IN THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	'04 NOV 12 PM 1 46
APPLICATION OF CHATTANOOGA	)	
GAS COMPANY, A DIVISION OF	)	
PIEDMONT NATURAL GAS COMPANY,	)	TN REGULATORY AUTHORITY DOCKET ROOM
INC., FOR AN ADJUSTMENT OF ITS	)	**DOCKET NO. 04-00034**
RATES AND CHARGES, THE	)	
APPROVAL OF REVISED TARIFFS AND	)	
APPROVAL OF REVISED SERVICE	)	
REGULATIONS	)	
	)	

CONSUMER ADVOCATE'S RESPONSE TO CHATTANOOGA GAS'S PETITION FOR RECONSIDERATION

Comes Paul G. Summers, Attorney General for the State of Tennessee, through the Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate"), and hereby files its response to Chattanooga Gas's Petition for Reconsideration of the Authority's October 20, 2004 Order. In its Petition for Reconsideration, Chattanooga Gas sets forth three areas of concern with the TRA order: (1) the overall rate of return is too low; (2) the capital structure is inaccurate; and (3) the return on equity is too low. As will be shown below, Chattanooga Gas's allegations are without merit and the Consumer Advocate will establish the following:

1. The overall rate of return approved by the TRA is reasonable and supported by the evidence.

2. The capital structure approved by the TRA is reasonable and supported by the evidence.

3. The return on equity approved by the TRA is reasonable and supported by the evidence.

Finally, if the TRA does decide to re-open this case, the Consumer Advocate reserves the right to ask the TRA to reconsider other aspects of the decision. First, the Consumer Advocate believes that the treatment of the $2,360,317 in profits made by Chattanooga Gas's affiliate, Sequent Energy Management, should be re-examined. In addition, if Chattanooga Gas is allowed to re-configure the capital structure, it is only fair that the Consumer Advocate be allowed to put forth arguments as to how the cost of each of the components is to be established. A motion for reconsideration should not be allowed to address only those things that Chattanooga Gas doesn't agree with; if the verdict is to be re-examined, all related aspects must be considered.

I. THE OVERALL RATE OF RETURN APPROVED BY THE TRA IS REASONABLE AND SUPPORTED BY THE EVIDENCE

First, it should be noted that the overall rate of return approved by the TRA (that is, the percentage Chattanooga Gas will be authorized to earn on its investment) is well within the range of figures supported by the evidence in this case. The TRA found an overall rate of return of 7.43%. The Consumer Advocate proposed a figure of 6.72%. Chattanooga Gas proposed a figure of 8.84%. Thus, the TRA's overall result is clearly within the range of the figures proposed by the two parties. Clearly, Chattanooga Gas has not established that the TRA's decision on the overall rate of return, which is, after all, the key figure in this case, is outside the "zone of reasonableness" established by Tennessee courts as the standard of review for agency decisions setting rates for utilities. CF Industries v. Tennessee Public Service Commission, 599

S.W.2d 536, 543 (1980). In CF Industries the Court held as follows:

> On fixing rates in general the Court has spoken in terms of what is just and reasonable "under the proven circumstances," of "regard to all relevant facts" and to a rate "in the zone of reasonableness." Southern Bell Telephone & Telegraph Co. v Tennessee Public Service Comm'n, 202 Tenn. 465, 304 S.W.2d 640 (1957).

599 S.W.2d at 543.

Moreover, Consumer Advocate witness Dr. Steve Brown testified that the Consumer Advocate proposed figure of a 6.72% overall rate of return, i.e., overall cost of capital (equity and debt), was consistent with the leading cases establishing the standards for just and reasonable rates, Bluefield Water Works & Improvement Co. v. Public Service Comm'n of West Virginia, 262 U S. 679 at 692-93, 43 S.Ct. 675 (1923) and FPC v Hope Natural Gas Co., 320 U.S. 591 at 605, 64 S.Ct. 281 (1944). See Testimony of Dr. Steve Brown, Hearing Transcript, Vol. VI (August 25, 2004) at pages 10-11.

Accordingly, it appears that Chattanooga Gas's main complaint in its Petition for Reconsideration is not with the result of this case but with the mechanics of how that result was achieved. As will be shown below, however, Chattanooga Gas's allegations that the TRA was deficient in its support of the overall result are without merit. If anything, the result of the findings produce a return which is more than reasonable.

II. THE CAPITAL STRUCTURE APPROVED BY THE TRA IS REASONABLE AND SUPPORTED BY THE EVIDENCE

Chattanooga Gas appears to be shocked that the TRA did not adopt verbatim the capital structure proposed by either the Company or the Consumer Advocate. Frankly, even though the Consumer Advocate has full confidence in the capital structure it proposed, the Consumer

Advocate would have been surprised if the TRA had merely rubber-stamped the structure it proposed or the one proposed by Chattanooga Gas.

Thus, instead of merely copying either of the two proposed capital structures, the TRA developed its own. Bizarrely, Chattanooga now claims that because the TRA used its own expertise to develop a capital structure, Chattanooga Gas was somehow deprived of an "opportunity to provide rebuttal testimony, cross-examine the proponent of the structure, or otherwise provide evidence relative to the proposal." Chattanooga Gas's Petition for Reconsideration at page 8. It is well recognized, however, that "in rate making and design cases [the TRA] is not solely governed by the proof although, of course, there must be an adequate evidentiary predicate." C.F. Indus., 599 S.W.2d at 543. It was not the TRA who initiated this proceeding and had the obligation of presenting a capital structure as part of its case. By the very nature of a contested case proceeding the TRA can put forth its finding as to the capital structure only after the proof has closed, so there can never, by definition, be any rebuttal or cross-examination of the TRA's findings. Here, the TRA has sifted through the evidence and, as required, based its decision upon the record. Moreover, Chattanooga Gas was fully aware before the hearing of the data used by the TRA; accordingly, Chattanooga Gas's complaints that it did not have an opportunity to provide evidence with regard to the TRA ruling are without merit.

Following is the capital structure as proposed by Chattanooga Gas and the Consumer Advocate, and as found by the TRA:

Line No.	Capital Structure Component	Ratio		
		CGC	CAPD	TRA
1	Short -Term Debt	4 3%	12 9%	16.4%
2	Long -Term Debt	40 1%	44 6%	37.9%
3	Preferred Stock	8 7%	0 0%	10.2%
4	Total Debt	53 1%	57 5%	64.5%
5	Common Equity	46 9%	42 5%	35.5%
6	Total Capitalization	100%	100%	100%

In his pre-filed testimony, Consumer Advocate witness Dr. Steve Brown set forth an exhibit which showed that he derived his proposed capital structure from the three year average (2001, 2002 and 2003) of the capital structure of ten comparable companies. Exhibit CAPD SB Schedule 3. This use of a three year average to derive a capital structure (as distinguished from the choice of companies upon which the average is based) was not disputed by Chattanooga Gas at the hearing.

Dr. Brown also testified that the TRA should disregard the capital structure as proposed by Chattanooga Gas witness Dr. Morin "because it is neither representative of the comparable companies nor representative of CGC's likely future behavior." Steve Brown Direct Testimony at page 28.

The capital structure as set forth by the TRA is consistent with the use of a three year average as proposed by Dr. Brown and also recognizes the need to capture, in Dr. Brown's words, "CGC's likely future behavior." The TRA, however, based its three year average on

AGLR itself rather than on the ten comparable companies. Chattanooga Gas now appears to be arguing that the TRA capital structure is not consistent with the "Attrition Period, CGC's Last Rate Case, or Other TRA Orders." Petition for Reconsideration at page 3. Such a belated objection, long after the proof has been closed and witnesses are no longer available for questioning, should not be allowed to overturn the decision in this case.

The use of a three year average is also supported by the fact that there was a great deal of uncertainty as to exactly what AGLR's capital structure would be in the near future. Several key points on this subject are referred to in the TRA Order at pages 57-58, including the questions of whether AGLR would issue any new stock in the rate-effective period and how the pending purchase of NUI Corporation, another gas distribution company, by AGLR would affect the capital needs of AGLR. TRA Order at page 58 ("During the hearing, CGC's witnesses were asked questions about the impending acquisition of NUI Corporation by AGLR. None of the witnesses mentioned that AGLR planned to issue new stock during the acquisition.") (footnote omitted).

In addition, the capital structure set forth by the TRA is, contrary to Chattanooga Gas's assertion, consistent with prior TRA decisions. In its Petition for Reconsideration at page 2, Chattanooga Gas states that the TRA capital structure is not "consistent with a prior CGC case, i.e., TRA Docket No. 97-00982 and other previous decisions of the Tennessee Public Service Commission ("TPSC"). " However, the TRA capital structure in the present case is clearly consistent with these prior decisions in that they use the capital structure of the parent company rather than the "stand alone" approach advocated by Chattanooga Gas whereby a subsidiary such as Chattanooga Gas would be given a completely unverified, hypothetical capital structure

which completely ignores the economic reality of the parent-subsidiary relationship that exists between Chattanooga Gas and AGLR. *See* TRA Order at pages 43-44.

Furthermore, just because the TRA used a three year average of parent AGLR's capital structure rather than a snapshot on a date named by CGC, does not mean that the capital structure is "inconsistent" with prior decisions. As stated above, in this particular case, given the difficulty of ascertaining financial information on any given day, the use of an average is quite reasonable.

In conclusion, there is more than sufficient evidence in the record to support the standard set forth in the case cited by Chattanooga Gas at page 8 of its Petition, Steele v. Metropolitan Board of Zoning Appeals, 1986 WL 3985 (Tenn.Ct.App.), at page 3, in which the Court held:

> As a general rule, for reasons as fundamental as due process, an agency may not base its decision on evidence outside the record.

In particular, the evidence of the AGLR capital structure is in the record and the methodology of taking a three year average, as well as reasons for taking an average rather than a snapshot in time, are also in the record.

The TRA, therefore, should deny Chattanooga Gas's request to overturn the capital structure as reflected in the TRA order.

III. THE RETURN ON EQUITY APPROVED BY THE TRA IS REASONABLE AND SUPPORTED BY THE EVIDENCE

The TRA found the return on equity to be 10.2%. Chattanooga Gas requested a return on equity of 11.25%. The Consumer Advocate proposed a return of 8.35%. See TRA Order at page 59. Chattanooga Gas has not established that the TRA's figure for return on equity is outside the "zone of reasonableness" standard set forth in CF Industries v. Tennessee Public Service Commission, 599 S.W.2d 536, 543 (1980).

In its Petition for Reconsideration, Chattanooga Gas refers to one of its discovery responses in which it set forth several recent findings of equity returns from other states. Petition for Reconsideration at page 12. Chattanooga Gas never established the relevance of this information and it is notoriously difficult to compare selected findings from other states to the proof developed in this hearing in which the TRA staff and Directors were able to hear and observe the witnesses. Furthermore, of the seven companies listed in this information, only one has been identified as a comparable company.

The Consumer Advocate would also note that Chattanooga Gas's argument concerning this information is flawed. In its Petition for Reconsideration, Chattanooga Gas states that of the seven gas utility decisions prior to the TRA Order, "only one was lower than 10.20% with six (6) of the decisions being higher." Petition for Reconsideration at page 12. However, this same exhibit to the discovery response referred to by Chattanooga Gas also reveals that five of the equity returns were below the 11.25% figure proposed by Chattanooga Gas. There are four decisions which are within the range of 10.9% and 10.0%. And there is only one decision above 11.25%. Thus, the 10.20% return on equity is actually within the range of the extremes of these findings by other state commissions whose relevance has not been established by Chattanooga Gas. So looked at from another angle, this information supports the findings of the TRA.

Furthermore, in response to arguments raised by Chattanooga Gas, the Consumer Advocate introduced evidence of numerous utilities which had an equity return lower than the 10.2% figure found by the TRA. See Testimony of Dr. Steve Brown, Hearing Transcript, Vol.VI (August 25, 2004) at page 26 and the list of companies with their recently determined rates of return provided to the TRA on August 25, 2004, attached hereto as **Exhibit 1**. It is, of course,

virtually impossible to compare the circumstances in other states with the situation of Chattanooga Gas in Tennessee, but since a Chattanooga Gas witness referred to other states and the TRA has considered this information, the Consumer Advocate is compelled to respond. As can be seen from this list of companies attached hereto as **Exhibit 1**, the TRA's decision with regard to equity is not at all unreasonably low as argued by Chattanooga Gas.

In summary, the TRA's capital structure is sound, the cost of equity is also sound, and both should be upheld.

CONCLUSION

For the foregoing reasons, the TRA should uphold its Order of October 20, 2004 and deny Chattanooga Gas's Petition for Reconsideration.

RESPECTFULLY SUBMITTED,

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CERTIFICATE OF SERVICE

I hereby certify that a true and exact copy of the foregoing has been served via the methods indicated on this 12th day of March, 2004, to the following:

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West Va American Water	7 00	West VA	Case 03-0353-W-42T
Chazy & Westport Telephone	8 01	New York	NY PUC Lexis 475
Kearsage Telephone	8 89	New Hampshire	NH Docket No DT 01-221
Crown Point Telephone	8 93	New York	NY PUC Lexis 474
Fishers Island Electric	9 01	New York	NY PUC Lexis 497
Wyoming Lower Valley Electric	9 21	Wyoming	Wyo PUC Lexis 128
Atlantic City Electric	9 75	New Jersey Brd of Public Utilities	Docket Nos E003020091
Verizon New Hampshire	9 82	New Hampshire	NH Docket No DT 02-110
Connecticut, Light & Power	9 85	Conn	Conn Docket No 03-07-02
Arkansas Western Gas	9 90	Arkansas	Ark PUC Lexis 397
New York Rochester Gas & Electric	9 96	New York	NY PUC lexis 140