BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

November 1, 2005

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

ORDER ON RECONSIDERATION

This matter came before Chairman Pat Miller, Director Deborah Taylor Tate and Director Sara Kyle of the Tennessee Regulatory Authority (the "Authority" or "TRA"), the voting panel assigned to this docket, for reconsideration of its decisions related to the return on equity and capital structure contained in the *Order* issued by the panel on October 20, 2004. For the reasons stated below, at a regularly scheduled Authority Conference held on February 28, 2005, the panel voted unanimously to uphold its previous decision concerning the return on equity. In addition, for the reasons stated below, at a regularly scheduled Authority Conference held on June 13, 2005, the panel voted unanimously to uphold its prior decision on capital structure.

TRAVEL OF THE CASE

The travel of this docket is more fully set forth in the *Order*. Briefly, on January 26, 2004, Chattanooga Gas Company ("Chattanooga Gas", "CGC" or the "Company") filed its *Petition* with the Authority pursuant to Tenn. Code Ann. § 65-5-203,[1] to place

[1] Tenn Code Ann. § 65-5-203 is now codified as Tenn Code Ann. § 65-5-103 (2004).

into effect a revised natural gas tariff, superceding its existing tariff and rate schedule previously filed with the Authority. Chattanooga Gas is a wholly-owned subsidiary of AGL Resources, Inc. ("AGLR").

At a regularly scheduled Authority Conference held on February 9, 2004, the panel voted unanimously to suspend the *Petition* and the rates filed therewith through May 29, 2004 and to appoint a Hearing Officer to hear preliminary matters prior to the Hearing. On March 1, 2004, Chattanooga Gas filed replacement pages to the tariff filed with its *Petition.*

Petitions to intervene were filed by the Consumer Advocate and Protection Division of the Office of the Attorney General ("Consumer Advocate"), the Chattanooga Manufacturers Association ("CMA") and the Gas Technology Institute ("GTI"). The Hearing Officer found that the petitions met the criteria in Tenn. Code Ann. § 4-5-310(a) (1998) and granted intervention to the Consumer Advocate, CMA and GTI.

On May 13, 2004, the Consumer Advocate filed the *Consumer Advocate's Motion to Extend the Hearing Time to Nine Months* ("*Motion*"). Chattanooga Gas filed a Response to the Consumer Advocate's *Motion* on May 21, 2004. On May 28, 2004, the Hearing Officer entered an Order suspending the effective date of the tariff filed in this docket with the *Petition* through July 28, 2004.

On July 9, 2004, Chattanooga Gas filed with the Authority a written request advising the Authority that the Company intended to place a tariff into effect for billing cycles after August 1, 2004 and asking the Authority to waive the bond requirement in

Tenn. Code Ann. § 65-5-203(b)(1).[2] After reviewing the July 9, 2004 filing by Chattanooga Gas, the Hearing Officer determined that, to the extent that any of the rates, charges, schedules or classifications in the tariff filed on July 9, 2004 had not been on file with the Authority a full six (6) months, as required by Tenn. Code Ann. § 65-5-203(b)(1),[3] such rates, charges, schedules or classifications could not be put into effect "for billing cycles after August 1, 2004," and could not be put into effect until a full six month period has expired. The Hearing Officer directed Chattanooga Gas to identify and segregate those rates, charges, schedules or classifications that would be eligible to go into effect on July 26, 2004 and those rates, charges, schedules or classifications that would not be eligible to go into effect until a later date. The Hearing Officer suspended until August 27, 2004 the effectiveness of those rates, charges, schedules or classifications contained in the tariff filed by Chattanooga Gas on July 9, 2004 that had not been on file with the Authority a full six (6) months on July 26, 2004.[4] On July 12, 2004, the Hearing Officer issued an *Order Establishing Schedule for Responses to Chattanooga's Motion filed July 9, 2004 and Reply Thereto*, which set forth a schedule for the filing of responses to Chattanooga Gas's request and of Chattanooga Gas's reply to any such responses. The Hearing Officer set the deadline for filing responses on July 19, 2004 and for filing a reply on July 22, 2004.

[2] *See* Notice of Intention to Place Proposed Rates into Effect, Request to Waive Bond and Request to Determine Method for Calculating Interest on Refunds, If Any (July 9, 2004) Tenn Code Ann § 65-5-203(b(1) is now codified as Tenn Code Ann. § 65-5-103(b)(1) (2004)

[3] Tenn Code Ann § 65-5-203(b)(1) is now codified as Tenn. Code Ann § 65-5-103(b)(1) (2004).

[4] *See Order Requiring Chattanooga Gas Company to Identify All Rates, Charges, Schedule or Classification in Its July 9, 2004 Tariff on File for Six Months and Suspending the Effectiveness of All Other Rates, Charges, Schedules or Classification in the July 9, 2004 Tariff* (July 12, 2004)

In another Order issued on July 12, 2004, the Hearing Officer determined that the Consumer Advocate's *Motion* was not proper and denied that motion.[5] In the absence of an agreed schedule, the Hearing Officer established a procedural schedule based on a Hearing to be held during the week of August 23, 2004.[6]

On July 19, 2004, the Consumer Advocate and CMA filed responses to Chattanooga Gas's July 9, 2004 Motion. Also, on July 19, 2004, Chattanooga Gas filed a letter in compliance with the Hearing Officer's July 12, 2004 Order, identifying any rates, charges, schedules and classifications that would not be on file with the Authority for six months as of July 26, 2004.[7] Chattanooga Gas reiterated its intent to place in effect "all other rates . . . for billing cycles on or after August 1, 2004."[8]

On the afternoon of July 21, 2004, counsel for Chattanooga Gas contacted the other parties and the Hearing Officer through electronic messaging with a proposal for moving to September 1, 2004 the date for putting rates into effect. Chattanooga Gas proposed to proceed with the Hearing during the week it was originally scheduled, except that it wanted to start the Hearing on August 24 instead of August 23, 2004. The Hearing Officer entered an Order on July 26, 2004 reflecting the agreement of the parties regarding the Hearing and the proposed date for putting rates into effect.[9]

A Pre-Hearing conference was held on August 18, 2004, at which time the Hearing Officer established the order of proof and resolved several procedural matters in advance of the Hearing. On August 24, 2004, the Hearing Officer entered an Order

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[5] *See Order Reflecting Status of Action, Denying Consumer Advocate's Motion to Extend Time and Establishing Procedural Schedule to Completion* (July 12, 2004)
[6] *Id*
[7] Letter from D Billye Sanders to Chairman Pat Miller (July 19, 2004).
[8] *Id* at 1
[9] *See Order Approving Agreement of Parties Regarding Effectiveness of Rates and Procedural Matters* (July 26, 2004)

severing the request of GTI for a surcharge for research and development from this docket.[10]

A Hearing was held before the voting panel on August 24, 25 and 26, 2004.[11] The *Petition* was considered at a regularly scheduled Authority Conference held on August 30, 2004. The *Order,* which memorialized the panel's findings and conclusions, was issued on October 20, 2004 and ordered the following:

1. The rates filed by Chattanooga Gas Company on January 26, 2004 and amended on March 1, 2004 were denied;

2. For purposes of the rates in the *Order*, the annual test period was the historical test period for the twelve (12) months that ended September 30, 2003, with adjustments for attrition through June 30, 2005;

3. For purposes of the rates in the *Order*, the carrying cost of gas inventory would be recovered through Chattanooga Gas Company's base rates and not through the Purchased Gas Adjustment;

4. For purposes of the rates in the *Order*, the rate base was $95,297,966, and the net operating income was $6,687,177;

5. For purposes of the rates in the *Order*, a capital structure consisting of 16.40% short-term debt, 37.90% of long-term debt, 10.20% of preferred equity, and 35.50% of common equity was approved;

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[10] *See Order Granting Motion to Sever of the Chattanooga Manufacturing Association* (August 24, 2004) The Hearing Officer granted the *Motion to Sever* filed by CMA on April 23, 2004

[11] During the Hearing, the parties agreed to remove three (3) items from consideration: the Chattanooga Assisted Rate for Energy Services ("CARES") program, the quality of service reporting and benchmarks, and the industrial tariff *See* Transcript of Proceedings, Vol. III, pp 3-6 (August 24, 2004)

6. For the purposes of the rates in the *Order*, a short-term debt cost of 2.31%, a long-term debt cost of 6.74%, a preferred equity cost rate of 8.54% and a common equity cost rate of 10.20% were approved;

7. For purposes of the rates in the *Order*, the capital structure and cost rates indicated above produced a fair rate of return of 7.43%;

8. For purposes of the rates in the *Order*, the Revenue Conversion Factor was 1.6521, resulting in a Revenue Deficiency of $642,777, the amount needed for the Company to earn a fair return on its investment during the attrition year;

9. The Revenue Deficiency would be allocated evenly to all customer classes except Special Contracts and allocated to volumetric rates only. Based upon a Revenue Deficiency of $642,777, this allocation would produce a 2.00% increase to all customer classes except Special Contracts.

10. The Company's request to reduce the rate billing blocks for the Residential and Commercial classes of customers was denied;

11. The Company's request to change to Therm billing for all customer classes was approved;

12. The Company's request to change the main and service line extension charges was approved;

13. The Company's request to allow customers to pay their bills through a third party service provider, as set forth in the tariff as TRA #2, Sheet 9, Number (9), was approved;

14. The Company's request for billing suspensions related to seasonal disconnections was approved;

15. The Company's request to increase charges to reconnect service for residential and business customers was approved;

16. The settlement agreement relating to Industrial Tariff issues other than rates that was negotiated by the Company and the Chattanooga Manufacturers Association, and a summary of which was submitted as Exhibit 1 at the Hearing on August 24, 2004, was approved;

17. The Company's request for a bare steel and cast iron pipe replacement tracker was denied;

18. The Company was directed to inform the Authority within two (2) weeks of its becoming aware of any future actions of the Securities and Exchange Commission that involve the financial statements of Chattanooga Gas Company, AGLR or its affiliates;

19. Chattanooga Gas Company was directed to file tariffs with the Authority that were designed to produce an increase of $642,777 in revenue for service rendered and any tariffs necessary to be consistent with the *Order*;

20. The tariffs would be filed within ten (10) business days after the date of entry of the *Order* and would become effective upon approval of the Authority.[12]

PETITION FOR RECONSIDERATION

Chattanooga Gas filed a *Petition for Reconsideration* on November 4, 2004.[13] In the *Petition for Reconsideration*, Chattanooga Gas requested that the panel reconsider the capital structure and the return on equity previously adopted by the panel and

[12] *Order*, pp. 64-66 (October 20, 2004).

[13] Attached to the *Petition for Reconsideration* were three exhibits Exhibit No Recon-1, Direct Testimony of Gerald A Hinesley in TRA Docket No 97-00892, Exhibit No Recon-2, the quarterly capital structures of AGLR during the attrition period and the resulting calculation of the projected average capital structure; and Exhibit No Recon-3, the supporting calculations of the projected capital structure as of December 31, 2004 for AGLR.

memorialized in the *Order*. Specifically, the Company argued that the Authority's stated methodology did not produce the capital structure adopted in the *Order*.[14] According to Chattanooga Gas, the capital structure approved by the Authority is not AGLR's capital structure and is not reflected in Exhibit CAPD-SB, Schedule 3.[15] This exhibit, cited as the source of AGLR's capital structure,[16] sets forth AGLR's capital structure at three different points in time, i.e. December 31, 2003, December 31, 2002 and December 31, 2001.[17] The Company stated that on none of the dates was AGLR's capital structure consistent with the capital structure adopted by the Authority, and that the *Order* did not provide any details or support regarding how the numbers were derived.[18] Further, Chattanooga Gas asserted that the capital structure was not consistent with the attrition period, the Company's last rate case or other TRA orders.[19] The Company argued that the capital structure adopted in the *Order* should have reflected known or reasonably anticipated changes to AGLR's capital structure, but did not.[20] Chattanooga Gas argued that the Authority's failure to adopt a capital structure based on the Authority's stated methodology or upon evidence in the record resulted in legal infirmities. The Company contended that "the capital structure adopted in the Order results in an extremely low rate of return which violates the standards set forth by the U.S. Supreme Court in the *Bluefield* and *Hope* cases."[21] Further, the Company maintained that:

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[14] *Petition for Reconsideration*, p 2 (November 4, 2004)
[15] Pre-filed Direct Testimony of Dr. Steven Brown, Exhibit CAPD-SB, Schedule 3, Page 1 of 11 (July 26, 2004)
[16] *See Order*, p 45, fn 89 (October 20, 2004)
[17] *Petition for Reconsideration*, p 3 (November 4, 2004).
[18] *Id*
[19] *Id* at 3-4
[20] *Id* at 6
[21] *Id* at 7 *See Bluefield Waterworks & Improvement Co v Public Serv Comm'n of West Virginia*, 262 U.S. 679, 692-93 (1923) and *Federal Power Comm'n v Hope Natural Gas Co* , 320 U S 591, 605 (1944)

> [b]ecause neither of the capital structures recommended in the record were adopted and the agency has not given an explanation of how the capital structure it adopted was derived, CGC has been deprived of an opportunity to address the reasonableness of the methodology. . . . CGC had no opportunity to provide rebuttal testimony, cross-examine the proponent of the structure, or otherwise provide evidence relative to the proposal. As a result, CGC has been denied procedural due process with respect to a matter for which no evidence was presented in these proceedings.[22]

Chattanooga Gas requested an explanation of the methodology used by the TRA in deriving the AGLR capital structure and an opportunity to respond to the methodology adopted by the Authority.[23]

Although Chattanooga Gas believed that a "stand alone" capital structure should have been adopted, it asserted that "if the TRA continues to support the capital structure of the parent AGLR, then the TRA should use the projected average capital structure for the attrition period which is consistent with the stated methodology in the Authority's Order."[24] Because such data was not presented by the parties during the proceeding, the Company sought to provide it as new evidence in Exhibit No. Recon-2, stating that "the lack of an opportunity to address this methodology during the proceeding provides a good cause basis for the introduction of new evidence on reconsideration."[25] In the alternative, if the TRA did not desire to have new evidence introduced, Chattanooga Gas suggested that the Authority use the capital structure as of the midpoint of the attrition period, or December 31, 2004.[26]

Finally, Chattanooga Gas argued that the rate of return on equity determined by the TRA failed to provide a fair rate of return and was inconsistent with recent decisions.

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[22] *Id.* at 8
[23] *Id* at 10
[24] *Id* at 10
[25] *Id* at 11
[26] *Id* at 11-12.

The Company maintained that it provided evidence showing that out of seven (7) recent gas utility decisions, only one decision on equity returns was lower than the 10.20% allowed by the Authority and six (6) decisions allowed were higher than 10.20%.[27] Accordingly, Chattanooga Gas requested the Authority reconsider and adopt an 11.25% return on equity.

Also on November 4, 2004, Mr. Steven Lindsey, Vice-President of Chattanooga Gas, wrote a letter urging the Directors to reverse their decision on the Company's capital structure.[28] In addition, on November 16, 2004, Mr. Archie Hickerson of AGLR sent an e-mail informing the Directors that AGLR had announced an equity offering of 9.6 million shares of common stock.[29]

On November 12, 2004 the Consumer Advocate filed its response to the *Petition for Reconsideration.*[30] The Consumer Advocate argued that the overall rate of return of 7.43% approved by the TRA was well within the range of the rates of return proposed by the parties, since the Company proposed 8.84% and the Consumer Advocate proposed 6.72% as a rate of return.[31] Thus, the Consumer Advocate asserted that the overall rate of return of 7.43% was not outside the "zone of reasonableness" established by the Tennessee courts as the standard of review for agency decisions setting rates for utilities.[32] Further, the Consumer Advocate stated that "instead of merely copying either

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[27] *Id.* at 12

[28] Letter from Steven Lindsey, Vice-President of Chattanooga Gas, to Chairman Pat Miller (November 4, 2004)

[29] *See* E-mail from Archie Hickerson, AGL Resources, to Director Debi Tate on November 16, 2004 (November 19, 2004) The TRA Directors and Dan McCormac of the Consumer Advocate and Protection Division received copies of this e-mail and its accompanying news release

[30] No other party filed a response to the *Petition for Reconsideration*

[31] *Consumer Advocate's Response to Chattanooga Gas's Petition for Reconsideration*, p 2 (November 12, 2004)

[32] *Id*

of the two proposed capital structures, the TRA developed its own."[33] The Consumer Advocated continued:

> 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.[34]

The Consumer Advocate also asserted that in his pre-filed testimony, Consumer Advocate witness Dr. Steven Brown, through Exhibit CAPD-SB, Schedule 3, used a three-year average to derive a capital structure.[35] According to the Consumer Advocate, the use of a three-year average to derive a capital structure was not disputed by Chattanooga Gas at the Hearing.[36] The Consumer Advocate argued that the capital structure as set forth by the TRA was consistent with the use of a three-year average as proposed by Dr. Brown, although the TRA based its three-year average on AGLR itself rather than on ten comparable companies as proposed by Dr. Brown.[37] The Consumer Advocate asserted that the use of a three-year average was supported by the uncertainty as to what AGLR's capital structure would be in the near future.[38] Given the difficulty of ascertaining financial information on any given day, the Consumer Advocate opined that the use of an average was quite reasonable.[39] In addition, the Consumer Advocate maintained that the capital structure was consistent with prior TRA decisions in that those decisions use the capital structure of the parent company rather than the "stand alone"

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[33] *Id* at 4.
[34] *Id.*
[35] *Id.* at 5
[36] *Id*
[37] *Id* at 5-6.
[38] *Id* at 6
[39] *Id* at 7

approach advocated by Chattanooga Gas.[40] The Consumer Advocate argued that evidence of the AGLR capital structure, the methodology of taking a three-year average, and the reasons for taking an average rather than a snapshot in time, were all in the record. Therefore, the Consumer Advocate urged the TRA to deny the Company's request to overturn the capital structure as reflected in the *Order*.[41]

Finally, the Consumer Advocate asserted that the return on equity of 10.20% approved by the TRA is within the range of returns on equity of 8.35% proposed by the Consumer Advocate and 11.25% requested by Chattanooga Gas. The Consumer Advocate maintained that Chattanooga Gas had not established that the approved return on equity was outside the "zone of reasonableness" standard set forth in *CF Industries v. Tennessee Public Service Commission*, 599 S.W.2d 536, 543 (1980).[42] Further, the Consumer Advocate stated that it provided evidence of numerous utilities which had an equity return lower than the 10.20% approved by the TRA.[43] In addition, the Consumer Advocate asserted that of the seven (7) gas utility decisions cited by Chattanooga Gas, five (5) were below and only one (1) was above the 11.25% figure proposed by Chattanooga Gas, while four (4) decisions were within the range of 10.00% to 10.90%.[44]

In conclusion, the Consumer Advocate asserted that the overall rate of return, the capital structure and the return on equity approved by the TRA were reasonable and supported by the evidence, and that the TRA should uphold the *Order* and deny the *Petition for Reconsideration*. However, if the TRA decided to reconsider its decision, then the Consumer Advocate argued it should be allowed to ask for reconsideration of

[40] *Id.* at 6.
[41] *Id.* at 7
[42] *Id*
[43] *Id* at 8
[44] *Id*

other aspects of the *Order*, such as the treatment of the $2,360,317 in profits made by the Company's affiliate, Sequent Energy Management.[45]

On November 19, 2004, the Consumer Advocate filed a letter with the Authority asking that the Directors take no notice of the e-mail from Mr. Hickerson, the letter from Mr. Lindsey and the direct testimony of Mr. Gerald A. Hinesley filed as Exhibit No. Recon-1 to the *Petition for Reconsideration*. The Consumer Advocate argued that these communications were attempts to file new information or testimony after the record in this proceeding was closed. If the Authority admitted such new evidence, the Consumer Advocate contended that its fundamental right to cross-examine and impeach the source of information and to contradict the information, and its right to a fair hearing, would be violated.[46]

Also on November 19, 2004, Chattanooga Gas filed a reply to the Consumer Advocate's response to the *Petition for Reconsideration*.[47] The Company argued that, if the *Petition for Reconsideration* were granted, the Consumer Advocate should not be allowed to raise issues beyond those raised by Chattanooga Gas. The Company asserted that the Consumer Advocate did not file a petition for reconsideration within the time frame required by statute and, therefore, should not be able to raise new issues for reconsideration in conjunction with the Company's *Petition for Reconsideration*.[48] Further, Chattanooga Gas contended that the Consumer Advocate sought to provide a rationale for the TRA's decision that was not stated in the *Order*.[49] Specifically, the

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[45] *Id* at 2
[46] Letter from Vance L. Broemel, Assistant Attorney General, to Chairman Pat Miller, p 2 (November 19, 2004)
[47] *Reply of Chattanooga Gas Company to Consumer Advocate's Response to Chattanooga Gas Company's Petition for Reconsideration*, p 1 (November 19, 2004).
[48] *Id* at 1-2
[49] *Id* at 2

Company asserted that the capital structure adopted by the Authority was not AGLR's capital structure, and that no explanation was given in the *Order* for how it was derived.[50] In addition, Chattanooga Gas argued that the explanation given by the Consumer Advocate was not consistent with the methodology adopted by the TRA or 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.[51] The Company alleged that, because the TRA's stated methodology did not produce the capital structure adopted in the *Order,* and the *Order* did not explain how the capital structure for AGLR was derived, the capital structure was unsupported by substantial and material evidence in the record, violated due process principles, was arbitrary and capricious and was made upon unlawful procedure.[52] Chattanooga Gas states that the Consumer Advocate's contention that it did not dispute Dr. Brown's methodology in arriving at the capital structure was erroneous.[53] Finally, Chattanooga Gas reiterated that the 10.20% return on equity adopted by the Authority failed to provide the Company a return that enabled it to maintain its financial integrity, attract capital and compensate its investors for assumed risk.[54] The Company argued that the mere fact that the Consumer Advocate recommended an 8.35% return on equity did not mean that any return above the recommendation was reasonable.[55]

At a regularly scheduled Authority Conference held on November 22, 2004, the panel voted unanimously to grant the *Petition for Reconsideration* and to limit

[50] *Id*
[51] *Id*
[52] *Id* at 3
[53] *Id.* at 4
[54] *Id* at 4-5
[55] *Id* at 5

reconsideration of the *Order* to those issues raised in the *Petition for Reconsideration.*[56] The panel directed any party desiring to make a filing in support of its position regarding those issues to do so no later than December 6, 2004.[57]

INTRODUCTION OF NEW EVIDENCE

On December 6, 2004, Chattanooga Gas filed the *Affidavit of Michael Morley* ("*Morley Affidavit*") and attachments in support of the issues raised in its *Petition for Reconsideration.*[58] The Company also requested that the TRA take official notice of AGLR's Form 10-Q filings with the United States Securities and Exchange Commission ("SEC") for the quarters ending March 31, 2004, June 30, 2004 and September 30, 2004 and the entire record in TRA Docket No. 97-00982, *In re: Petition of Chattanooga Gas Company to Place into Effect a Revised Natural Gas Tariff.*[59] Chattanooga Gas stated that its request to introduce new evidence was for "good cause" because the methodology for calculating the Company's capital structure was not presented by any party to the proceeding and therefore the data necessary to calculate the average capital structure for AGLR for the attrition period was not in the record.[60]

In the *Morley Affidavit*, Mr. Morley provided additional information regarding how Exhibit No. Recon-2, which was attached to the *Petition for Reconsideration,* was calculated and addressed the impact the TRA's decision on the capital structure had on the Company's overall rate of return and revenue requirement.[61] Mr. Morley stated that

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[56] The panel scheduled oral argument for December 13, 2005 and limited argument to the issues raised in the Company's *Petition for Reconsideration,* excluding from consideration the subsequent communications from Chattanooga Gas *See* Transcript of Authority Conference, pp. 17-19 (November 22, 2004).

[57] *See Order Granting Chattanooga Gas Company's Petition for Reconsideration of the Authority's October 20, 2004 Order* (February 16, 2005)

[58] *See* Letter from D Billye Sanders to Chairman Pat Miller, p. 1 (December 6, 2004)

[59] *Id.*

[60] *Id* at 1-2.

[61] *Affidavit of Michael Morley*, Item 5 (December 6, 2004)

in Docket No. 97-00982, the TRA adopted a projected average capital structure of the parent for the attrition period. Because the capital structure cited in the *Order* was not based on AGLR's projected capital structure, Exhibit No. Recon-2 was intended to illustrate what AGLR's projected capital structure would have been based on actual and projected information available at the time of the *Petition for Reconsideration.*[62] Mr. Morley also explained how the projected capital structure of AGLR was calculated based on actual capital structure of AGLR for the quarters ended June 30, 2004 and September 30, 2004 and the projected capital structure of AGLR for the quarters ended December 31, 2004, March 31, 2005 and June 30, 2005.[63] Mr. Morley then calculated the average of these five (5) capital structures to determine the projected capital structure for AGLR for the attrition period ending June 30, 2005.[64] Mr. Morley also explained that he used AGLR's Form 10-Q filings with the SEC as the basis for the actual capital structure of AGLR for the quarters ended June 30, 2004 and September 30, 2004.[65] Further, he made adjustments to exclude the impact of financial instruments on long-term debt and preferred stock and to exclude the impact of other comprehensive income on common equity.[66] Mr. Morley also stated that while the 7.43% rate of return established by the TRA was within the range of overall returns proposed by the parties, each component was outside the range of figures proposed.[67]

In a notice attached to the *Morley Affidavit*, Chattanooga Gas stated that, pursuant to Tenn. Code Ann. § 4-5-313(2) (1998), the other parties were allowed seven (7) days

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[62] *Affidavit of Michael Morley*, Item 6 (December 6, 2004)
[63] *Affidavit of Michael Morley*, Item 7 (December 6, 2004).
[64] *Id*
[65] *Affidavit of Michael Morley*, Item 8 (December 6, 2004)
[66] *Id.*
[67] *Affidavit of Michael Morley*, Item 12 (December 6, 2004)

after delivery of the affidavit to inform the Company if they wished to cross-examine Mr. Morley, and that Mr. Morley would not be called to testify orally and cross-examined unless the other parties notified Chattanooga Gas of their intent.[68] Because the seventh day after delivery was December 13, 2004, the date for oral argument, Chattanooga Gas requested that any party wishing to cross-examine Mr. Morley notify it by December 8, 2004.[69]

On December 9, 2004, the Consumer Advocate filed an objection to the Company's filing of the *Morley Affidavit* as part of its *Petition for Reconsideration.*[70] In its objection, the Consumer Advocate argued that the *Morley Affidavit* sought to introduce testimony and other evidence which were not part of the original contested case hearing and, therefore, were not a proper part of a *Petition for Reconsideration.*[71] Further, if the testimony and evidence in the *Morley Affidavit* were allowed, the Consumer Advocate asserted it would be deprived of its rights to a fair hearing because it would be unable to adequately cross-examine the affiant.[72] The Consumer Advocate asserted that the *Morley Affidavit* was the type of new evidence specifically prohibited by TRA Rule 1220-1-2-.20 *et seq.* except for "good cause" shown, and that Chattanooga Gas had made no such showing in this case. The Consumer Advocate argued that there could be no acceptable explanation as to why the material in the *Morley Affidavit* was not presented at the original hearing.[73] In addition, the Consumer Advocate contended that the *Morley Affidavit* was not set forth in the original *Petition for Reconsideration* and

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[68] *Notice Regarding Affidavit*, p 1 (December 6, 2004)
[69] *Id*
[70] *Consumer Advocate's Objection to Chattanooga Gas's Attempted Submission of Post-Hearing Affidavit of Michael Morley as Part of Its Petition for Reconsideration* (December 9, 2004)
[71] *Id.* at 2
[72] *Id* at 5
[73] *Id* at 3

should be barred under TRA Rule 1220-1-2-.20(d) because it was not "described in the petition for reconsideration."[74] Moreover, if the *Morley Affidavit* was allowed, the Consumer Advocate maintained it must be allowed to present rebuttal proof under TRA Rule 1220-1-2-.20(c), but given the lateness of its filing, the nearness of the hearing date and the unavailability of its expert witness, the Consumer Advocate would not be able to present effective rebuttal testimony.[75] Finally, the Consumer Advocate noted that the TRA's notice for oral argument did not mention testimony by affidavit or live witness.[76]

DECEMBER 13, 2004 AUTHORITY CONFERENCE

During a regularly scheduled Authority Conference held on December 13, 2004, the panel considered the Company's request to present new evidence and to take official notice of the SEC Form 10-Q filings of AGLR Resources for the quarters ending March 31, 2004, June 30, 2004 and September 30, 2004 and the entire record in TRA Docket No. 97-00982, *In re: Petition of Chattanooga Gas Company to Place into Effect a Revised Natural Gas Tariff.* Following a lengthy discussion, the parties[77] agreed to the introduction of Exhibit No. Recon-2 and to the exclusion of the *Morley Affidavit.*[78] In addition, the panel voted unanimously to take notice of the entire record in TRA Docket No. 97-00982 and the SEC Form 10-Q filings for March 31, 2004, June 30, 2004 and September 30, 2004.[79] Chattanooga Gas and the Consumer Advocate also presented oral argument with regard to the capital structure and to the allowed return on equity.

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[74] *Id*
[75] *Id* at 3-4.
[76] *Id.* at 4
[77] CMA took no position on the evidentiary issues or the *Petition for Reconsideration* *See* Transcript of Authority Conference, pp 112-113 (December 13, 2004).
[78] Transcript of Authority Conference, pp 111-113 (December 13, 2004)
[79] *Id* at 113.

FEBRUARY 28, 2005 AUTHORITY CONFERENCE

At a regularly scheduled Authority Conference held on February 28, 2005, the panel considered its previous ruling regarding the return on equity. Chattanooga Gas had argued that the return on equity was out of line with other major gas cases decided in 2004 because six of the seven had a higher return on equity than the 10.2% return in this docket.[80] The Company had suggested that the Authority eliminate two of the rates of return obtained using the Discounted Cash Flow ("DCF") method because the DCF method historically had produced low returns. The panel found, however, that Chattanooga Gas failed to explain how the two lower returns on equity obtained using the DCF method were unreliable or how their use was inappropriate. In addition, because the Consumer Advocate proposed a return on equity of 8.35% and Chattanooga Gas requested a return on equity of 11.25%, the panel found that the evidence provided by Chattanooga Gas did not support the assertion that 10.20% was outside the "zone of reasonableness" for a return on equity as established in *CF Industries v. Tennessee Public Service Commission*, 599 S.W.2d 536, 543 (1980). Further, although the average return on equity of the seven (7) companies referenced by Chattanooga Gas was 10.84%, only two (2) companies were allowed more than 11% return on equity while three (3) companies were allowed between 10% and 10.5% return on equity. Therefore, the panel voted unanimously to uphold its prior decision on the return on equity.

In addition, the panel found that additional evidence was needed in order to consider properly the evidence on capital structure previously admitted into evidence on December 13, 2004. Therefore, the panel voted unanimously to order Chattanooga Gas to provide additional testimony or supporting documentation regarding Exhibit No.

[80] *Petition for Reconsideration*, p 12 (November 4, 2004)

Recon-2 no later than March 14, 2005. The panel ordered that such additional material should include all assumptions used to derive the projected capital structure, an explanation why equity and debt ratios drastically changed from December 31, 2003 to the subsequent reporting periods, and any other relevant documentation. Further, the panel ordered the Consumer Advocate to file any written response no later than March 28, 2005. Finally, the panel set a deadline of April 4, 2005 for Chattanooga Gas to file a reply to the response of the Consumer Advocate. The panel determined that, unless either party requested an evidentiary hearing, the Authority would conduct a "paper hearing" and set the matter for deliberation at a future hearing. If either party requested an evidentiary hearing, the panel would determine the date of the hearing.

ADDITIONAL FILINGS BY THE PARTIES

On March 14, 2005, Chattanooga Gas filed additional testimony of Mr. Morley with attached documentation. In response to the additional testimony provided by Chattanooga Gas, the Consumer Advocate filed the affidavits of Dr. Stephen N. Brown and Mr. Daniel W. McCormac on March 30, 2005. On April 6, 2005, Chattanooga Gas filed testimony of Mr. Morley in response to the testimonies of Dr. Brown and Mr. McCormac. The Consumer Advocate then filed the *Consumer Advocate's Objections to and Motion to Strike Portions of Response Testimony of Michael J. Morley Regarding Recon-2 Filed April 6, 2005* ("*Motion to Strike*") on April 22, 2005. The *Motion to Strike* argued that Mr. Morley's testimony constituted improper legal opinions as to the permissible scope of testimony, which was outside his area of expertise.[81] Additionally, the *Motion to Strike* stated that portions of Mr. Morley's testimony showed personal

[81] *See Motion to Strike*, pp. 2-3 (April 22, 2005)

animosity towards Dr. Brown and constituted improper personal attacks.[82] The *Motion to Strike* alleged that Mr. Morley's testimony was inadmissible because it introduced new evidence related to the capital structure of various AGLR subsidiaries and to the financing of the NUI acquisition by AGLR to which the Consumer Advocate had no opportunity to respond.[83] Finally, the *Motion to Strike* alleged that numerous portions of Mr. Morley's testimony were unsupported allegations and conclusions which should be stricken from the record.[84] On April 26, 2005 the Consumer Advocate filed a *Motion for Leave to Supplement the Record*, which requested leave to supplement the record with the 35-CERT documents referenced on pages 26-27 of the response testimony of Mr. Morley. On May 4, 2005, Chattanooga Gas filed a response to the *Motion to Strike* and the *Motion for Leave to Supplement the Record.*[85]

MAY 16, 2005 AUTHORITY CONFERENCE

At a regularly scheduled Authority Conference held on May 16, 2005, the panel considered the various motions filed by the parties. The panel voted unanimously to grant the Consumer Advocate's *Motion to Strike* with regard to Mr. Morley's statements regarding the scope of the proceedings and noted that his statements would be disregarded. However, the panel voted unanimously to deny the *Motion to Strike* with regard to portions of Mr. Morley's response testimony referred to by the Consumer Advocate as personal attacks. Further, the panel voted to deny the *Motion to Strike* regarding information related to the acquisition of NUI, but to limit consideration of the information to the extent the acquisition costs are embedded in the numbers supporting

[82] *Id.* at 5-6
[83] *Id* at 6-7
[84] *Id.* at 8-9
[85] *See Chattanooga Gas Company's Response to CAPD's Objections and Motion to Strike and CAPD's Motion for Leave to Supplement the Record* (May 4, 2005)

Exhibit No. Recon-2. The panel voted unanimously to grant the Consumer Advocate's *Motion to Strike* page 21, lines 2-8 of Mr. Morley's response testimony and the attached Exhibit MJM-Support Response 1. The panel found that neither this testimony nor this exhibit were relevant to the subject matter of Exhibit No. Recon-2. The panel voted unanimously to deny the Consumer Advocate's *Motion to Strike* Mr. Morley's statements described as unsupported allegations and conclusions. The panel found these statements reflected an expert witness' understanding of the issues and should be allowed. Finally, the panel voted unanimously to deny the Consumer Advocate's *Motion for Leave to Supplement the Record* with the 35-CERT documents filed with the SEC. The panel found that that the documents were not relevant to Exhibit No. Recon-2.

JUNE 13, 2005 AUTHORITY CONFERENCE

At a regularly scheduled Authority Conference held on June 13, 2005, the panel found, after reviewing the *Order* and the supplemental filings, that the *Order* referenced consistencies between it and the order in TRA Docket No. 97-00982 only in regard to using the capital structure of the parent company, AGLR, instead of the capital structure of comparable companies to derive the capital structure and the cost of capital of Chattanooga Gas. The capital structure approved in the *Order* resulted from a three-year average of AGLR's capital structure from December 31, 2001 to December 31, 2003 as provided in the record by Exhibit CAPD-SB, Schedule 3, p. 1. In addition, the panel found that neither the October 20, 2004 *Order* nor the Order in TRA Docket No. 97-00982 contained a specific methodology deriving AGLR's capital structure for the attrition year. Rather, both Orders rejected the stand-alone approach advocated by Chattanooga Gas and explained that AGLR was relevant in the determination of the Company's return on equity and cost of capital. The panel further found that the

Company had not demonstrated that its capital structure forecast was more reliable than the three-year historical average used by the Authority as the projected capital structure. As a result, the panel voted unanimously to uphold its previous decision on capital structure.

IT IS THEREFORE ORDERED THAT:

1. The Authority takes official notice of the SEC Form 10-Q filings of AGLR Resources for the quarters ending March 31, 2004, June 30, 2004, and September 30, 2004 and the entire record in TRA Docket No. 97-00982, *In re: Petition of Chattanooga Gas Company to Place into Effect a Revised Natural Gas Tariff.*

2. Exhibit No. Recon-2, submitted by Chattanooga Gas Company on November 4, 2004, is admitted into the record in this docket.

3. The *Consumer Advocate's Objections to and Motion to Strike Portions of Response Testimony of Michael J. Morley Regarding Recon-2 Filed April 6, 2005* is granted in part and denied in part, as stated herein.

4. The Consumer Advocate's *Motion for Leave to Supplement the Record* is denied.

5. Upon reconsideration, the Authority declines to modify or alter its decision regarding the return on equity as approved in the October 20, 2004 *Order.*

6. Upon reconsideration, the Authority declines to modify or alter its decision on the capital structure as approved in the October 20, 2004 *Order.*

7. Any party aggrieved by the Authority's decision in this matter has the right to judicial review by filing a Petition for Review in the Tennessee Court of Appeals, Middle Section, within sixty (60) days from the date of this Order.

Pat Miller, Chairman

Deborah Taylor Tate, Director

Sara Kyle, Director