiscal 2001 Form 10-K

Financial Statements Required

Item 10 of Form U5S requires that consolidating financial statements for the parent holding company and each of its subsidiaries for the year of the report, including a balance sheet, income statement, statement of retained earnings and statement of cash flows The plant and related depreciation and amortization accounts shall be supported by classified schedules as prescribed by this Form The individual financial statements shall be those included in the audited consolidated financial statements reported for the same year in the form 10-K or annual reports to shareholders incorporated herein and in substantially the same form The individual financial statements should be reconciled to the consolidated financial statements by an elimination column, the entries in which shall be keyed to identify by item, offsetting debits and credits Instructions for financial statements are also included in the U5S

According to AGLR 2001 Annual Report to shareholders, AGLR is organized into three operating segments (1) distribution operations (2) wholesale services and (3) energy investments Additionally, AGLR treats corporate as a nonoperating business segment Corporate includes AGLR, AGSC, nonregulated financing and captive insurance subsidiaries, and intercompany eliminations

Item 9 of Form U5S among other things, requires disclosure of exempt wholesale generators EWGs and foreign utility companies (FUCOs) If the company is a subsidiary company of the registered holding company, financial statements are required in Exhibit H AGLR response indicated that it has no EWG or FUCOs as of September 30, 2001, therefore, Exhibit H does not apply

The Examination Staff reviewed Item 10 of 2001 Form U5S of AGLR for compliance with the requirements of this Form This review disclosed financial statements were not included for the statutory subsidiaries listed below

	2001 Form U5S omitted financial statements for the following entities	Examination Response
1	AGL Macon Holdings, Inc	No included because there were no balance sheet and income statement for this company
2	Sequent, LLC	Sequent Energy Management, LP includes the financial statements of this entity
3	Sequent Energy Marketing, LP	Sequent Energy Management, LP includes the financial statements of this entity
4	Sequent Holdings, LLC	Sequent Energy Management, LP includes the financial statements of this entity
5	Southeastern LNG, Inc	Sequent Energy Management, LP includes the financial statements of this entity
6	Sequent Energy, LP	
7	Sequent Energy Services (Not listed on Item 1 of Form U5S)	Sequent Energy Management, LP includes the financial statements of this entity
8	AGL Energy Corporation	AGL Propane Services, Inc includes its financial statements and of this entity
9	Pivotal Energy Services, Inc	Sequent Energy Management, LP includes the financial statements of this entity
10	Georgia Energy Company	Energy Investments –Other includes the financial statements of AGL Investments, Inc and this entity includes the financial statements of Georgia Energy Company

Action Required

1. **Examination Staff concludes that AGLR did not include the required financial statements for all of its majority-owned subsidiary companies in its Form U5S filed for**

the year ended September 30, 2001. Examination responses indicated that Sequent Energy Management, LP as presented in the U5S includes the financial statements for the entities: Sequent Energy Services; Sequent Holdings, LLC; Sequent Energy Marketing, LP; Pivotal Energy Services, Inc.; and Southeastern LNG, Inc. In addition, Energy Investments – Other as presented in Item 10 of Form U5S includes, among other entities, the financial statements of AGL Investments Inc. and, this entity includes Georgia Energy Company's financial statements. However, financial statements for those entities listed above were not included in Item 10 of the U5S. AGLR needs to include consolidating financial statements, including the eliminations for all of its subsidiaries that are combined for reporting purposes and specifically for those listed above in future SEC filing on Form U5S.

2. **Examination Staff recommends that the amounts shown on the consolidating financial statements be change to thousands because there are several accounts with less than one million shown.**

3. **The word "consolidated" should appear to indicate that the financial statements presented are consolidated. For example, the word "consolidated" was omitted on the financial statements of (a) distribution operations (b) wholesale services, (d) energy investments, (e) corporate, (f) Sequent Energy Management, LP, and (g) Other.**

4. **AGLR's examination response stated that AGL Macon Holdings, Inc.; Utilipro International, Inc.; and Utilipro Canada Company were not included because there were no income statements or balance sheets for those entities. The General Instructions No. 4 to Form U5S states "information required need be given only insofar as it is known or can be obtained by the system company without unreasonable effort or expense. Omission should be explained briefly. AGLR needs to explain in its U5S as to why the omission of financial statements for these entities.**

Finding 10 (Item 27)

The October 5, 2000 Order authorized the formation and financing of AGLR and included the following two matters (a) applicant asked the Commission to reserve jurisdiction over the retention by AGLR of its interests in Trustee Investments, Inc pending completion of the record, and (b) a request was made for exemption for Atlanta Gas Light Company, and AGLR was evaluating whether to restructure its utility holdings by acquiring all the outstanding shares of Chattanooga Gas from Atlanta Gas Light Company and retaining it as a direct subsidiary The Examination Staff asked for an update on these two matters

AGLR still holds its interest in Trustee Investments, Inc ("Trustees") and maintains that it is entitled to retain this non-utility business No application supplementing the record in favor of retention has been filed Trustees owns Trustees Gardens, a residential and retail development located in Savannah, Georgia adjacent to a former manufactured gas plant ("MGP") site owned by AGLC and Trustees According to AGLR, these sites have varying levels of contamination as a result of their prior industrial use AGLR management determined that to avoid problems with uses incompatible with the current conditions of the MGP sites, it is preferable to maintain control over the sites pending any necessary environmental remediation AGLR claims that Trustee's interest in Trustees Gardens, a retail and residential development located in Savannah, Georgia, is reasonably incidental, economically necessary and appropriate to AGLR's gas utility operations because Trustees Gardens is located on and adjacent to one of the MGP sites It is claimed that Trustees Gardens is a relatively small asset and its management diverts no attention or resources from the operations of AGLR's utility businesses

AGLR acquired all the outstanding shares of Chattanooga Gas Company from Atlanta Gas Light Company as of October 6, 2000 Consequently, Chattanooga Gas Company is a direct subsidiary of AGL

Action Required

AGLR must file a post-effective amendment requesting authority to retain Trustees. This application should discuss the specific contamination of the residential and retail properties and provide a timetable for environmental remediation. In addition, because this is not a passive investment in real estate, AGLR should also discuss how these properties are managed.

Finding 11 (Item 28)

The following non-utility companies have suffered losses and have negative retained earnings as of September 30, 2001 The Examinations Staff asked for an analysis of the business and reasons for the losses

	Negative Retained Earnings ($ in 000's)
AGL Peaking Services, Inc	$ 1,400
Georgia Natural Gas Company	$ 6,300
AGL Networks LLC	$ 1,500
Customer Care Services Company	$ 5,800
AGL Energy Wise Services, Inc	$ 500
Retired Main LLC	$ 100
AGL Resources, Inc (Parent)	$ 196,800
AGL Capital Corporation	$ 500
AGL Capital Trust I	$ 300
AGL Capital Trust II	$ 400
Others	$ 3,400

The Examination Staff was provided with descriptions of the nature and business purpose of each of the above mentioned entities Three types of transactions are recorded against retained earnings

Net income and/or net loss
Settlement of intercompany balances
Subsidiary dividends to parent

Discussed below is the detail by company of the amounts by transaction type that impacted retained earnings during the fiscal year ended September 30, 2001

- **AGL Peaking Services, Inc. (AGPS)** – AGPS was established as a holding company and does not engage in any separate business activities AGPS had a 50% ownership interest in Etowah LNG Company, LLC (Etowah) Etowah was a limited liability company that was established to construct and operate a liquefied natural gas (LNG) peaking facility in the state of Georgia Additionally, it was planned for Etowah to provide natural gas storage and peaking services to Atlanta Gas Light Company and other non-related customers

  In September 2001, AGPS began the process of dissolving Etowah This final dissolution took place December 31, 2001 The losses estimated upon dissolution were recorded as of September 30, 2001

- **Georgia Natural Gas Company (GNGC)** – GNGC was established as a holding company and does not engage in any separate business activities GNGC has a 50% ownership interest in Southstar Energy Services, LLC Southstar engages in business under the trade name Georgia Natural Gas Services and offers a combination of unregulated energy products and services to residential, industrial and commercial principally in Georgia

- **AGL Networks LLC (AGLN)** - AGLN was formed August 15, 2000 in order to serve the demand for high-speed network capacity AGLN seeks to serve the demand for high-speed network capacity in metropolitan areas within the United States

- **Customer Care Services, Inc. – (CCSI)** – On March 2, 2001, AGLR sold substantially all of the assets of its wholly-owned subsidiary Utilipro, Inc On March 5, 2001, Utilipro, Inc changed its name to Customer Care Services, Inc The current business purpose for CCSI is to fulfill its remaining obligations to third parties These obligations primarily relate to lease agreements and other long-term contracts All obligations are expected to be fulfilled by April 2004

- **AGL Energy Wise Services, Inc. (AGLE)** - AGLE was established to provide informational services to customers on how to be more energy efficient The Company was to lease gas monitors to large customers, which would enable them to monitor their gas usage on a daily basis AGLE was inactivated for accounting purposes in March 2002 due to no activity

- **Retired Main LLC (MAIN)** – MAIN was established March 29, 2001 to provide internet sales, auctioning, brokering, advertising and other services in connection with the sale and transfer of rights and interests in and to retired natural gas mains MAIN would act primarily as advertiser and broker, receiving a commission fee for any retired main sold or leased through the web site Operations for this company never materialized, and it is all but inactive for accounting purposes

- **AGL Capital Corporation, Inc. (AGCC)** – AGCC was established to segregate the financing functions of AGLR into a separate legal entity AGCC issues commercial paper and other short-term and long-term debt for the benefit of AGLR and its subsidiaries AGCC also provides funding to AGL Services Company for administration and management of the company's money pool Please note that the negative retained earnings amount referenced above (500) relates to "other comprehensive income" and not retained earnings

- **AGL Capital Trust I (TRUST I)** – TRUST I was established to issue and sell \$75 million in 8 17% trust preferred securities The proceeds were used to purchase junior subordinated deferrable interest debentures from AGLR

- **AGL Capital Trust II (TRUST II)** – TRUST II was established to issue and sell \$150 million of 8 00% in trust preferred securities The proceeds were used to purchase junior subordinated deferrable interest debentures from AGCC

- **Other** – The amounts included in "other" relate primarily to the company's corporate tax business unit The applicable statutory income tax rate is used at the entity level The corporate tax business unit is used to adjust the income tax rate AGLR's consolidated effective tax rate Additionally, during fiscal 2001, this business unit was used to record intercompany interest expense on notes payable/receivable that had not been executed These amounts were subsequently reversed and adjusted to the appropriate AGL system company upon execution of the notes If the notes were not executed, the interest income/expense was simply reversed

Action Required:

The Examination Staff requires additional explanation for three companies. AGLR did not adequately explain the reason for the losses for GNGC, AGLN, and the reason for the negative "other comprehensive income" for AGCC.

<u>Finding 12 (Item 29)</u>

The Examinations Staff inquired of AGLR as to whether there were any other SPE's, Limited Liability Corporations, Joint Ventures or Partnership arrangements in the AGLR System and to explain the details of them

The Examination Staff concluded that the responses did not adequately answer the questions as they were posed The object of the exercise was to identify special purpose entities (now, variable interest entities "VIEs") on the AGLR system and to determine the validity of their accounting treatment As a preliminary matter, it should be noted that the business form or purpose, e g partnerships, joint ventures or non-profits, does not bear on these matters

Action Required:

1. **Identify each VIE on the AGLR system;**
2. **Indicate for each VIE investment whether it was consolidated on AGLR's balance sheet or recorded as an equity investment in a subsidiary, with revenues appearing on AGLR's income statement;**
3. **Explain each determination made in #2. above in light of FASB Interpretation No. 46, interpreting ARB No. 51.**

Finding 13 (Item 31)

The Examination Staff reviewed the service agreements of AGSC Executed service agreements were provided for the active system companies, with the following exceptions

AGLR (service agreement not yet executed)
Global Energy Resource Insurance Corporation (service agreement not yet executed)
AGL Capital Trust II (service agreement not yet executed)
Customer Care Services, fka Utilipro Inc (name changed in 2001, but no new service agreement executed)
Sequent Energy Management, LP, fka AGL Energy Services (name changed in 2001, but no new service agreement executed)

The service company should be more vigilant in requiring that all affiliates execute services agreements, as expressly contemplated by the October 5, 2000 merger order

There did not appear to be any significant differences between the utility versus non-utility agreements The service agreements are set up such that each year AGL Services will send an annual service proposal form to each company on or about July 1 listing the services proposed for the next fiscal year Companies can choose which services they will want each year It appears that all the companies at least take the services we would define as corporate governance such as legal, internal audit, financial services, executive, investor relations, etc The service agreements include a provision for interest to be charged on overdue bills in excess of thirty days old The service agreements include information on the allocation methods to be used, and the particular allocation method used for each department, such as Internal Auditing, Strategic Planning, Legal Services, etc The agreements also have a termination clause that either party may cancel the agreement with sixty days advance written notice

Action Required:

AGSC should execute the missing service agreements, including amending those where there has been a name change for: AGLR, Global Energy Resources Insurance Corporation, AGL Capital Trust II, Customer Care Services, and Sequent Energy Management.

Finding 14 (Item 32)

The Examination Staff asked for a current copy of AGSC's Policy & Procedures Manual that should include time card and work order procedures, budgeting process and expense versus capital items (or draft as the October 30, 2001 letter to Robert Wason from Elizabeth White stated the procedures would be finalized by 12/31/02)("October Letter")

AGSC does not have a formalized Policy and Procedures Manual Instead, the Company's policies and procedures are decentralized through out the company and exist in differing formats Therefore, the Company is currently in the process of centralizing and preparing a standardized Policies and Procedures Manual and expects to have a draft by December 31, 2002, which will primarily encompass accounting and financial related policies and procedures

The Examination Staff received and reviewed the following documents

Time Keeping Procedures for AGSC Services personnel, Capital Expenditure Guidelines, Budget Assumptions, Corporate Compliance, Software Capitalization, Billing Revenue Recognition, Unclaimed Property, Accounts Payable Processing, Expenditure Approval Policy, Expense Report Policy and Instructions, Procurement Card Program, Purchasing and Contracts, Record Retention, Travel Policy and Risk Management Policy

Action Required:

The Examination Staff requires that AGL Services maintain a Policies and Procedures Manual and that it be maintained in a common depository. Preferably on the AGSC intranet so that it can be accessed by all service company employees. AGL Services should send its its standardized Policies and Procedures Manual to the Examination Staff within ten business days upon its completion (no later than September 30, 2003).

Finding 15 (Item 33)

The Examination Staff asked for a current copy of your Work Order Manual with detail of each approved SEC allocation basis (per order or 60 Day letter) and the percentage allocation to each affiliate and the corporate holding company The October Letter stated that no project or work order system was presently in place We asked for sufficient detail and examples of AGSC's current system and how it complies with the requirements of the Commission's Uniform System of Accounts which requires a work order system

AGSC does not have a work order system SEC order HCAR No 27243 (dated October 5, 2000) states that "AGL Services, which would provide a variety of services to the companies in the AGLR System, and also asks that the Commission find under rule 88(b) that AGL Services will be so organized and so conducted as to meet the requirements of section 13(b) The SEC Uniform System of Accounts ("USA") is the accounting tool for maintaining compliance with section 13(b)

AGSC provided the Examination Staff with its cost allocation policy Shared services costs of AGSC Services are charged back to the subsidiaries of AGLR at cost and in accordance with the Act, specifically Rules 90 and 91 The methodologies utilized to charge back these costs and the services provided to the subsidiaries by AGL Services are also in accordance with the AGL Services Agreement executed between AGL Services and each subsidiary

AGL Services total operating expenses are charged back in the following three-step process

Direct Charge- Whenever possible, all costs incurred for any subsidiary of AGLR are direct charged However, this step also includes the charge back of costs for fleet services, facilities, benefits, stores/materials management and information system and technology as based upon a standard rate,

Direct Assignment- AGL Services remaining costs (total operating expenses net of direct charges) are charged back based upon the percentage of time spent providing services to the subsidiaries, and

Allocation- AGL Services remaining costs (total operating expenses net of direct charges and direct assignments) are charged back based upon certain allocation drivers These remaining costs are associated with unassigned time or time spent providing internal services.

As an example of a direct charge, if an affiliate uses 10 trucks that are maintained by AGL Services, it directly charges the affiliate AGL Services' standard maintenance rate With respect to direct assignment, when an AGL Services accountant performs accounting services for an affiliate, the AGL Services employee records the amount of time he or she spends on the project on a timesheet which is approved by the employee's supervisor AGSC captures all such hours within its On-line Time Entry System (OTIS) and AGL Services accounting systems and calculates the ratio of the total number of service hours performed by the respective AGL Services department for the affiliate divided by the total number of service hours performed by the department for all affiliates This ratio is then multiplied by the department's total net operating expense and the resulting amount is then directly assigned to the affiliate

AGL Services' service categories utilize one of six different factors to allocate total operating expenses remaining after direct charges and direct assignment Causal relationships between the services provided and the allocation factors are identified and utilized as the basis for selecting the appropriate allocation driver For example, Employee Services utilized the number of employees allocation factor, which has a causal relationship with the services provided The composite factor is utilized for those service providers for which a causal relationship can not be identified The composite factor is the average of four additional ratios as follows (1) number of employees, (2) total operating expenses, (3) operating margin, and (4) total assets

Action Required:

The SEC Uniform System of Accounts ("USA") Instruction 00-1 Preface "requires the Service company to 1) design sub-accounts and keep memorandum and time records to facilitate the preparation of reports and statements required by regulatory commissions and the conduct of audit and account inspection programs, 2) establish a work order system to accumulate reimbursable costs and charges to customers, and 3) account for compensation for use of capital, if paid".

AGSC should establish a work order system in order to track costs as part of a "cost accounting system" that can be used to readily identify costs and provide an audit trail. This should be in place by December 31, 2003.

Finding 16 (Item 34)

The Examination Staff asked for a copy of the current Internal Audit Policies and Procedures Manual AGSC did not have a Internal Audit Procedures and Policy Manual They are in the process of designing a Manual They did provide the Examination Staff with the methodology used to decide on which areas of the company to audit The Audit Staff is fairly small There is a Director (Ann Tkacs) who actually is an attorney and came from the legal department There are four internal auditor positions, two of which were vacant at the end of March 2003, and two information systems auditors, as well as an administrative assistant One of the current auditors is a CPA and one is a CIA

The internal audit department reports to the Senior Vice President and General Counsel for administrative matters and to the Audit Committee of the Board of Directors for other matters The reporting to the senior legal officer of the company is a relationship the Examination Staff has not seen before It actually may lend itself to more independence for internal audit, as opposed to the usually reporting to the Chief Financial Officer

The Examination Staff reviewed the Audit Committee Charter which was recently revised to reflect new requirements of Sarbanes/ Oxley The charter had a provision that stated as follows "Review and concur in the appointment, replacement, reassignment, or dismissal of the Internal Audit Director for the Company Confirm the functional independence of the internal auditors by assuring that the Internal Audit Charter requires the Internal Audit Department to function independently and by inquiring of the Internal Audit Director regarding Internal Audit's functional independence" We would like to see this same language added to the Internal Audit Charter We were not provided with the internal audit charter as we understand it was under revision

Internal Audit uses the Risk Based Integrated Audit (RBIA) methodology and follows the procedures and approach defined in the RBIA methodology All auditors receive extensive training in the RBIA methodology and procedures Internal Audit reinforces this training with an RBIA manual and with periodic RBIA workshop sessions When new members join the Internal Audit staff, they attend a seminar to learn this audit methodology We also use audit workpapers and project management software related to the RBIA methodology and procedures

The RBIA approach involves

(1) A quarterly dialogue with audit customers* to identify business risks and to determine the level of risk tolerance acceptable to each customer for those risks With respect to legal and regulatory compliance -related risks, Internal Audit always assumes that the Company has zero-tolerance for any noncompliance
(2) Forming audit teams with subject matter experts for each RBIA project
(3) Using audit and subject matter expertise to form a hypothesis for each project regarding the ability of existing risk mitigation techniques to keep the audited risk within acceptable limits
(4) Designing a project plan to prove or disprove the hypothesis through a standard audit testing methodology
(5) Drafting Team Success Objectives (TSO's) for each project Every RBIA project involves value, time, and cost TSO's
(6) Before beginning work, communicating project plans and expected costs for each project to the audit customer for that project Obtaining audit customer buy-in regarding the scope and value of each project
(7) Managing each project to the project TSO's in order to assure that every project provides value to the audit customer
(8) Communicating results to the audit customer in a format preferred by that customer
(9) Soliciting customer feedback regarding the value provided to them by the audit

* Audit customers include members of the Audit Committee of the Board of Directors, as well as officers of the Company

The Examination Staff also reviewed the Internal Audit Report to the Audit Committee of the Board of Directors for the quarters ending March 31, 2002 and March 31, 2003

Action Required:

The Examination Staff would like a copy of the completed internal audit policies and procedures manual within thirty days of its completion. The Examination Staff would like to have a copy of the internal audit charter that "mirrors" the revisions recently made to the Audit Committee Charter.

Finding 17 (Item 35)

The Examination Staff selected for review some audit reports and other studies issued by the Internal Audit Department for the periods October 5, 2000 through September 30, 2002

The following internal audit reports were selected for review

Executive Expense Reports	Quarterly
Virginia Natural Gas Materials Management and Procurement Process	3/15/01
Captive Insurance Company	3/12/01
VNG Purchase Agreement Compliance	5/31/01
Vendor Payment Processing	8/28/01
Charitable Contributions	10/18/01
Capital Approval Process	2/21/02
Bank Reconciliation Process and New Treasury System	3/18/02
Corporate Consolidation	2/22/02
Monitoring Compliance with SEC and VSCC Orders and Regulations	3/27/02
Compliance Tracking System	5/24/02
VNG Political Action Committees (PACS)	5/7/02
Financial Forecasting Model I Implementation Phase I	5/2/02
Budgeting and Financial Forecasting System Implementation	8/21/02

Follow-Up Audits

Authorization for Expenditure	12/31/00
Service Center Reviews	12/31/00
Asset Management and Project Costing	6/30/01
Captive Insurance Company	9/30/01
VNG Contract Administration	9/30/01
Political Action Committee Processes	3/31/02
Charitable Contributions Processes	3/31/02
Bank Reconciliation and the New Treasury System	6/30/02
Processes for Ensuring Accurate, Timely Vendor Payments	6/30/02
Virginia Natural Gas Political Action Committee	9/30/02

Subsequent to the field work and the interview with the Director of Internal Audit, AGSC disclosed that there were two additional audit reports which were left off the original list provided to the Examination Staff They were entitled "AGL Networks Allocation Process" and "Charge-back of Costs to Affiliates" We reviewed these audits One interesting concept was disclosed Apparently, the service company has an internal goal that eighty percent of service company costs should be either directly charged or directly assigned and twenty percent of costs should be allocated Financial Accounting, on a quarterly basis, is to analyze a Payroll Hour Report to identify the departments that do not meet AGL Service's 80/20 Goal The downside to this goal would be if personnel do not charge their time accurately in order to meet this goal

There were no significant follow-up issues on the other audit reports reviewed during the Examination

The Company does not have a formally documented policy for tracking executive expenses by the date, nature and type, amount, and subsidiary charged The internal audit reviews showed a number of sizable purchases or expenses lacking documentation concerning the purpose, nature and type of expenditure, and the subsidiary charged for the expense

Action Required:

The Examination Staff recommends that AGSC develop a formal executive expense policy manual and a formal documentation/review process. In addition, provide the Examination Staff with any documentation where the 80/20 Goal is presented to company personnel (i.e. is this part of their incentive goals, etc.)

Finding 18 (Item 36)

The Examinations Staff inquired about any executives that belonged to country clubs/social clubs We asked, for the years 2001 and 2002, for AGSC to provide copies of vouchers or expense statements for all country club/social club dues and sporting event expenses, which showed the amounts and how such costs were allocated to AGLR or its subsidiaries

There are executives that belong to country/social clubs For the year 2001 and prior, each executive had the option of being reimbursed for expenses incurred for membership dues through their Executive Allowance Fund (EAF) account These expenses fall below the line and are not allocated because they are considered to be non-operating expenses They were included in "Other income/expense" on the income statement The "other income/expense" accounts are excluded from AGL Services allocation process

After review of all country club dues and expenses it was noted that $6,629 had been incorrectly recorded in O&M dues and subscriptions and allocated to the affiliates

For the year 2002 and after, the company no longer has the EAF account and any club expenses incurred by executives are their own personal responsibility.

From January 2001 to December 2002 AGSC spent a total of $56,356 on sporting event tickets AGLR's policy is to charge these costs to general ledger account 449-600, Governmental Affairs or FERC Account number 426 4 (Other Income Deductions), which is for expenditures related to certain civic, political and related activities Costs charged to this account are not included in the pool of operating costs charged back to the affiliates because these costs are not considered to be related to services performed for associate companies However, of the $56,356 in sporting event costs, $43,356 was charged to various accounts incorrectly, in violation of their own policy, and included in the pool of costs charged back to each affiliate

Action Required:

AGL Services is required to bill out all its costs to associate companies. It should have zero net income. AGL Services should reallocate the $6,629 and $43,356 to the Parent Company in accordance with its policy of billings such costs to shareholders.

Finding 19 (Item 38)

The Examination Staff asked whether certain audits are performed at regular intervals, particularly any involving the review of AGL Services' methods of allocating and billing its charges for services

Internal Audit uses an Audit Universe to track audit coverage and frequency of review for risk areas Internal Audit uses a risk assessment process to develop its audit plan on a quarterly basis

Internal Audit conducts quarterly reviews of expense reports and procurement card transactions for executives and their assistant Internal Audit reviews each executive's documentation at least once each year

Action Required:

The Examination Staff recommends that an audit of the billings and allocation methods of the service conducted be conducted at least every two years. The proposed scope of this audit should be submitted to the Examination Staff in advance to see if we have any additions to the scope. In addition, a copy of the audit report should be sent to the Examination Staff within thirty days of its completion.

Finding 20 (Item 40)

The Examination Staff reviewed the benchmarking studies that have been completed during the periods of October 5, 2000 through September 30, 2002 We asked for an explanation of AGLR's benchmarking program/plans in general The October Letter discussed a Shared Services Measures Benchmarking Study conducted by The Benchmarking Network which was to have been completed in April 2002, and it was included as part of our review

Currently AGSC does not have a formal benchmarking program or policy The examination Staff was informed, however, that AGLR intends to develop a program that will test each major service area in its service company on a three-year rolling basis

The only benchmarking exercise conducted by AGSC during the period was a shared services study conducted by The Benchmarking Network for The Electric Utility Benchmarking Association covering an annual period ending September 30, 2001 ("Study") The Study examined data supplied by 28 utility and non-utility companies of comparable size, which provide comparable services to associate companies The Study determined the median and average cost to furnish accounting, finance and treasury, human resources, information technology, procurement and supply chain, legal, regulatory, auditing, corporate communications and external affairs, facilities and real estate, security, environmental, fleet and corporate and strategic planning services The cost of services for any given participant is not knowable from the Study, which simply allows each participant to compare its cost of service with the normative findings

Action Required:

AGSC should establish a written benchmarking program. The program should provide for periodic cost of service reviews of each major service area and for a mechanism to review any given service area on an expedited basis. Minimally the program should compare service costs to associate companies that are available from third-party providers and examine other services to see if they are being provided economically and efficiently. Service company providers and a representative group of service recipients should develop the program. Please provide the Examination Staff with a copy of this program, by December 31, 2003.

Finding 21 (Item 42)

The Examination Staff selected forty employees from the AGLR telephone directory to complete a timekeeping survey

The Examination Staff received 29 out of 40 questionnaires by May 27, 2003 With the exception of one respondent, all stated they either received one-to-one training from an assistant or supervisor or had some type of group training One respondent stated he had received no training

Persons employed in the financial sector of AGSC's operations reported having formal training sessions in 2000 and had knowledge of the website training program Persons employed in the financial sector were also more familiar with the requirements of PUHCA Technical personnel were unfamiliar with PUHCA Only one engineer reported billing work to projects, while other personnel reported either billing one company or the need to split time among companies benefiting from the service provided In all cases, personnel reported that supervisors monitored their timesheets

Only the financial personnel expressed that formal training sessions had been conducted with staff Otherwise, informal training methods from coworkers appeared to be the predominant training mechanism for AGLR personnel

Action Required:

Unless a respondent worked in the financial sector, AGSC's personnel was reliant on more informal coworker training for accurate recording of time spent for a particular company or project. The industry has gone through restructuring, nonregulated corporate entities now receive the benefit of service company employees and old ways of billing time to rate regulated entities are not always relevant for some of the work service company employees are performing. For these reasons, AGSC should devise formal timesheet training for financial and nonfinancial personnel that depict situations in which it is appropriate and crucial that nonregulated and/or non-utilities are billed time for services performed by service company employees. The focus appears to be billing the utility or regulated entities and not the non-utility or nonregulated entities. In addition, AGSC should conduct periodic internal audits on timesheets to evaluate the effectiveness of this training and their internal controls for accurate recording of time spent for utility and non-utility entities or projects.

<u>Finding 22 (Item 43)</u>

The Examination Staff reviewed the money pool operation and interviewed personnel from the Treasury department

According to Michael Morley, no written money pool procedures have been created Alternatively, the money pool is managed in accordance with the executed money pool agreements between AGSC and each participant The following materials were provided

Attachment A- procedures for importing the daily cash balances from Wachovia

Attachment B- procedures for recording the daily cash balance from Wachovia into PeopleSoft, their financial software system

Attachment C- procedures on the reconciliation of the monthly Wachovia bank statements to their general ledger balance

Additionally, a list of money pool participants and non-participants dated 10/3/01 was provided Companies on the list are divided into three classifications restricted pool participants, unrestricted pool participants, and non-participants AGSC also provided the Examination Staff with additional documentation to show the controls over the segregation of funds

It was further stated that the key components of the above procedures and of the operations of the money pool for those affiliates participating in the money pool are

- Cash (check, wire, ACH, etc) received is deposited in the AGSC money pool bank account and recorded in the general ledger on a daily basis,
- Cash disbursements (checks, wires, ACH, etc) are made out of the AGSC money pool bank account and recorded in the general ledger on a daily basis,

- The cash receipts and disbursements are tracked by affiliate and the appropriate general ledger entries are recorded in the affiliates' general ledger on a daily basis These general ledger entries reflect whether the affiliate loaned money to (affiliate cash receipt) or borrowed money from (affiliate cash disbursement) the AGSC money pool, and
- Interest (income and expense) is calculated and recorded in each affiliates general ledger based on the average interest rate on commercial paper and the borrowings from and loans to the AGSC money pool

Actions Required

A number of issues need clarification. First, the distinction between the unrestricted money pool and the restricted money pool is not clear. By HCAR 27243 ("Merger Order"), the Commission authorized AGLR and its existing subsidiaries (other than ETC, FUCO and EWG subs) to participate in a combined money pool (as distinguished from two money pools, a utility money pool and a non-utility money pool), subject to certain conditions. Jurisdiction was reserved over participation in the money pool by subsequently organized and acquired subsidiaries. Second, not all participants in the money pools have been authorized to do so. In the Merger Order, jurisdiction was reserved over participation in the money pool by subsequently organized and acquired subsidiaries. The Merger Order contemplated the organization of AGL Services, but that company was not in existence at the time the order was issued. Therefore, technically, AGL Services, which is listed as a participant in the restricted money pool, is not authorized to participate in the money pool.[3] Similarly, Sequent Energy Management, LP., listed as a participant in the restricted pool, was formed in July of 2001 (after the Merger Order was issued), and therefore is not authorized to participate in the money pool.

It is not clear whether other participants have been properly authorized to participate in the money pool. Specifically: AGL Capital Trust is listed as a participant in the restricted pool, but is not identified in either the U-5B or Merger Order; Southeastern LNG, listed as a participant in the restricted money pool, is not identified in the Merger Order; AGL Energy Corp. is listed as a participant in the restricted money pool, but is not identified in the Merger Order; AGL Propane Services, Inc. is listed as a participant in the restricted money pool, but is not identified in the Merger Order; Customer Care Services Co. is listed as a participant in the restricted money pool, but is not identified in the Merger Order; Pivotal Energy Services, Inc., listed as a participant in the restricted money pool, is not identified in the Merger Order;[4] Sequent Energy Marketing, LP is listed as a participant in the restricted money pool, but is not identified in the Merger Order; Sequent Holdings, LLC is listed as a participant in the restricted money pool, but is not identified in the Merger Order; AGL Capital Corp. is listed as a participant in the unrestricted money pool, but is not identified in the Merger Order; AGL Networks is listed as a participant in the unrestricted money pool, but is not identified in the Merger Order; AGL Resources Services Co. is listed as a participant in the unrestricted money pool, but is not identified in the Merger Order;[5] Network Energies, Inc. is listed as a participant in the unrestricted money pool, but is not identified in the Merger Order;[6] Network Energies, LP is listed as a participant in the unrestricted money pool, but is not identified in the Merger Order;[7]
AGL Capital Trust II is listed as a participant in the unrestricted money pool, but is not identified in the Merger Order.[8]

[3] The Merger Order does not mention the service company at all in discussing the money pool

[4] Interestingly, this company is listed as inactive on the U-5B, and it is not clear why an inactive company would participate in a money pool

[5] This company is not listed on the U-5B, so it may have been dissolved

[6] This company is not listed on the U-5B, so it may have been dissolved

[7] This company is not listed on the U-5B, so it may have been dissolved

[8] This company is not listed on the U-5B, so it may have been dissolved

AGLR must file, within thirty days of notification by the Examination Staff, a post-effective amendment with the Commission requesting authority for its unauthorized subsidiaries to participate in the money pool. In that amendment, the company must: (1) explain how its money pool operates, specifically discussing the distinction between the restricted and unrestricted money pools; and (2) propose to amend the money pool agreement to provide that the money pool will satisfy the capital requirements of the public-utility company participants before meeting the needs of non-utility participants.

In the interim, AGSC must create a set of written procedures that governs the money pool operations. This manual must contain, among other things, the following information:

1. **the names of all money pool participants;**
2. **participants' borrowing limits, if any (*i.e.*, AGLR may not borrow; EWGs, FUCOs, and ETCs may not borrow or otherwise participate; the borrowing limits of each participating utility subsidiary); and**
3. **a description of how the money pool is to operate, including the allocation method of interest income and expenses and the method of calculating interest.**

As a side matter, it is not clear whether AGLR was authorized to acquire two subsidiaries identified on the money pool list: (1) Georgia Natural Gas Company, which was listed in the Merger Order as an inactive company but identified in the U-5B as an active, non-utility company; and (2) Customer Care Services, which was not identified in the Merger Order but is described in the U-5B only as a non-utility company. AGLR must describe the non-utility operations of these companies and cite the legal authority relied upon to acquire (*i.e.*, operate) them.

Finding 23 (Item 46)

The Examination Staff made inquiries about Accounts Receivable form Associate Companies – Account 146 for the September 2001 U-13-60 WE asked about any receivables over 60 days overdue and to describe the services for the $600,446 in Account 143 – Accounts Receivable

As of September 2001, the receivables were netted against the payables Proper presentation in the U-13-60 would not allow for netting In 2001 and 2002, AGL Services did not have any receivables more than 60 days overdue at any one time The service agreements have a provision that any amount unpaid after thirty days following receipt of the bill will be charged interest from the date of the bill at an annual rate of two percent above the interest rate on thirty day commercial paper as listed on the last working day of that month in the Wall Street Journal The details of the $600,446 was also reviewed

Action Required:

The Account 146 Receivables should be shown separately in the Form U-13-60 and not netted against payables. The U-13-60 should be corrected.

Finding 24 (Item 48)

The Examination Staff looked into Account 207-Premium on Capital Stock of $310,379 There are two components of the Premium on Capital Stock A contra amount of ($13,282) is the premium on common stock This amount should have been reflected in the books and records of AGLR A correcting journal entry was recorded in November 2001 to reclass the balance from AGL Services to AGLR

The other item, $323,661, is unearned compensation Unearned compensation is restricted stock that is issued to key employees at the beginning of their tenure with the Company The restricted stock is that of AGLR, the holding company of the AGLR system At the time the stock is issued, a credit is recorded to treasury stock and a debit to a contra equity account (unearned compensation) The contra equity account is adjusted down as employees vest in the restricted stock This is done on a monthly basis and the expense is recorded on the books of AGSC The expense is then allocated through the normal allocation process to the affiliated companies The balance on September 2001 represents the unvested portion of restricted stock issued to key employees

Action Required:

The Examination Staff requests that this premium be transferred to the books of the Parent company, since the stock is that of the Parent and not of the service company. In addition, the expense for the release of the restricted stock, since it is for key employees, should be charged to the Parent company for all of the corporate executive officers and to the individual companies for the other key employees.

Finding 25 (Item 49)

The Examination Staff reviewed the Analysis of Billing Associate Companies – Account 457 which had Direct Costs Charged of $839,833 to AGLR and no indirect charges All of indirect charges were allocated to other companies in the System We asked for an explanation of this and also to explain the type of costs included in "indirect costs"

AGLR receives only direct costs and assigned time from AGSC through the charge back process AGLR does not receive allocated charges because AGLR is not included in the composite ratio that drives the allocated charge backs The time assignments made to AGLR are mostly a result of time spent by AGL Services employees on mergers and acquisitions related activities, which are the responsibility of shareholders

The composite ratio is an average of the Number of Employees, Total Assets, Operating Expenses and Operating Margin AGL Services has made a conscious effort to exclude AGLR total assets and operating expenses from this ratio

The Examination Staff believes that the Holding Company as the overseer of system assets has a fiduciary duty to ensure that the AGLR equity continues to grow at a reasonable rate of return and therefore should receive a fair and equitable allocation of Corporate Governance costs generated by the service company

Action Required:

See response to Finding 36 (Item 62) for Action Required.

Finding 26 (Item 50)

Schedule XVII – Schedule of Expense Distribution by Department or Service Function does not show any Overhead Explain why there is no overhead and further describe the types of overheads AGL Services uses and where the costs are allocated Provide examples how overhead expenses are actually added to an invoice, work order and labor costs If a percentage is applied and "trued-up" to actual costs at year-end, explain (give at least two examples using year 2001) of how the overhead percentage is determined which includes a prorated share of the actual overhead expenses that were incurred by AGL Services in 2001 If a percentage is not used, explain how AGL Services determined the amount of overhead costs that were added to an invoice (give at least two examples using year 2001) Provide journal and memorandum entries that were prepared monthly, by the departments for overhead costs in these months that match the two examples above AUDIT KEY – A& C&P

AGSC does not follow a methodology in which an overhead percentage is applied to actual costs and subsequently trued-up Instead, AGSC charges back all actual operating expenses to the affiliates on a monthly basis, therefore, no true-up entry is necessary AGSC could consider the pool of costs to be allocated (total operating expenses net of direct charges and direct assignments) to be a proxy for overhead costs described in the question above These costs are expenses that cannot be directly charged to an affiliate or directly assigned to an affiliate through time assignments For example, these costs would include salary expense related to AGSC employees for vacation and sick time, as well as when those employees perform services for AGSC However, since an overhead percentage methodology is not utilized and only actual costs are charged back to the affiliates, these allocated costs were not shown as overhead on Schedule XVII

Action Required:

The USA requires overhead to be shown as a separate column in Schedule XVII of the U-13-60. The U-13-60 should be corrected such that the overhead column should be shown for the period ending December 31, 2003.

<u>Finding 27 (Item 51)</u>

The Examination Staff was concerned that the Departmental Analysis of Salaries – Account 920 shows only \$7,262 in salaries charged to the Parent from the Executive Department and only \$174,214 of \$21,773,909 (approximately 0 8%) in total charges to the Parent for salaries We asked for further explanation

The company responded that AGLR, Atlanta Gas Light Company, Virginia Natural Gas, Chattanooga Gas Company, AGL Investments Inc , AGL Networks, Sequent Energy Management, etc ("subsidiary companies"), has limited capitalization and is, for all intents and purposes, solely a registration company Additionally, due to the Company's small size and proven cost efficiencies, AGSC provides substantially all of the corporate governance and management for the subsidiary companies The Examination Staff, in other areas of the examination including a review of the invoices, has concluded that the parent company is not receiving its fair share of corporate governance cost Costs such as those relating to merger and acquisition activities are directly charged to AGLR

AGLR does not employ any people The officers of AGLR reside in other companies, such as AGL Services, Atlanta Gas Light Company, etc The Examination Staff believes the physical location of the executive staff does not necessarily govern where their time should be charged The Parent company should be charged a fair amount of corporate governance costs It is assumed that corporate executives perform a significant portion of corporate governance work Corporate governance areas include accounting (financial reporting and consolidation accounting), strategic planning, legal, human resources, benefits for corporate officers and directors, advertising, lobbying, investor relations, and finance In addition, corporate officer are principally responsible for the capital formation and credit standing of the System The salary charges shown in account 920, executive and all other areas, are the result of direct assigned time charged on the timesheets of AGSC employees for services rendered to AGLR

Action Required:

The Examination Staff is asking AGSC to recommend an allocation method that will charge a fair and equitable amount of corporate governance costs to the Parent.

Finding 28 (Item 52)

The Examination Staff reviewed the allocation methodology used to allocate the costs of Employee Pensions and Benefits – Account 926 Of the $23,408,421 in costs, we asked how much related to special plans for executive level officers, what are the plans and how were the costs allocated

The following is a list of current incentive compensation plans for executive employees of AGLC, AGLR and AGSC A total of $2,071,286 of the $23,408,421 was paid to officers through the various plans in 2001 The expenses related to the benefit plans are allocated as follows

All payroll and benefits, including executive compensation and awards, associated with the common officers of AGLR and AGL Services are expenses of AGL Services These costs are charged back in the following manner

- Direct charged to each affiliate, including AGSC, based on the percentage of full time employees (FTE's) Each AGL Services' department receives a portion of these costs (referred to as internal loading of costs) since AGL Services has employees
- The internally loaded costs are included within all other operating costs of each AG service provider department and are included in the costs charged back to the affiliates under the "Direct Assigned" and "Allocated" steps of the charge back process

Enumerated below are the AGLR compensation plans

Annual Performance Team Incentive (ATPI) Plan- rewards based on corporate and individual performance objectives In 2001, $1,787,945 was paid out to officers of AGLC, AGLR, and AGSC for ATPI

1998 Performance Awards-The Long-Term Stock Incentive Plan (LTSIP) issues performance shares which shall vest at the end of the third consecutive one-year measurement periods based on a combination of the Company's average annual increase in earnings per share ("EPS") and average percentile of annual total shareholder return (defined as stock prices appreciation plus dividends) versus the Standard and Poor Utility Index In 2001, $60,574 was paid out to officers of AGLC, AGLR and AGL Services

1999 Performance Units-The award of performance units is designed to have executives focus on two primary measures - growth in earnings and total shareholder return Those objectives help ensure that executives are driven to increase the value of shareholders' investment Executives are rewarded only when other shareholders are rewarded and when the Company's earnings growth objectives are met In 2001, $31,488 was paid out to officers of AGLC, AGLR, and AGL Services

Officer Incentive Plan (OIP)- AGLR has established the AGLR Officer Incentive Plan to further the growth and development of the Company The OIP provides the Company and its Related Companies a plan under which to offer a proprietary interest in the Company's Common Stock as a material inducement to certain officer level individuals to enter employment with the Company and its Related Companies In 2001, $161,304 was paid out to officers of AGLC, AGLR and AGL Services

Non-Qualified Savings Plan (NSP)-The NSP is a non-qualified deferred compensation plan provided by the Company to allow a select group of management or highly compensated employees of the Company and its affiliated companies and opportunity to save for retirement on a tax-favored basis. The plan is an unsecured promise by the Company to pay the participant the specified benefits at some future date

None of the costs associated with the following compensation plans for the common officers of AGLR and AGL Services were allocated to the Parent Company These common officers have a fiduciary duty to preserve the assets of the AGL System and to insure that the system increases in value The Examination Staff believes that some of these costs should be allocated to all associate companies including AGLR

Annual Performance Team Incentive Plan (ATPI): **$912,000**

	Direct Charged Percentage	Direct charged portion of ATPI $
Trustees Investments, Inc	06%	547
Virginia Natural Gas Company	15 58%	142,090
AGL Networks, LLC	32%	2,918
Atlanta Gas Light Company	52 52%	478,982
Chattanooga Gas Company	2 38%	21,706
AGL Service Company	29 15%	265,848

1998 Performance Awards (LTSIP): **$15,183**

	Direct Charged Percentage	Direct charged portion of LTSIP $
Trustees Investments, Inc	06%	9
Virginia Natural Gas Company	15 50%	2,353
AGL Networks, LLC	32%	49
Sequent Energy Management LP	0 50%	76
Atlanta Gas Light Company	52 26%	7,935
Chattanooga Gas Company	2 36%	358
AGL Service Company	29 %	4,403

1999 Performance Units: **$37,622**

	Direct Charged Percentage	Direct charged portion of Performance Units $
Trustees Investments, Inc	06%	23
Virginia Natural Gas Company	15 58%	5,831

AGL Networks, LLC	32%	120
Sequent Energy Management LP	0 50%	188
Atlanta Gas Light Company	52 52%	19,661
Chattanooga Gas Company	2 38%	888
AGL Service Company	29 15%	10,910

Non-Qualified Savings Plan (NSP): **$37,000**

	Direct Charged Percentage	Direct charged portion of NSP $
Trustees Investments, Inc	06%	22
Virginia Natural Gas Company	15 58%	5,735
AGL Networks, LLC	32%	118
Sequent Energy Management LP	0 50%	185
Atlanta Gas Light Company	52 52%	19,336
Chattanooga Gas Company	2 38%	873
AGL Service Company	29 15%	10,730

Action Required:

Section 13(b) of the Act requires a fair allocation of costs throughout a holding company system. The Examination Staff believes that the Composite Formula as calculated by AGL Services to allocate costs incurred by the common AGLR and AGL Services officers, does not result in a fair and equitable allocation of costs to AGLR since this method as calculated by AGL Services allocates no costs to AGLR.

It is the Examination Staff's position that AGSC should use a method of allocation that will recognize the value of the service earned by the Parent Company from the service being rendered. The intent of our position is to emphasize the Corporate Governance and influence of the common officers of AGLR and AGL Services from Board representation to capital formation and credit standing. These common officers have a fiduciary duty to preserve the assets of the AGL System and to insure that the system increases in value. The Examination Staff believes that some of these costs should be allocated to all associate companies including AGLR.

AGL Services should establish a new method of allocation that will

result in a fair and equitable allocation of costs incurred by the common AGLR and AGL Services officers to all associate companies including the Parent Company. All such future type costs should be allocated under this new allocation method.

AGL Services should reallocate the $912,000 of ATPI paid to the common officers in 2001 based on the new method that allocates some costs to the Parent Company. All such future awards to the common officers of AGLR and AGL Services should be allocated based on the same method unless AGL Services request a change from the Commission via a 60-day letter.

AGL Services should reallocate the $15,183 of LTSIP for the common officers receiving such awards based on the new method that allocates some costs to the Parent Company. All such future awards to the common officers of AGLR and AGL Services should be allocated based on the same method unless AGL Services requests a change from the Commission via a 60-day letter.

AGL Services should reallocate the $37,622 of 1999 performance units for the common officers based on the new method that allocates some costs to the Parent Company. All such future awards to the common officers of AGLR and AGL Services should be allocated based on the same method unless AGL Services requests a change from the Commission via a 60-day letter.

AGL Services should reallocate the $37,000 of NSP for the common officers based on the new method that allocates some costs to the Parent Company. All such future awards to the common officers of AGLR and AGL Services should be allocated based on the same method unless AGL Services requests a change from the Commission via a 60-day letter.

Finding 29 (Item 53)

The Examination Staff reviewed copies of the two largest invoices (that includes how the costs were allocated) for General Advertising Expenses – Account 930 1 for the following vendors Ivory, Gas Product Company, and Leader Publishing Explain in more detail, the specific use of the advertising, including the name of the company promoted in the advertising AUDIT KEY - A

1 Ivory billed AGSC $3,751 97 and $10,820 00 in January 2001 for production services in connection with a civic awards event – the Shining Light Award AGLR sponsored the event

2 The Leader Publishing Group billed AGLR twice in 2001 in the same amounts of $9,156 00 for advertising a promotional event sponsored by AGLR including Atlanta Jewish Life and Divas

3 Gas Products Company, Inc billed AGSC $4,764 in January 2001 for products (gaslights) used in a promotional event sponsored by AGLR

The costs are allocated out based on payroll costs for the Civic and Community Affairs Department and a minimal charge is allocated to the parent It appears the composite rate is used to allocate these costs The composite rate appears to be used where the major companies in the system benefit from the particular costs When costs are allocated across the system, our assumption is that there is a benefit to each one The Parent company should not be excluded from this benefit since it is the governing body of the System

Action Required:

The Examination Staff recommends an allocation be established to charge a fair and equitable amount of these type costs to the Parent company. Advertising will result in name recognition for the Parent for which they should pay part of the costs.

<u>Finding 30 (Item 54)</u>

The Examination Staff inquired as to the nature of the $1,277,540 in sub lease credits for rents The credits are the result of a sublease of corporate office space, the term of which began December 1, 1998 and expired on January 3, 2003

It was stated that most of the costs -- approximately 90% -- were "allocated to other Services Company departments through the facilities direct charge process " An analysis of department 1695 for May 2001 was attached to the response

This analysis does not indicate which companies were directly charged (or credited) or how the costs and credits were allocated

Action Required

See Finding 15 (Item 33) for Action Required.

<u>Finding 31 (Item 55)</u>

The Examination Staff reviewed the two largest invoices (to include the allocation methodology) for each of these vendors in Account 426 1 Donations

The Examination Staff reviewed invoices for Junior Achievement of Georgia ($4,000), Zoo Atlanta ($10,000), Hearts with Hope Celebration ($5,000), Clean Air Campaign ($12,500), Habitat for Humanity ($4,061), VSA Arts of Georgia ($4,000), Standard Press-Christian Council Brochure ($3,507), Metropolitan Arts Fund ($5,000), Fernbank Museum of Natural History ($10,000), Morris Brown College ($3,788), Georgia Hispanic Chamber of Commerce ($15,000), United Way of Metropolitan Atlanta ($50,000), United Way of Metropolitan Atlanta ($100,000), Atlanta Symphony Orchestra ($10,000), City of Macon ($5,000), and Leadership Atlanta ($5,000) AGL Services stated that these costs are not allocated to the affiliated entities as they are community involvement type expenses paid to various civic and charitable organizations The company believes these type expenses should be paid by the shareholders of the company Yet, the costs are not allocated to the holding company, but the company states these expenses fall below the line Since the service company has to be a net income of zero, the Examination Staff is unclear where these costs are located, since there is no "below the line" concept except for utility companies As stated earlier, the USA requires all costs to be recovered from associate companies

Action Required:

The Examination Staff requires the charitable costs to be charged to the parent company since these are costs AGLR believes should be shareholder responsibility. This will clearly differentiate that the costs are shareholder costs and to ensure the service company does not have any unallocated costs.

<u>Finding 32 (Item 56)</u>

The Examination Staff asked for additional information on the Other Deductions – Account 426 5 on the item "Executive Allowance Fund Expenses"

The purpose of the Executive Allowance Fund (EAF) is to provide a program through which eligible participants can design and fund a flexible executive benefits package suitable to their personal and individual business needs The EAF benefits is offered based on market research indicating that it is a competitive executive benefit

The company explained that these expenses fall below the line and are not allocated The service company structure under the Act does not allow for a "below the line" expense These costs should be allocated to the parent company and expensed on its books The benefits paid as of September 30, 2001 were $99,873 and for January and February 2002 were $75,007 After February 2002, the company no longer continues to support the EAF

Action Required:

The Examination Staff requires the EAF costs to be charged to the parent company and expensed on its books.

<u>Finding 33 (Item 57)</u>

The Examination Staff reviewed how AGSC calculated and billed for compensation for the use of capital For 2001, the cost of capital was charged to the affiliates of AGLR from AGL Services on a monthly basis and calculated by multiplying AGL Services net book value (asset cost net of accumulated depreciation) by the authorized rate of return of Atlanta Gas Light Company The annual authorized rate of return was 9 11%, which was authorized by the Georgia Public Service Commission Under Docket No 9390-U Effective May 1, 2002, AGL Services decided to change the cost of capital calculation to only charge back AGL Services actual interest expense to the affiliates

The cost of capital is charged back to the affiliates based on each affiliates' composite ratio The Examination Staff reviewed the June 2001 calculations The problem with the composite ratio is that the Parent company is not included in the allocation Service Company work is performed on behalf of the parent company and they should share in the cost to maintain the service company infrastructure

Action Required:

The Examination Staff agrees with the use of the actual AGSC interest rate, but the methodology needs to be revised to include the Parent Company.

<u>Finding 34 (Item 60)</u>

The Examination Staff reviewed the allocation methods used by AGSC We had asked the company to provide us with the detailed calculations (raw data for numerator and denominator) for the specific allocation methods used in 2001 and 2002 by AGL Services For each of the allocation methods used, we asked the company to identify the pertinent Commission authorization (Order or 60 Day Letter) We also asked whether allocation methods are associated with particular service company departments

AGSC uses several allocation cost drivers number of end use customers, total assets ratio, number of employees ratio, number of stores issues ratio, square footage ratio, number of vehicles/rate per vehicle, operating margin ratio, operating expense ratio, composite ratio, hours worked ratio, rate per user and rate per employee

The composite ratio is comprised of the average of the number of employees ratio, the total assets ratio, the operating expenses ratio, and the operating margin (revenue less cost of goods) ratio The composite ratio is commonly used for the executive, external relations, financial services, internal auditing, investor relations, legal services and risk management, strategic planning service areas These are all considered corporate governance areas Based on two sample months, June 2001 and June 2002, AGLR received only zero and $16,115 respectively of allocated charges from AGL Services The same two months, the parent received $5,855 and $47,977 respectively of direct charges and $79,316 and zero respectively of assigned charges The percentages of each of these types of charges, direct, assigned and allocated charged to the parent therefore varied from zero to 0 6% for the months of June 2001 and June 2002 The Examination Staff does not believe these amounts reflect the true value of corporate governance services provided to the parent company The composite allocation also seemed to have several variations, where different companies were included at different times (we noticed this in our review of the invoices in Item 61) The information provided also did not show the raw data for the numerator and denominator of the various allocations

Action Required:

The Examination Staff recommends AGL Services develop a new method of allocation which more fairly allocates corporate governance costs to the parent company. AGSC must provide the raw data for the calculation of the allocations. In addition, for any variation of an approved method, such as the composite method, that exceeds the 50,000 or 5% threshold must be submitted for approval.

<u>Finding 35 (Item 61)</u>

The Examination Staff reviewed many invoices selected from Account 921-Office Supplies and Expenses, Account 923-Outside Services Employed and Account 930 2-Miscellaneous General Expenses We had issues on a vast majority of them The two issues involved the lack of a work order system and the difficulty in tracking how an actual invoice is allocated Second, as the invoices became part of a larger pool of costs allocated to various companies based on a payroll calculated factor, very little costs were charged to the Parent company

1 Deloitte invoice for $36,333 was for services related to the annual audit This amount was allocated based on the Composite Method that allocates costs based on Number of Employees, Total Assets, Operating Expenses and Operating Margin AGL Services has consciously excluded AGLR from this formula The detail worksheet supporting this allocation was based on a total Deloitte invoice of $543,440 Since these services relate to the external audit of AGLR, retirement, health and welfare plans that benefit the entire AGLR System, this total amount should be reallocated based on a new method that allocates costs fairly and equitably to all associate companies

2 Dickstein invoice for $17,854 was for services related to Chattanooga LNG This cost should be allocated 100% to Chattanooga Gas Company The supporting documentation showed an allocation based on the Composite Method with no audit trail to determine how the $17,854 was ultimately allocated

3 E K Williford invoice for $6,800 was for services related to telecommunications evaluation and implementation The Examination Staff could not determine how this invoice was allocated to associate companies This is a good example that supports our position that AGL Services does not have an adequate cost accounting system for tracking and verifying that costs are properly allocated to clients

4 Ecomm invoice for $27,300 was for services related to Norton Antivirus The Examination Staff could not determine how this invoice was allocated to associate companies This is a good example that supports our position that AGL Services does not have an adequate cost accounting system for tracking and verifying that costs are properly allocated to clients

5 EquiServe invoice for $23,007 was for services related to stockholder records It can not be determined how this cost was allocated to associate companies based on the data provided This cost benefits the entire AGLR system and AGL Services should provide a new method that

allocates costs fairly and equitably to all associate companies All EquiServe invoices should be allocated based on this new method

6 Ernst & Young invoice for $50,000 is related to federal tax planning There is no support to verify how this cost was allocated to associate companies This cost benefits the entire AGLR system and AGL Services should provide a new method that allocates costs fairly and equitably to all associate companies An additional invoice of $50,000 should also be allocated based on this new method

7 Execu-Source invoice for $10,600 is related to the placement fee for Gena Corbert, an AGSC employee This amount could not be verified in the total that was provided as support and allocated based on the Composite Method

8 Two Executive Benefit Consultant invoices for $14,400 each was for services related to the selection of new actuary It was difficult to track either invoice thru the documentation provided by AGL Services

9 Deloitte invoice for $43,495 was for services respect to state tax filing requirements derived from the business operation of Sequent Energy It could not be verified how this cost was allocated by AGL Services This cost should be allocated 100% to Sequent Energy

10 Deloitte invoice for $27,500 was for a review of Federal consolidated income tax return for the fiscal year ended December 31, 2001 It could not be verified how this cost was allocated by AGL Services This service benefits the entire AGLR system and AGL Services should provide a new method that allocates costs fairly and equitably to all associate companies All comparable invoices should be allocated based on the same new methodology

11 Deloitte invoice for $39,666 is included in Item 1 as part of the total $543,540

12 Andersen invoices for $37,405 and $21,648 was for professional services in connection with the Energy Diagnostic Review for Sequent Energy Management This amount could not be verified in the total that was provided as support and allocated based on the Composite Method The $37,405 should be billed 100% to Sequent

13 Atlanta Group Systems invoice for $23,940 appears to be services for Atlanta Gas Light The Examination Staff could not determine how this invoice was allocated to associate companies This is a good example that supports our position that AGL Services does not have an adequate cost accounting system for tracking and verifying that costs are properly allocated to clients

14 Avail Staff invoice for $16,963 appears to be services for Atlanta Gas Light The Examination Staff could not determine how this invoice was allocated to associate companies This is a good example that supports our position that AGL Services does not have an adequate cost accounting system for tracking and verifying that costs are properly allocated to clients

15 Acxiom invoice for $9,235 appears to be services for Virginia Natural Gas ("VNG") There is no documentation to support how this cost was allocated to associate companies This item should be reallocated 100% to VNG

16 Ziglar Training invoice for $12,000 appears to be services for Atlanta Gas Light It could not be verified how this cost was allocated by AGL Services

17 Atlanta Press Club invoice for $2,000 for 2002 sponsorship program for community affairs and corporate communications It could not be verified how this cost was allocated by AGL Services

18 The Colad Group invoice for $3,949 for a construction manual binder could not be verified as to how allocated to associate companies

19 The Georgia Conservancy invoice for $5,000 related to the TGC Oyster Roast Reception in Savannah could not be verified as to how it was allocated to associate companies

20 AGL Services could not provide the actual $17,000 Powerplan invoice They Provided a correction journal voucher that showed the service was for tax depreciation software This invoice would benefit those companies that have depreciable assets This cost was probably allocated based on the Composite Formula that excludes the Parent Company Since AGLR has no depreciable assets, the Examination Staff believes the Composite Formula would be correct

21 The Premier Partners invoice for $27,582 related to CIS maintenance CIS relates to the AGLC and Chattanooga Gas Co ("CGC") billing system according to Mike Morley It appears these costs were allocated based on the Composite Formula These costs should be reallocated to AGLC and CGC under a different formula

22 PWC Consulting invoice for $175,810 relates to CIS Tactical Planning project CIS relates to the AGLC and CGC customer billing system It appears these costs were allocated based the Composite Formula These costs should be reallocated to AGLC and CGC under a different formula

23 PWC Consulting invoice for $191,366 relates to CIS Tactical Planning project It appears these costs were allocated based the Composite Formula These costs should be reallocated to AGLC and CGC under a different formula

24 PWC Consulting invoice for $187,724 relates to CIS Tactical Planning project It appears these costs were allocated based the Composite Formula These costs should be reallocated to AGLC and CGC under a different formula

25 PWC Consulting invoice for $190,144 relates to CIS Tactical Planning project It appears these costs were allocated based the Composite Formula These costs should be reallocated to AGLC and CGC under a different formula

26 LeBoeuf invoice for $23,513 is a component of a larger invoice of $54,937 There is no documentation supporting how this cost was allocated It was most likely allocated based on the Composite Formula that allocated no cost to AGLR The services state they were for application of FERC's present and proposed affiliate rules to AGLR There is also a reference to Miscellaneous Corporate It appears that these types of services benefit the entire AGLR System and therefore AGL Services should recommend a new method for allocating these costs that include all associate companies including the Parent Company

27 LeBoeuf invoice for $6,017 were for services in connection with a possible acquisition It appears that this cost was allocated based on the Composite Formula Since the cost is related to an acquisition it should be reallocated 100% to the Parent Company

28 Littler Mendelson invoice for $15,173 appears to be for services related to an Atlanta Gas Light legal issue This cost appears to have been allocated based on the Composite Formula Since the cost is related to an Atlanta Gas Light issue it should be reallocated 100% to the Atlanta Gas Light Company

29 Littler Mendelson invoice for $3,500 did not have enough support to determine the type of service and who should be charged AGSC should be written up for accepting insufficient data on their invoices

30 Long Aldridge invoice for $9,176 was related to AGLR non-utility contracts It appears that this cost was allocated based on the Composite Formula that allocated costs to utilities and non-utilities This cost should be reallocated to the appropriate non-utility

31 Long Aldridge invoice for $14,248 was related to AGLR non-utility contracts It appears that this cost was allocated based on the Composite Formula that allocated costs to utilities and non-utilities This cost should be reallocated to the appropriate non-utility

32 Alston & Bird invoice for $12,826 relates to a number of Corporate Governance filings i e proxy filing, Form 8-K, Form 10-Q It appears that these costs were allocated based on the Composite Formula that allocated costs to all companies except the Parent Company These Corporate Governance filings benefit the entire AGLR System and should be reallocated based on a new method that allocates costs to all associate companies including AGLR

33 Alston & Bird invoice for $33,322 relates to corporate compliance program related to Sequent and VNG It appears that these costs were allocated based on the Composite Formula that allocated costs to all companies except the Parent Company It is delineated on the invoice the hours and cost by subject matter These costs should be reallocated to only impact Sequent and VNG

34 Analysts International invoice for $10,282 relates to professional services that are not clearly delineated on the invoice It appears that they were for Atlanta Gas Light but allocated to all companies based on the Composite Formula These costs should be reallocated 100% to Atlanta Gas Light

35 Analysts International invoice for $12,870 relates to professional services that are not clearly delineated on the invoice It appears that they were for Atlanta Gas Light but allocated to all companies based on the Composite Formula These costs should be reallocated 100% to Atlanta Gas Light

36 Anderson Kill invoice for $15,034 relates to the captive insurance company It appears that these costs were allocated based on the Composite Formula that allocated costs to all companies except the Parent Company This cost should be reallocated 100% to Global Energy Resources Co

37 Latin American Association invoice for $5,000 relates to AGLR as a sponsor for the Latin Fever Ball on October 5, 2002 It appears that these costs were allocated based on the Composite Formula that allocated costs to all companies except the Parent Company These costs should be reallocated on a new method that would allocate some costs to the Parent Company since in fact these costs are associated with a form of branding that benefit the entire AGLR System including the Parent Company

38 League of Women Voters of Atlanta-Fulton County invoice for $6,000 relates to the 15th Annual State of the Community Luncheon that benefits the Atlanta community It appears that these costs were allocated based on the Composite Formula that allocated costs to all companies except the Parent Company These costs should be reallocated to the Georgia companies and Parent that benefit from this local community event

39 Winward invoice for $33,768 relates to South Star LLC It appears that it was allocated to all system companies except AGLR This cost should be reallocated 100% to the Parent Company and then AGLR should bill South Star LLC directly

40 Wise invoice for $22,767 relates to AGLR investor package There is no support to determine how this cost was allocated to associate companies Based on a review of numerous invoices in this examination it is assumed that it was allocated based on the Composite Formula This cost should be reallocated 100% to the Parent Company since it deals with AGLR investor information

41 Al Keith invoice for $3,406 relates to facilities services There was no support to determine how this was allocated to associate companies

42 Alliant Public Relations invoice for $6,000 relates to financial, trade and Houston area media relations and branding support to AGLR It appears this cost was allocated based to the Composite Formula It is the opinion of the Examination Staff that branding type costs benefit the entire holding company system including AGLR and therefore AGL Services should recommend a new method for allocating these costs that include all associate companies including the Parent Company

43 Allison invoice for $10,495 relates to upgrade of data cabling at new Peachtree center The Examination Staff could not determine how this invoice was allocated to associate companies This is a good example that supports our position that AGL Services does not have an adequate cost accounting system for tracking and verifying that costs are properly allocated to clients

44 Allison invoice for $22,023 relates to work performed on 4th floor computer room The Examination Staff could not determine how this invoice was allocated to associate companies This is a good example that supports our position that AGL Services does not have an adequate cost accounting system for tracking and verifying that costs are properly allocated to clients

45 Alston invoice for $17,037 relates to legal work performed for securities matters related to Regulation FD, insider trading policy and Sarbanes-Oxley These are Corporate Governance costs that benefit the entire AGLR System and therefore AGL Services should recommend a new method for allocating these costs that include all associate companies including the Parent Company

46 RR Donnelley invoice for $5,179 was for services related to employee stock purchase plan and prospectus These are Corporate Governance costs that benefit the entire AGLR System and therefore AGL Services should recommend a new method for allocating these costs that include all associate companies including the Parent Company

47 RDA invoice for $10,687 was for services related to CIS System Architecture project There is no support to determine how these costs were allocated As we have determined in reviewing previous invoices, CIS relates to the AGLC and Chattanooga Gas Co ("CGC") billing system according to Mike Morley These costs should be reallocated to AGLC and CGC under a different formula

48 RDA invoice for $53,250 was for software development services related to the Pipeline Phase II FP project Mike Morley stated this project related to gas supply monitoring and applied to the three utilities The Examination Staff could not confirm how these costs were allocated to the associate companies These costs should be allocated to the three utilities based on an approved PUHCA method

49 Royal Staffing invoice for $11,000 relates to the finders fee associated with the hiring of someone for the AGLC/VNG call center It appears from the support documentation that these costs were properly allocated to AGLC and VNG

50 Invoice for $375,000 from Dakin Group for consulting agreement in which Dakin agrees to manage/coordinate efforts to amend or defeat any legislation that would mandate Georgia Power's designation as the regulated provider of natural gas The Service Company books the cost to Outside Services (GL 670200, FERC 923) and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR) VNG and CGC receive approximately 23% of the cost The Examination Staff believes that 100% of the cost should be charged to Georgia companies

51 Invoice for $2,052 from Rutherford Publishing for a Total Wellness Newsletter and postage The Service Company books the cost to Department 1426 and allocates it to AGLR's subsidiaries based on payroll dollars, so only affiliates with employees were charged The Total Wellness Letter is a monthly publication promoting healthful habits and providing general health information The Parent company should be allocated a portion of the charges based on the executive officers

52 Invoice for $11,715 from Select International, Inc , for a T3 Training Workshop for 6 participants The Service Company books the cost to Department 1423 The allocation method is not identified The T3 Workshop provided training on interviewing skills The costs went to those affiliate business units with employees Again, the Parent company would be excluded

53 Invoice for $24,360 from Skybridge, Inc for consulting services provided by Clifford M Smith The Service Company books the cost to Outside Services Skybridge provides consulting services associated with the Human Resources module of the PeopleSoft system The costs were charged to those affiliate business units with employees using the percentage of FTE's The parent and some other subsidiaries were excluded, but the charges should be allocated based on which companies get charged for salaries

54 Invoice for $7,000 from The Training Edge Group for diversity consulting The Service Company books the cost to Outside Services (GL 670200, FERC 923) and allocates it to AGLR's subsidiaries based on payroll dollars

55 Invoice for $21,888 from Thorpe Building Services for janitorial services at 1219 and 1254 Caroline Street The services provided consisted of general maintenance such as trash pickup, mat services, and the wages of three on-site janitors The Service Company charged the costs to VNGC, AGL Networks, LLC ("AGLN"), Sequent Holdings, LLC ("SEQT"), AGLC, and Chattanooga Gas Company ("CHAT") All of the companies in the system, including the Parent, benefit from these services performed for the service company The costs should be reallocated

56 Invoice for $53,519 from Weltner Communications for professional services The type and nature of the services is not given The Service Company books the cost to Outside Services and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR) The Examination Staff can partly tie the invoice to the GL support

57 Invoice for $34,038 from Capstone Consulting Partners for consulting services Capstone provides consulting services for the GIS mainframe system such as security and general maintenance by on-site consultants The costs were charged to those affiliates deemed to use the information services, Trustees Investments, Inc ("TRUS"), Virginia Natural Gas ("VNGC"), AGLI, AGLN, SEQT, AGLC, and CHAT The Parent company is excluded It would appear a mainframe system would benefit all companies in the System, so the costs should be reallocated

58 Invoice for $62,293 from Capstone Consulting Partners for consulting services Capstone provides consulting services for the GIS mainframe system such as security and general maintenance The Service Company books the cost to Outside Services and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR) This composite charged the costs to TRUS, VNGC, AGLI, AGLN, SEQT, AGLC, and CHAT All companies, including the Parent should be charged for this benefit

59 Invoice for $4,025 from C&J Services for Caroline Street landscaping services The Service Company books the cost to XXXX and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR) The Examination Staff cannot tie the invoice to GL support The Examination Staff believes that the AGLR should be allocated a fair and equitable amount of these costs

60 Invoice for $12,067 from Buck Consultants for health and welfare budget projections and contribution pricing setup The Service Company books the cost to Outside Services and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR) The Examination Staff cannot tie the invoice to GL support

61 Invoice for $18,128 from Burson-Marstellar for professional services involving media strategy The focus is on how the local community perceives AGLR as a company The Service Company books the cost to Outside Services and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR) Included in the composite were AGL Energy Corporation ("AGEC"), AGL Propane Services, Inc ("AGPS"), VNGC, AGLI, AGLN, SEQT, AGLC, and CHAT The Examination Staff believes that the AGLR, the holding company, should be allocated a fair and equitable amount of these costs

62 Invoices for $47,147 and $44,534 from Wachovia Corporate Services for Treasury Professional/Consulting Services The Service Company books the cost to Outside Services (GL 670200, FERC 923) and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR) The Examination Staff believes that the AGLR, the holding company, should be allocated a fair and equitable amount of these costs

63 Invoice for $28,875 from Complysite, Inc to purchase Compliance Software Package The Service Company books the cost to Outside Services (GL 670200, FERC 923) and allocates it to AGLR's utility subsidiaries using a LDC composite ratio

64 Invoice for $7,064 from Novare Biltmore Associates, LLC for W Peachtree parking fees The Service Company books the cost to Office & Administrative Expense (GL 670100, FERC 921) and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR) The Examination Staff believes that the AGLR, the holding company, should be allocated a fair and equitable amount of these costs

65 Invoice for $47,500 from PeopleSoft USA, Inc for an Education Services & Training Prepayment Agreement The Service Company books the cost to Office Supplies and Expense (GL XXXX, FERC 921) and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR) The Examination Staff believes that the AGLR, the holding company, should be allocated a fair and equitable amount of these costs

66 Invoice for $7,783 from Personnel Decisions International for 50 PRF for Managers/Professionals Questionaire Packets The Service Company books the cost to Office Supplies and Expense (GL 670102, FERC 921) and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR)

67 Invoice for $14,823 from Pinnacle Towers, Inc for leases The Service Company books the cost to Office Supplies and Expense (GL 670050-670950) and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR)

68 Invoice for $2,800 from Eggleston Software Professionals for consulting services Eggleston provides presentation services to the officers of AGLR and its affiliates These services include power point presentations for on-site and off-site meetings such as the annual shareholders meeting, speech presentation materials, letters presented to the board of directors, and other special projects The Service Company books the cost to Office & Administrative (GL 670100, FERC 921) and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR) The Parent company, through its officers, benefits from these services and should receive part to the cost

69 Invoice for $10,000 from Elizabeth S Kelly, LLC for consulting services The specific nature of the service is not identified The Service Company books the cost to Civic Participation –

Community Development (GL 670122, FERC 921), and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR)

70 Invoice for $10,000 from Elizabeth S Kelly, LLC for consulting services The specific nature of the service is not identified The Service Company books the cost to Civic Participation – Community Development (GL 670122, FERC 921), and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR)

71 Invoice for $10,000 from Elizabeth S Kelly, LLC for consulting services The specific nature of the service is not identified The Service Company books the cost to Civic Participation – Community Development (GL 670122, FERC 921), and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR)

72 Invoice for $16,794 from Emtec, Inc for Sun Educational Services training The specific nature of the service is not identified The Service Company books the cost to Operational Training (GL 670105, FERC 921) and allocates it to AGLR's subsidiaries using a composite ratio (excluding AGLR)

73 Invoice for $7,500 from U S Dept of Transportation /Pipeline Safety Program for Pipeline Safety User Fee Assessment of Macon, Cherokee County, and Riverdale LNG plants The Service Company books the cost to Tax and License (GL 670080, FERC 921), directly assigns 82% to AGLC and 4% to Chattanooga, and allocates the remainder to AGLR's subsidiaries using a composite ratio (excluding AGLR) The Examination Staff believes that 100% of the cost should be charged to Georgia

74 Invoice for $7,500 from U S Dept of Transportation /Pipeline Safety Program for Pipeline Safety User Fee Assessment of Macon, Cherokee County, and Riverdale LNG plants The Service Company books the cost to Tax and License (GL 670080, FERC 921), directly assigns 82% to AGLC and 4% to Chattanooga, and allocates the remainder to AGLR's subsidiaries using a composite ratio (excluding AGLR) The Examination Staff believes that 100% of the cost should be charged to Georgia

75 The $5,265 is part of a check for $10,265 60 to Verlene Cobb for payment of Retiree services The supporting documentation showed an allocation based on FTE Retiree services benefit the whole system so a portion of the cost should have gone to the parent, AGLR

76 The $13,796 15 is for Checking Account Service Charges (per invoice) and the Payable Voucher Detail list this as Consultant Services The company has marked on the Payable Voucher Detail item 145 but the amount associated with this is $4,091 The supporting documentation showed an allocation based on the Composite Rate Factor Checking Account Services benefit the whole system so a portion of the cost should have gone to the parent, AGLR

77 The Weltner Communications invoice paid $26,808 48 $25,000 for professional services-retainer and 1808 48 for out of pocket expenses The supporting documentation showed an allocation based on the Composite Rate Factor Part of these costs should be charged to the Parent

78 Weltner Communications invoice paid $26,271 00 $25,000 for professional services- retainer and 1271 00 for out of pocket expenses The supporting documentation showed an allocation based on the Composite Rate Factor Part of these costs should be charged to the Parent

79 The $12,504 21 is for Checking Account Service Charges (per invoice) and the Payable Voucher Detail list this as Bank Analysis The supporting documentation showed an allocation based on the Composite Rate Factor Checking Account Services benefit the whole system so a portion of the cost should have gone to the parent, AGLR

80 Two invoices for $5,000 each to the Atlanta Symphony for Gold sponsor of the Ball The composite factor was used which included all the AGLR companies except the Parent Company The Parent company should be included in the allocation since it would also benefit from the name recognition

81 Addison was paid $36,500 for AGLR Brand Framework and core identity program This was allocated using mostly a composite rate, excluding the Parent company The Parent company should be included in the allocation as it would benefit from the name recognition associated with branding

82 Creaxion was paid $34,510 for creative and strategic marketing The cost was allocated using mostly a composite rate which excluded the Parent company The Parent company should be included in the allocation as it would benefit from creative and strategic marketing

83 Cookerly was paid $18,042 58 for PR counsel, planning and materials The cost was allocated using mostly a composite rate which excluded the Parent company The Parent company should be included in the allocation as it would benefit from public relations costs

84 The Clean Air Campaign was paid $75,000 It appears Atlanta Gas Light utility company name and logo is used The costs was allocated using mostly a composite rate These costs should be direct charged to the Atlanta Gas Light utility company

85 Rights Management Consultants was paid $16,800 We could not determine exactly what the service provided was and how it was allocated

86 Microsoft was paid $138,750 The original cost was allocated using a composite rate where each company received a share of the costs except the Parent company Costs were reallocated to fewer companies, mainly the utility companies It would seem software costs would benefit all companies in the system, including the Parent

87 Acxiom was paid $11,326,73 for printing invoices for VNG This cost was allocated using mostly a composite ratio It appears that only VNG benefitted from the costs Costs should be direct charged to VNG

88 United Youth Adult Conference was paid $6,000 for the 2002 event sponsorship of the UYAC Gala The cost was allocated using mostly a composite rate which excluded the Parent company The Parent company should be included in the allocation as it would benefit the name recognition of event sponsorships

89 Simpsonwood was paid $1,000 for the annual sponsorship of the Simpsonwood Golf Classic The cost was allocated using mostly a composite rate which excluded the Parent company The Parent company should be included in the allocation as it would benefit the name recognition of event sponsorships

90 Ecomm was paid $13,800 for computer security The original allocation benefitted all companies except the Parent A reallocation was made so mainly the utility companies were charged It appears all companies whose records are kept on the computer system should be charged including the Parent These costs should be reallocated

91 Witness System was paid $40,098 for annual support All companies in the AGLR System would benefit from this cost Expand allocation to include the Parent company

92 McKenna, Long and Aldridge was paid $31,596 75 for Board of Directors matters, the AGLR Finance and Risk Committee, PWC engagement letter, etc The cost was allocated using mostly a

composite rate which excluded the Parent company The Parent company should be included in the allocation since these are corporate governance matters

93 Charitable Connections, Inc was paid $5,000 for the 2002 National Black Arts Festival and sponsorship of Kenny's Alley Stage and Blues Awards Show The cost was allocated using mostly a composite rate which excluded the Parent company The Parent company should be included in the allocation since it would benefit from name recognition at charitable events

94 Acxiom was paid $9235 71 for printing VNG invoices Several companies were charged It appears only VNG should be charged for the costs

95 Internal Revenue Service was paid $16,264 05 for penalty for underpayment of income taxes The cost was allocated using mostly a composite rate which excluded the Parent company Since the tax preparation is the responsibility of the service company, any late fees should be a shareholder costs and charged to the Parent company

96 Bernie Rose was paid $13,784 19 for vehicle property damage on a 1997 Ford Explorer This was allocated using mostly a composite ration which excluded the Parent company We are not sure why all companies are charged for this damage Explain this further

97 Nationwide was paid $3,388 54 for a vehicle claim All companies, except the Parent shared in this cost Explain this further

98 Strickland was paid $7,500 and Washington was paid $8,000 for a disability settlement The costs appeared to relate to a matter of AGLC A composite method was used which allocated costs to all companies except the Parent Please explain why costs should not be reallocated to AGLC

99 USAA was paid $18,950 15 for vehicle damages It appears this is an AGLC utility matter, but the costs were charged out to all companies Please explain why costs should not be reallocated to AGLC

100 Peeples Associates were paid $9,270 for project management and other work related to the AGLR com web site All companies in the system, including the Parent would benefit from this website, but the allocation only went to select companies

101 Weltner was paid $53,519 05 for professional services related to advertising It would appear all companies would benefit and should be allocated a portion of the charges AGLC and VNG were allocated the majority of the charges and the Parent company was excluded

102 Mark Jadwin of Millar & Mixon was paid $25,000 for settlement of personal property damage It appears from the "Release of Claims" that this was a AGLC utility matter A composite allocation was used that allocated to all companies except the Parent These costs should be reallocated to AGLC

103. The Georgia Department of Revenue was paid $28,564 16 related to Insurance premiums for excess liability, worker's compensation, directors and officers liability and fiduciary A composite method is used to allocate to all companies excluding the Parent Insurance benefits all companies and certainly the director's and officer's liability insurance directly applies to Parent company director's and officers Cost should be reallocated to include the Parent company

104. Dan Henning was paid $76,000 (two $38,000 invoices) He is a consultant and is acting Vice President of Human Resources for the AGLR System The costs were charged to affiliates with employees, to include, TRUS, VNGC, AGLN, SEQT, AGLC and CHAT The Vice President of Human Resource would make policy and coordinate personnel for the entire system The costs should be reallocated to include the Parent company and any other companies that was charged for payroll

105. Choicepoint Services was paid $4024 54 Choicepoint provides background investigations for interviewees and potential employees of the AGLR System These costs are allocated to those affiliates with employees that utilize information system services All companies in the system would benefit from information technology services, including the Parent, so therefore the costs should be reallocated

106. Sunguard was paid $9,084 for mainframe memory back up services The costs were charged to affiliates with employees that utilize information system services AGLN, AGLC, CHAT, SEQT, TRUS, and VNGC The mainframe supports all companies in a system, including the Parent company Costs should be reallocated

107. Avaya, Inc was paid for telephone services such as telephone equipment, voice mail, teleconferencing, and other telephone maintenance services These costs were charged to affiliates with employees that utilize the telecommunication services TRUS, VNGC, AGLI, AGLN, SEQT, AGLC, and CHAT All companies in a system, including the Parent, benefit for phone services and should be allocated some of the costs

108. United Way was paid for consultants associated with the United Way campaign United Way is a charitable organization that provides helpful services to the community AGLR uses the United Way as a channel for community involvement and fund raising The costs were charged out to virtually all companies in the system, except the Parent company The allocation should include the Parent company

Action Required:

The Examination Staff requires a new type of allocation method be developed (for example, see #1, 5, 10, 21, 37, etc.) that will fairly and equitably include the Parent company in the allocation of costs. In addition, there are several items above which must be reallocated based on improper coding. The items to be reallocated should be completed for all the costs paid to that vendor, not just the sample invoices we selected for review. Finally, due to the lack of a work order system, there are several items which were difficult to track to know how much of a particular costs was allocated to various companies.

__Finding 36 (Item 62)__

The Examination Staff reviewed Schedule XVII, Expense Distribution by Department or Service Function of the Form U-13-60 submission as of December 31, 2001, and we asked for a schedule or report that showed the amount that was direct billed (e.g. legal work performed for Atlanta Gas Light Company rate case) and the amount that was allocated to each associate company (e.g. legal work performed in reviewing executive compensation package) for each department, included in the schedule.

AGSC provided a schedule that showed the direct and indirect costs by department The Examination Staff reviewed the billings for fair and equitable allocation to all associate companies including the Parent Company In particular, the Examination Staff focused on the allocation of Corporate Governance costs These types of costs benefit the entire holding company system and should be fairly and equitably allocated to all associate companies For the most part, AGL Services allocated Corporate Governance costs based on the Composite Formula that allocated zero costs to AGLR and a minimal amount to non-utility companies In total, AGL Services billed $103,784,279 for the nine months ended 2001 to its customers of which only $839,833 or 008% of these costs were allocated to AGLR

Due to the regional scope/presence of the AGLR System, the Examination Staff believes an appropriate amount of certain Corporate Governance costs should be allocated to the holding company parent and non-utility companies These Corporate Governance costs include but are not limited to

1 The common officers of the service company and parent
2 Accounting– financial reporting and consolidation accounting
3 Strategic Planning
4 Legal
5 Human Resources/Benefits for corporate officers and directors
6 Advertising
7 Lobbying
8 Consolidated Taxes
9 Investor Relations
10 Finance

Action Required:

Section 13(b) of the Act requires a fair allocation of costs throughout a holding company system. It's the Examination Staff's position that AGSC has not selected a method to allocate Corporate Governance costs fairly and equitably to all associate companies including the Parent Company.

The following Corporate Governance activities benefit the entire AGLR System including the Parent and non-utility companies. We have established that none of these indirect costs have been charged to the Parent and non-utility companies. AGL Services should file with the Examination Staff a new allocation method that would allocate these Corporate Governance costs fairly and equitable to all associate companies including the Parent and non-utility companies. The 2001 costs should be reallocated based on the new method and all comparable future Corporate Governance costs should be allocated based on the same method. Also see Item 60 and Item 61.

Finding 37 (IER 65)

The AGL Service Company annual report filed on Form U-13-60 for the period ending September 30, 2001 reported Net Income of $209,673 in Schedule XV

The Examination Staff asked AGSC to provide information on how this income was earned and the components We also asked if AGSC had authority from the Commission that allows a return on capital

AGL Services Company's pool of costs to be charged back to the subsidiary companies of AGLR consists of operation and maintenance expenses, capitalized and distributed expenses, depreciation and amortization, taxes other than income and a cost of capital component However, the pool of costs does not include operating revenues and those items recorded to other income and expense

AGL Services Company's net income of $209,673 consists of the following components

Sources of Income

$	215,516	**Miscellaneous service revenue (Account # 488)**
$	4,050	**Rent from gas property (Account # 493)**
$	107,407	**Miscellaneous income or loss (Account # 421)**

$ 22,252	**Other utility operating income (Account #414)**
$ 115,634	**Interest and dividend income (Account # 419)**
$ 918,433	**Return on capital – See computation and discussion below**
$ 1,383,292	**Total Sources of Income**

Sources of Expense

$ 439,772	**Donations (Account # 426.1)**
$ 15,589	**Penalties (Account # 426.3)**
$ 299,114	**Expenditures for certain civic, political and related activities (Account # 426.4)**
$ 135,258	**Other deductions (Account #426.5)**
$ 4,963,849	**Income taxes, utility operating income (Account # 409.1)**
$(4,743,932)	**Provision for deferred income taxes, utility operating income (Account # 410.1)**
$ 13,668	**Miscellaneous production expense (Account # 735)**
$ 50,303	**Purchased gas expense (Account # 807)**
$ 1,173,619	**Total Sources of Expense**

$ 209,673	**Net Income**

The return on capital component of $918,433 is the difference between AGL Services Company's total compensation for use of capital (account number 457-3) of $3,113,399 charged back to the subsidiaries of AGLR and other interest expense (account number 431) of $2,194,966 incurred by AGL Services Company A return on capital component was computed and charged back to the subsidiaries because under Atlanta Gas Light Company's then effective rate order, Docket 8390-U, "Atlanta Gas Light Company's Filing of Election and Application for New Rates", a return on capital component was authorized by the Georgia Public Service Commission The authorized cost of capital component was based on Atlanta Gas Light Company's authorized cost of capital of 9 11% and the services company's net property, plant and equipment However, in connection with Atlanta Gas Light Company's rate proceeding in Docket 14311-U, "Earnings Review To Establish Just and Reasonable Rates for Atlanta Gas Light Company", the Company proposed that the cost of capital to be charged back by AGL Services Company be equal to AGL Services Company's interest expense consistent with other registered holding company systems under the Public Utility Holding Company Act of 1935 The Georgia Public Service Commission authorized and ordered such cost of capital to be equivalent to AGL Services Company's interest expense, which was implemented by AGL Services Company on May 1, 2002 (effective date of Docket 14311-U)

The only allowable income to be retained by the service company is the compensation of use of capital All other income items must be allocated out to the companies in the holding company system which received charges

On the expense side, all expenses have to charged out to the service company Since AGLR believes that expenses such as donations, civic, political and related costs, other deductions, etc are Parent company costs and should not be allocated to the various companies in the holding company system, these costs should be charged to the Parent company This same recommendation is made several times in the examination report Items such as income taxes should be allocated

Action Required:

The Examination Staff would like more information on the components of the miscellaneous service revenue ($215,516), and the miscellaneous income or loss ($107,407). All of the income items should not be retained by the service company except for the return on capital. All the expenses must be allocated to the Parent or other companies in the System. Please provide an accounting of the reallocation of the income and expenses for the period ending September 30, 2001 and for the period ending December 31, 2002.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
PUBLIC UTILITY REGULATION

April 23, 2004

Mr. Richard T. O'Brien
Executive Vice President and Chief Financial Officer
AGL Resources, Inc.
817 West Peachtree Street N.W.
Atlantic, Georgia 30308

RESPONSE OF THE OFFICE OF
PUBLIC UTILITY REGULATION
DIVISION OF INVESTMENT MANAGEMENT

AGL Services Company
("AGSC")

By your letters dated December 5, 2003, February 13, 2004, March 10, 2004 and April 8, 2004 (collectively "60-Day Letters"), AGSC, a wholly owned service company subsidiary of AGL Resources ("AGLR"), a registered holding company, notified the Commission that it proposes to modify its cost allocation methodology and the allocation method for Holding Company or Parent Company Costs.

The 60-Day Letters are a result of an Examination (Commission Staff letter of June 20, 2003) conducted by the Office of Public Utility Regulation that required AGSC to develop and adopt an allocation method to allocate a fair and equitable share of the following costs to the Parent: executive officer's salary and expenses, restricted stock expense for corporate executive officers, corporate governance costs, costs associated with the common officers of AGLR and AGSC, including incentive compensation, advertising costs, and cost of capital.

AGSC has implemented a Peoplesoft O&M Project Costing system. Actual payroll and related benefit costs will now be charged to work orders and charged to AGLR System companies, including the Parent.

The Composite Method, which is the ratio of the average of the following four ratios, Number of Employees, Total Assets, Operating Expenses, and Operating Margin will be revised to include the parent Company. The Parent's investment in its subsidiaries will be added into Total Assets, officers common to both AGLR and AGSC will be added to Number of Employees and dividends received from subsidiaries will be added into Operating Margin. Based on these changes, for the years ending September 30, 2001, December 31, 2001, December 31, 2002, and December 31, 2003, approximately \$4.0 million of costs will be reallocated to the Parent that was previously charged out to subsidiaries in the AGLR System. The revised Composite Method is effective beginning January 1, 2004. Please provide evidence to the Commission Staff of the reallocation by May 20, 2004.

AGL Resources has filed a declaration under file no. 70-10218 for the service company to provide services to SouthStar (at other than "at cost"). AGSC will need to incorporate SouthStar into the Composite Method and other appropriate allocation factors.

For the years prior to 2003 (back to September 30, 2001), incentive compensation and restricted stock for corporate executive officers should be analyzed and identified by first allocating based on the Hours Worked Ratio. Any remaining costs should be allocated based on the Composite Ratio. For incentive compensation and restricted stock expense for corporate executive officers for all years after 2003, AGSC is to charge back these costs based on how the corporate executive officers' salary was charged to the AGLR System Company work orders. Any remaining costs is to be allocated based on the Composite ratio.

It is our opinion, based on the particular facts and representations stated in your letters, AGSC proposal is consistent with the 60-Day Letter procedures authorized by the Commission in it's order dated October 5, 2000 (HCAR 27243) ("2000 Order"). Furthermore, it does not appear that a declaration is necessary with regard to the proposed changes.

Because this determination is based on the facts and representations in your letters, you should note that any different facts or circumstances might require a different conclusion. Pursuant to the 2000 Order, AGLR is required to give further written notification to the Commission with regard to any other changes in the organization of, method of allocation of, or in the scope and character of the services to be rendered by AGSC

Sincerely,

RPW

Robert P. Wason
Branch Chief, Auditing
And Financial Policy and
Chief Financial Analyst

Cc: Brian Little

Chattanooga Gas Company
Docket No. 04-00034
TRA FG- Item No.80
Date 2/2/2004
Page 1 of 1

FG-80

Provide a copy of any information filed with other Regulatory Commissions (other than the Tennessee Regulatory Authority) where such information describes the Company's debt position and equity position. Provide all data submitted in the last twelve-(12) months and also on a forward-going basis.

Response:

Attached are Schedules 3, 4 & 5 included in Virginia Natural Gas, Inc.'s (VNG) Annual Informational Filing Based on the 12 Months Ended September 30, 2002, filed April 8, 2003.

Schedule 3, page 1 of 3 Part A reflects the consolidated capital structure of AGL Resources. Parts B & C are based on the capital structure for regulatory reporting purposes for VNG. This capital structure is the capital structure of VNG's former parent company prior to AGL Resources Inc.'s acquisition of VNG in October 2000. Parts D&E represent the actual costs of AGLR Short term debt. Long term debt and Investment Tax Credits are 2002 AGLR actual costs adjusted to make the imputed costs equal to the capital structure approved for regulatory reporting purposes.

Schedule 3, page 2 of 3 is a reconciliation of the hypothetical capital structure to actual. The amounts of Short Term Debt, Long Term Debt, and Common Equity reflected in column 2 have been adjusted to include an allocated portion of Investment Tax Credit.

Schedule 3 page 3 is the development of hypothetical capital structure used for ratemaking purposes.

Schedule 4 is the Embedded Cost of Long-Term Debt at September 30, 2002.

Schedule 5 is the Schedule of Short-Term Debt outstanding at September 30, 2002.

AGL RESOURCES, INC.
CAPITAL STRUCTURE AND COST OF CAPITAL STATEMENT - PER BOOKS AND AVERAGE
CASE NO. PUE-2003-00004

	(1) 1998	(2) 1999	(3) 2000	(4) 2001	(5) Test Year Ended Sep. 30, 2002	(6) Average*
A. Capital Structure Per Balance Sheet ($000's)						
Short Term Debt	$76,500	$1,500	$141,200	$303,400	$320,200	$327,300
Other Current Liabilities	$0	$0	$0	$0	$0	$0
Long Term Debt	$660,000	$660,000	$610,000	$890,000	$845,000	$867,500
Preferred Stock	$74,300	$74,300	$74,300	$219,900	$225,506	$220,450
Common Equity	$654,100	$661,500	$620,900	$671,400	$732,105	$722,425
Investment Tax Credits	$12	$67	$35	$13	$2	$26
Other Deferred Credits	$0	$0	$0	$0	$0	$0
Other Liabilities	$0	$0	$0	$0	$0	$0
Total Capitalization	$1,464,912	$1,397,367	$1,446,435	$2,084,713	$2,122,814	$2,137,701 A - Includes Preferred Stock
B. Capital Structure for Ratemaking Purposes ($000's)						
Short Term Debt	$142,172	$154,467	$185,243	$204,548	$208,286	$209,747
Long Term Debt	$503,715	$527,003	$544,422	$778,019	$792,238	$797,794 A x B
Investment Tax Credits	$8,269	$5,834	$5,724	$10,319	$10,508	$10,581
Cost Free Capital	$0	$0	$0	$0	$0	$0
Common Equity	$810,756	$710,063	$711,047	$1,091,827	$1,111,782	$1,119,579
Total Capitalization	$1,464,912	$1,397,367	$1,446,435	$2,084,713	$2,122,814	$2,137,701
C. Capital Structure Weights for Ratemaking Purposes (%)						
Short Term Debt	9 705%	11 054%	12.807%	9 812%	9 812%	9 812%
Long Term Debt	34 385%	37 714%	37 639%	37 320%	37 320%	37 320% B
Investment Tax Credits	0 564%	0 417%	0 396%	0 495%	0 495%	0 495%
Cost Free Capital	0 000%	0 000%	0 000%	0 000%	0 000%	0 000%
Common Equity	55 345%	50 814%	49 159%	52 373%	52 373%	52 373%
Total Capitalization	100 000%	100 000%	100 000%	100 000%	100 000%	100 000%
D. Component Capital Cost Rates (%)						
Short Term Debt	5 210%	5 800%	6 480%	5 190%	2 623%	2 623%
Long Term Debt	7 110%	7 100%	7 110%	7 089%	7 756%	7 756%
Investment Tax Credits	9 440%	9 280%	9 250%	9 315%	9 592%	9 827%
Cost Free Capital	0 000%	0 000%	0 000%	0 000%	0 000%	0 000%
Common Equity	10 900%	10 900%	10 900%	10 900%	10 900%	10 900%
E. Component Weighted Cost Rates (%)						
Short Term Debt	0 510%	0 640%	0 830%	0 509%	0 257%	0 257%
Long Term Debt	2 440%	2 680%	2 680%	2 646%	2 895%	2 895%
Investment Tax Credits	0 050%	0 040%	0 040%	0 046%	0 049%	0 049%
Cost Free Capital	0 000%	0 000%	0 000%	0 000%	0 000%	0 000%
Common Equity	6 030%	5 540%	5 360%	5 709%	5 709%	5 709%
Total Capitalization	9 030%	8 900%	8 910%	8 910%	8 910%	8 910%

* Column 6 of Part A is the average capital structure from the most recent AGL Resources (AGLR) four quarters
Column 6 of Parts B and C are based on a hypothetical Consolidated Natural Gas Company (CNG) capital structure
Column 6 of Parts D and E represent the actual costs for AGLR short term debt. Long term debt and Investment Tax Credits are 2002 AGLR actual costs adjusted to make the imputed costs equal to the hypothetical CNG capital structure

Chattanooga Gas Company
TRA Econ # 1
Data Request No. 2
Docket Number 04-00034
5/3/2004
Page 1 of 1

Data Request No. 2

You provide your Capital Structure and Cost of Capital Statement in Data Response No. 80 on a consolidated basis. Provide this same schedule for the year ended December 31, 2003.

Response:

Attached are Schedules 3, 4 & 5 included in Virginia Natural Gas, Inc.'s (VNG) Annual Informational Filing Based on the 12 Months Ended December 31, 2003, filed April 29, 2004.

Schedule 3, page 1 of 3 Part A reflects the consolidated capital structure of AGL Resources. Parts B & C are based on the capital structure for regulatory reporting purposes for VNG. This capital structure is the capital structure of VNG's former parent company prior to AGL Resources Inc.'s acquisition of VNG in October 2000 Parts D&E represent the actual costs of AGLR Short term debt. Long term debt and Investment Tax Credits are 2003 AGLR actual costs adjusted to make the imputed costs equal to the capital structure approved for regulatory reporting purposes.

Schedule 3, page 2 of 3 is a reconciliation of the hypothetical capital structure to actual. The amounts of Short Term Debt, Long Term Debt, and Common Equity reflected in column 2 have been adjusted to include an allocated portion of Investment Tax Credit.

Schedule 3 page 3 is the development of hypothetical capital structure of VNG's former parent, used for ratemaking purposes.

Schedule 4 is the Embedded Cost of Long-Term Debt at December 31, 2003.

Schedule 5 is the Schedule of Short-Term Debt outstanding at December 31, 2003.

AGL RESOURCES, INC.
CAPITAL STRUCTURE AND COST OF CAPITAL STATEMENT - PER BOOKS AND AVERAGE
Based on the Twelve Months Ended December 31, 2003

Schedule 3
Page 1 of 3

	(1) 1999	(2) 2000	(3) 2001	(4) 2002	(5) Test Year Ended Dec. 31, 2003	(6) Average*
A. Capital Structure Per Balance Sheet ($000's)						
Short Term Debt	$1,500	$141,200	$303,400	$320,200	$308,426	$173,767
Other Current Liabilities	$0	$0	$0	$0		$0
Long Term Debt	$660,000	$610,000	$890,000	$845,000	$806,621	$813,671
Preferred Stock	$74,300	$74,300	$219,900	$225,506	$221,845	$221,443
Common Equity	$681,500	$620,900	$671,400	$732,105	$985,689	$956,236
Investment Tax Credits	$67	$35	$13	$2		$29
Other Deferred Credits	$0	$0	$0	$0		$0
Other Liabilities	$0	$0	$0	$0		$0
Total Capitalization	$1,397,367	$1,446,435	$2,084,713	$2,122,814	$2,320,681	$2,165,146 (A) Includes Preferred Stx
B. Capital Structure for Ratemaking Purposes ($000's)						
Short Term Debt	$154,467	$185,243	$204,548	$208,286	$227,691	$212,440
Long Term Debt	$527,003	$544,422	$778,019	$792,238	$866,046	$808,037 (A) x (B)
Investment Tax Credits	$5,834	$6,724	$10,319	$10,508	$11,487	$10,717
Cost Free Capital	$0	$0	$0	$0	$0	$0
Common Equity	$710,063	$711,047	$1,091,827	$1,111,782	$1,215,358	$1,133,952
Total Capitalization	$1,397,367	$1,446,435	$2,084,713	$2,122,814	$2,320,581	$2,165,146
C. Capital Structure Weights for Ratemaking Purposes (%)						
Short Term Debt	11 054%	12 807%	9 812%	9 812%	9 812%	9 812%
Long Term Debt	37 714%	37 639%	37 320%	37 320%	37 320%	37 320% (B)
Investment Tax Credits	0 417%	0 398%	0 495%	0 495%	0 495%	0 495%
Cost Free Capital	0 000%	0 000%	0 000%	0 000%	0 000%	0 000%
Common Equity	50 814%	49 159%	52 373%	52.373%	52 373%	52.373%
Total Capitalization	100 000%	100 000%	100 000%	100 000%	100 000%	100 000%
D. Component Capital Cost Rates (%)						
Short Term Debt	5 800%	6 480%	5 190%	2 623%	2 532%	2.532%
Long Term Debt	7 100%	7 110%	7 089%	7 756%	7 783%	7 783%
Investment Tax Credits	9 280%	9 250%	9 315%	9 592%	9 603%	9 603%
Cost Free Capital	0 000%	0 000%	0 000%	0 000%	0 000%	0 000%
Common Equity	10 900%	10 900%	10 900%	10 900%	10 900%	10 900%
E. Component Weighted Cost Rates (%)						
Short Term Debt	0 640%	0 830%	0 509%	0 257%	0 248%	0 248%
Long Term Debt	2 680%	2 680%	2.646%	2 895%	2 905%	2 905%
Investment Tax Credits	0 040%	0 040%	0 046%	0 049%	0 048%	0 048%
Cost Free Capital	0.000%	0 000%	0 000%	0 000%	0 000%	0 000%
Common Equity	5 540%	5 360%	5 709%	5 709%	5 709%	5 709%
Total Capitalization	8 900%	8 910%	8 910%	8 910%	8 910%	8 910%

* Column 6 of Part A is the average capital structure from the most recent AGL Resources (AGLR) four quarters
Column 6 of Parts B and C are based on a hypothetical Consolidated Natural Gas Company (CNG) capital structure
Column 6 of Parts D and E represent the actual costs for AGLR short term debt Long term debt and Investment Tax Credits are 2003 AGLR actual costs adjusted to make the imputed costs equal to the hypothetical CNG capital structure

Chattanooga Gas Company
Statement of Income with Proposed Rate Adjustment - Revised
Twelve Months Ended June 30, 2005 (Attrition Period)

Line No.	Description		1 Pro Forma Attrition Period	2 Proposed Rate Adjustments		3 Attrition Period with Rate Adjustment	
1	Revenues - Sales of Gas		$92,444,773	$3,645,575	(A)	$96,090,348	
2	Cost of Gas		63,221,551			63,221,551	
3	Base Revenues		29,223,222	3,645,575		32,868,797	
4	Other Revenues		973,248	81,079	(B)	1,054,327	
5	AFUDC		142,441	-		142,441	
6	Total Operating Revenues		30,338,911	3,726,655		34,065,566	
7	Operation and Maintenance Expense		13,602,586	37,488	(C)	13,640,074	
8	Depreciation Expense		5,194,810	-		5,194,810	
9	Interest on Customer Deposits		112,191	-		112,191	
10	Taxes Other than Federal Income		3,419,475	-		3,419,475	
11	Income Taxes		1,811,965	1,447,264	(D)	3,259,229	(E)
12	Total Operating Expenses		$24,141,027	$1,484,752		$25,625,778	
13	Operating Income for Return		$6,197,884	$2,241,903		$8,439,787	
14	Rate Base	(F)	$95,473,111			$95,473,111	
15	Rate of Return	(G)	6 49%			8 84%	

(A) MJM 7-2 Line 10

(B) MJM 7-2 Line 11 + Line 14

(C) MJM 7-2 Line 12 x MJM 7-3 Line 4

(D) Line 11, Column 3 - Column 1

(E) MJM 7-4 Line 21

(F) MJM 7-6 Line 9

(G) Line 13/Line 14

Docket No. 04-00034
Rebuttal Testimony
Exhibit - MJM 7-2

Chattanooga Gas Company
Revenue Adjustment Calculation - Revised
For the Twelve Months Ending June 30, 2005 (Attrition Period)

Line No.		Amount	
1	Rate Base	$95,473,111	(A)
2	Operating Income at Present Rates	6,197,884	(B)
3	Earned Rate of Return	6 49%	(C)
4	Proposed Rate of Return	8 84%	(D)
5	Required Operating Income	8,439,823	(E)
6	Operating Income Deficiency	2,241,939	(F)
7	Gross Revenue Conversion Factor	165 213%	(G)
8	Revenue Deficiency	$3,703,975	
9	Components of Revenue Deficiency		
10	Revenues - Sales of Gas	3,645,575	
11	Other Revenues	58,400	
12	Total Revenue Deficiency	$3,703,975	
13	Forfeited Discount Ratio	0 6123%	(H)
14	Forfeited Discount	$22,679	(I)

(A) MJM 7-6 Line 9

(B) MJM 7-1 Line 13, Column 1

(C) Line 2/Line 1

(D) Direct Testimony - MJM-4, Schedule 1, Line 6

(E) Line 4 x Line 1

(F) Line 5 - Line 2

(G) MJM 7-3 Line 10

(H) MJM 7-3 Line 2

(I) Line 12 * Line 13

Docket No. 04-00034
Rebuttal Testimony
Exhibit - MJM 7-3

Chattanooga Gas Company
Revenue Conversion Factor
For the Twelve Months Ending June 30, 2005 (Attrition Period)

Line No.	Revenue Conversion Factor	Rate		Balance
1	Operating Revenues			100.000%
2	Add Forfeited Discount Ratio	0 6123%	(A)	0 006123
3	Balance			1 006123
4	Deduct: Uncollectible Ratio	1 0121%	(B)	0 010183
5	Balance			0 995939
6	Deduct State Excise Tax Rate	6 5000%	(C)	0 064736
7	Balance			0 931203
8	Deduct Federal Income Tax	35 0000%	(C)	0 325921
9	Retention Factor			60 528%
10	Revenue Conversion Factor			165 213%

(A) Revenue Workpapers

(B) Operating Expenses Workpapers

(C) Statutory Rates

Docket No. 04-00034
Rebuttal Testimony
Exhibit - MJM 7-4

Chattanooga Gas Company
Tennesse Excise and Federal Income Taxes - Revised
Twelve Months Ended June 30, 2005 (Attrition Period)

Line No.	Description	(A) Attrition Period at Current Rates	(A) Attrition Period at Proposed Rates
1	Revenues - Sales of Gas	$92,444,773	$96,090,348
2	Cost of Gas	63,221,551	63,221,551
3	Base Revenues	29,223,222	32,868,797
4	Other Revenues	973,248	1,054,327
5	AFUDC	142,441	142,441
6	Total Operating Revenues	30,338,911	34,065,566
7	Operation and Maintenance Expense	13,602,586	13,640,074
8	Depreciation Expense	5,194,810	5,194,810
9	Interest on Customer Deposits	112,191	112,191
10	Taxes Other than Federal Income	3,419,475	3,419,475
11	Net Operating Income Before Interest and Income Taxes	$8,009,849	$11,699,016
12	Interest Expense	3,398,843	3,398,843 (B)
13	Net Income Before Income Taxes	$4,611,007	$8,300,173
14	Permanent Adjustments to Book Income	8,407	8,407
15	Net Taxable Income	4,619,414	8,308,580
16	Excise Tax Rate	6 50%	6 50%
17	Excise Tax	$300,262	$540,058
18	Federal Taxable Income	$4,319,152	$7,768,522
19	Federal Income Tax Rate	35%	35%
20	Federal Income Tax Expense	$1,511,703	$2,719,171
21	Tennessee Excise and Federal Income Tax Expense	$1,811,965	$3,259,229

(A) MJM 7-1 (except line 10 - see(B) below))

(B) Direct Testimony - MJM-3, Schedule 1, Line 9 x MJM-4, Schedule 1, Line 4

Docket No. 04-00034
Rebuttal Testimony
Exhibit - MJM 7-5

Chattanooga Gas Company
Adjustments to Operating Expenses
Twelve Months Ended June 30, 2005 (Attrition Period)

	Description		
1	Payroll	(A)	(81,942)
2	Bad Debt Expense	(B)	(639,865)
3	Administrative and General - Benefits expense realted to above payroll adjustment	(A)	(5,228)
4	Administrative and General - Other Post Retirement Benefits		(108,779)
5	Total Adjustment to Operations and Maintenance Expense		(835,814)
6	Operation and Maintenance Expense - Direct Testimony		14,438,400
7	Revised Operation and Maintenance Expense		**13,602,586**
8	Taxes Other than Income	(A)	(6,269)
9	Taxes Other than Income - Direct Testimony		3,425,744
10	Revised Taxes Other than Income		**3,419,475**

(A)	Rebuttal Testimony - Exhibit MJM 2-1	
(B)	Gas Revenues - Direct Testimony - Exhibit MJM-1, Schedule 1	63,221,551
	Estrimated percent of gas included in revenues	1 0121%
	Bad debt expense reduction	639,865

Docket No. 04-00034
Rebuttal Testimony
Exhibit - MJM 7-6

Chattanooga Gas Company
Average Rate Base
For the Twelve Months Ending June 30, 2005 (Attrition Period)

Line No.		Attrition Period	
1	Utility Plant in Service	$164,561,353	(A)
2	Construction Work In Progress	3,544,977	(A)
3	Working Capital Requirement	13,134,372	(B)
		$181,240,702	
	Less		
4	Accumulated Provision For Depreciation	$71,307,914	(A)
5	Accumulated Deferred Income Taxes	12,012,158	(A)
6	Contributions in Aid of Construction	2,161,125	(A)
7	Customer Advance For Construction	286,394	(A)
8	Total Deductions	$85,767,591	
9	Rate Base	$95,473,111	

(A) Rate base work papers

(B) MJM 7-7 Line 12

Docket No. 04-00034
Rebuttal Testimony
Exhibit - MJM 7-7

Chattanooga Gas Company
Working Capital Requirement
For the Twelve Months Ending June 30, 2005 (Attrition Period)

Line No.		Attrition Period	
1	Requirement For Lead Lag	$1,542,309	(A)
2	Materials and Supplies	170,409	(B)
3	Stored Gas Inventory	14,193,526	(B)
4	Prepayments	20,358	(B)
5	Other Accounts Receivable	57,547	(B)
6	Deferred Rate Case	250,000	
7	Total Additions	$16,234,149	
8	Reserve for Uncollectibles Accounts	$435,822	(B)
9	Customer Deposits	1,869,853	(B)
10	Accrued Interest on Customer Deposits	794,102	(B)
11	Total Deductions	$3,099,777	
12	Working Capital Requirement	$13,134,372	

(A) MJM 7-7 Line 25

(B) Working capital work papers

Docket No. 04-00034
Rebuttal Testimony
Exhibit - MJM 7-8

Chattanooga Gas Company
Lead Lag Requirement After Revenue Adjustment
For the Twelve Months Ending June 30, 2005 (Attrition Period)

Line No.		Required Income Statement Attrition Period	Lag Days	$ Days
1	Revenues	$ 97,287,306	46.05	4,480,080,434
2	Gas Purchased	$ 63,221,551	39.66	2,507,366,719
3	Salary and Wages	2,889,643	12.00	34,675,710
4	Pension	155,166	166.56	25,844,449
5	Insurance Expense	47,780	-	
6	Allocated Cost	7,019,019	38.71	271,706,225
7	Uncollectibles	360,718		
8	Other Operating	3,167,618	34.64	109,726,288
9	Depreciation and Amortization	5,194,810	-	-
10	Taxes - Other Than Income Tax	3,419,475	177 78	607,914,266
11	SIT Current	421,251	59.25	24,959,130
12	SIT Deferred	118,828	-	-
13	FIT Current	1,704,554	37.75	64,346,919
14	FIT Deferred	1,014,537	-	-
15	Interest on Customer Deposits	112,191	-	-
16	Interest ST Debt	114,572	(23 34)	(2,674,118)
17	Interest LT Debt	2,577,877	93.38	240,732,507
18	Preferred Dividends	706,529	66.18	46,757,407
19	Equity Return	5,041,183	-	-
20	Total Operating Funds	$ 97,287,303	40 41	$ 3,931,355,503
21	Net Lead (Lag) Days		5 6	
22	Average Daily Operating Expenses			$ 266,541
23	CWC Required for Operating Expenses			1,503,356
24	Tax Collections Withheld			38,953
25	Net Cash Working Capital Provided			$ 1,542,309

Docket No. 04-00034
Rebuttal Testimony
Exhibit - MJM 8-1

Chattanooga Gas Company
Comparison of CAPD and CGC Cases
For the Twelve Months Ending June 30, 2005 (Attrition Period)

1	CGC Revised Revenue Deficiency		$3,703,975
2	CAPD Recommendation - Revenue Reduction		($2,572,230)
3	CGC Proposed overall Rate of Return		8.84%
4	CAPD Recommended Overall Rate of Return		6.72%
5	CGC Proposed Return on Equity		11.25%
6	CAPD Recommended Return on Equity		8.35%
	Capital Structure - Equity		
7	CGC		46.89%
8	CAPD		42.50%

Reconciliation of Revenue Deficiency/Reduction

9	Proposed Rate Increase - CGC		3,703,975
10	Sequent Related Costs - CAPD		(2,369,939)
11	Bad Debt Expense Adjustment - CAPD Adjustment	(615,976)	
12	Bad Debt Expense Adjustment - CGC Adjustment	639,865	
13	Net Difference		23,889
14	Salary and Wages, plus related benefits and taxes - CAPD Adjustment	(344,521)	
15	Salary and Wages, plus related benefits and taxes - CGC Adjusment	93,439	
16	Net Difference		(251,082)
17	Allocations (Sharing of VNG Savings) - CAPD		(533,803)
18	Rate Case Amortization - CAPD		(100,000)
19	CGC Reduction for other post retirement benefits		108,779
20	Rate Base (CGC $95,473,111 CAPD $94,939,114) - $533,997		(77,989)
21	**CAPD Revenue Adjustment - Before Cost of Capital Impact**		**$503,830**
	Cost of Capital Impact on Revenue Requirement		
22	Weighted cost of Debt		(370,263)
23	Weighted cost of Equity		(2,713,535)
24	**Total Capital Structure and Cost of Capital**		**(3,083,798)**
25	**Reconciled CGC with CAPD adjustments**		**(2,579,968)**
26	**As Recommended by the CAPD**		**(2,572,230)**
27	**Unreconciled difference**		**(7,738)**

Docket No. 04-00034
Rebuttal Testimony
Exhibit - MJM 8-2

Chattanooga Gas Company
Comparison of CAPD and CGC Cases
For the Twelve Months Ending June 30, 2005 (Attrition Period)

CAPDCapital Structure And Cost of Capital

	Ratio	Cost	Weighted Costs
Long Term Debt	44 60%	6 74%	3 01%
Short Term Debt	12.90%	1 26%	0 16%
Preferred Stock	0 00%	0 00%	0.00%
	57 50%		3 17%
Stockholder's Equity	42 50%	**8.35%**	3 55%
Total	100 00%		**6.72%**

CGC Capital Structure and Cost of Capital

Long Term Debt	40 10%	6 74%	2 70%
Short Term Debt	4 31%	2 69%	0 12%
Preferred Stock	8 70%	8 54%	0 74%
Total Debt	53 11%		3 56%
Common Equity	46 89%	**11.25%**	5 28%
	100 00%		**8.84%**