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November 19, 2004

**VIA HAND DELIVERY**

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

Re: Petition of Chattanooga Gas Company for Approval of Adjustment  
of its Rates and Charges and Revised Tariff  
Docket Number 04-00034  
Reply of Chattanooga Gas Company to Consumer Advocate and  
Protection Division's Response to Chattanooga Gas Company's  
Petition for Reconsideration

Dear Chairman Miller,

Enclosed you will find the original and 13 copies of Chattanooga Gas  
Company's Reply to the Consumer Advocate and Protection Division's Response to  
Chattanooga Gas Company's Petition for Reconsideration.

Sincerely,



D. Billye Sanders  
Attorney for Chattanooga Gas  
Company

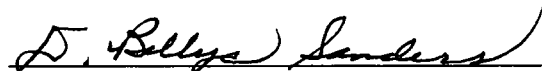
cc: Parties of Record  
Steve Lindsey  
Archie Hickerson  
Elizabeth Wade, Esq.  
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November 19, 2004

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**CERTIFICATE OF SERVICE**

I hereby certify that on this 19<sup>th</sup> day of November, 2004, a true and correct copy of the foregoing document was delivered by hand delivery, email, facsimile or U.S. mail postage prepaid to the other Counsel of Record listed below.

  
D. Billye Sanders, Esq.

November 19, 2004

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BEFORE THE TENNESSEE REGULATORY AUTHORITY  
NASHVILLE TENNESSEE

IN RE:	)	
	)	
PETITION FOR CHATTANOOGA	)	
GAS COMPANY FOR APPROVAL	)	DOCKET NO. 04-00034
FOR ADJUSTMENT OF ITS RATES	)	
AND CHARGES AND REVISED	)	
TARIFF	)	

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REPLY OF CHATTANOOGA GAS COMPANY TO CONSUMER ADVOCATE'S  
RESPONSE TO CHATTANOOGA GAS COMPANY'S PETITION FOR  
RECONSIDERATION

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Chattanooga Gas Company ("CGC") respectfully replies to the Consumer Advocate and Protection Division's ("CAPD's") Response to its Petition for Reconsideration as follows:

1.     The CAPD's statement that if reconsideration is granted, it reserves the right to raise additional issues is not supported in the law.

If the TRA grants CGC's Petition for Reconsideration, the Authority should not allow the CAPD to raise issues beyond the scope of those raised by CGC. T.C.A. § 4-5-317 and TRA Rule 1220-1-2-.20 address the timing and scope of Petitions for Reconsideration. CGC filed a timely Petition for Reconsideration and stated the grounds upon which relief was requested with reasonable specificity as required by T.C.A. § 4-5-317 and TRA Rule 1220-1-2-.20. The CAPD did not file a petition for reconsideration in the time frame required by statute. If the CAPD wanted other issues to be reconsidered in this docket, it could have filed a Petition for Reconsideration within 15 days of the Authority's October 20, Order in

this Docket. The CAPD failed to file a petition,<sup>1</sup> and now cannot raise new issues for reconsideration in conjunction with CGC's Petition. Consistent with the law cited above and the law regarding judicial review (i.e. T.C.A. § 4-5-322), it is common practice for a limited number of issues to be reconsidered or even appealed in an administrative proceeding.<sup>1</sup> The CAPD's arguments that the scope of reconsideration should be expanded are without merit.

2. CAPD seeks to provide a rationale for the TRA's decision which is not stated in the TRA's October 20, 2004 Order in this Docket. The TRA's Order clearly states that the TRA found that AGLR's capital structure was the appropriate capital structure for determination of CGC's cost of capital.<sup>2</sup> As stated in CGC's Petition for Reconsideration, the capital structure that the Authority adopted is not AGLR's capital structure and no explanation was given in the Order for how it was derived.<sup>3</sup> The CAPD seeks to provide its own explanation for the capital structure adopted in the Order, however the CAPD's explanation does not cure the defects in the Order, nor is the CAPD's explanation consistent with the methodology which the TRA stated it was adopting (i.e. the methodology in TRA Docket No. 97-00982). Further, the explanation provided by the CAPD is not consistent with the case law which requires the TRA to make adjustments for known changes and those that are likely to occur in the immediate future.<sup>4</sup> More

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<sup>1</sup> In *Tennessee-American Water Company vs Tennessee Public Service Commission*, 1985 Tenn. App. LEXIS 2800, Tenn. Ct App, April 11, 1985, the only issue on appeal in the rate case was the rate of return

<sup>2</sup> October 20 Order in this Docket at p 44

<sup>3</sup> CGC's Petition for Reconsideration at pp 2-3.

<sup>4</sup> *South Central Bell Telephone v. Tennessee Public Service Commission*, 579 S W 2d 429, (TN Ct App. 1979)

specifically, consistent with the TRA's prior orders, the adopted capital structure should be the capital structure expected to be in place during the attrition period ended June 30, 2005. In projecting such a capital structure, established case law requires that known or reasonably anticipated changes to AGLR's capital structure should be reflected in the derivation.<sup>5</sup> However, the Order fails to do so.

The CAPD's response fails to address the significant case law cited by CGC in support of its procedural due process concerns. The TRA stated methodology does not produce the capital structure adopted in the Order. Moreover, the Order does not explain how the TRA actually derived the capital structure it utilized for AGLR. Thus, the capital structure is unsupported by substantial and material evidence in the record, violates due process principles, is arbitrary and capricious and was made upon unlawful procedure because CGC was deprived of an opportunity to address the reasonableness of the methodology during the proceeding. As stated in CGC's petition, in *Tennessee American Water Company v. Tennessee Public Service Commission*, the Court of Appeals reversed and remanded the decision of the Public Service Commission that provided a rate of return outside the scope of evidence and that provided no explanation for the agency's reliance on its own expertise.<sup>6</sup> In *Steel v. Metropolitan Board of Zoning Appeals*, the Tennessee County of Appeals reversed an agency decision because the agency failed to place in the record information that it considered.<sup>7</sup> Moreover, in *McNeil v. Tennessee Board of Medical Examiners*, the Tennessee Court of Appeals

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<sup>5</sup> *Id.*

<sup>6</sup> In *Tennessee-American Water Company vs. Tennessee Public Service Commission*, *Ibid*

<sup>7</sup> *Steel v. Metropolitan Board of Zoning Appeals*, 1986 WL 3985 (Tenn Ct. App.).

overruled the decision of the agency because it failed to put into the record evidence of the special knowledge of the board members upon which the Board apparently relied.<sup>8</sup>

The CAPD's contention that CGC did not dispute Dr. Brown's methodology in arriving at capital structure also is erroneous. The CAPD's attempt to suggest the company did not object to the use of a three-year historical average of comparable companies in determining capital structure is disingenuous. CGC disputed Dr. Brown's use of a 12.9% short-term debt ratio and his exclusion of preferred stock from the capital structure as erroneous. Accordingly, CGC's dispute of Dr. Brown's capital structure results is necessarily an indictment of his methodology in deriving the mathematical results. Simply stated, his historical average failed to provide a capital structure reasonably expected to be in a place during the attrition period ended June 30, 2005 and failed to make adjustments for known and reasonably anticipated changes in capital structure. Significantly, even through Dr. Brown's methodology led to an erroneous capital structure recommendation, the capital structure adopted in the Order falls even below Dr. Brown's recommendation.

3. The low overall rate of return that resulted from the error in the capital structure is compounded by the low return on equity adopted by the Authority. The return on equity of 10.20% adopted by the TRA should be adjusted upward to 11.25 % to allow CGC a fair return on equity. The return on equity adopted by the Authority fails to provide CGC a return that enables it to maintain

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<sup>8</sup> *McNeil v. Tennessee Board of Medical Examiners*, 1997 WL 92071 (Tenn Ct. App ),

its financial integrity, attract capital and compensate its investors for assumed risk as required by the *Bluefield* and *Hope* cases, which set the standards for reasonableness.<sup>9</sup> As stated in CGC's Petition, there had been seven gas utility decisions on equity returns prior to the Order. Of the decisions, only one was lower than 10.2% with six of the decisions being higher. Significantly, four of the decisions were between 10.9% and 12.00%, in keeping with the 11.25% return on equity requested by CGC in this proceeding. The CAPD's Response suggests that because it recommended an extremely low 8.35% return on equity in the proceeding that somehow the return on equity is within "the zone of reasonableness" is without merit. The mere fact that a CAPD witness is willing to testify to such an extremely low return on equity does not mean legally or practically that anything above the low recommendation is therefore reasonable. A review of CGC's Supplemental Response to Discovery Request Number 15 of the CAPD, which was filed on August 18, 2004, demonstrates clearly how out of line the CAPD's recommendation was. Of the seven gas utility decisions on equity returns decided prior to the Order, none were as low as that recommended by the CAPD. In fact, the lowest awarded return was 175 basis points higher than the CAPD's recommended return on equity. Accordingly, CGC respectfully requests that the Authority reconsider and adopt an 11.25% return on equity.

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<sup>9</sup> *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); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 at 605, 64 S Ct. 281 (1944)



### Conclusion

Failure of CGC to address every argument made by the CAPD in its Response should not be construed as agreement. CGC reiterates and incorporates by reference the arguments in and reasons for its Petition for Reconsideration and respectfully requests that its Petition for Reconsideration be granted for the reasons stated therein and that the TRA modify and amend its Order to correct and capital structure and provide a rate of return on equity consistent with CGC's Petition.

Respectfully Submitted,

Chattanooga Gas Company

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I, hereby certify that on this 19<sup>th</sup> day of November, 2004, a true and correct copy of the foregoing was delivered by hand delivery, or U.S. mail postage prepaid and email to the other Counsel of Record listed below.

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