BEFORE THE
TENNESSEE REGULATORY AUTHORITY

PREPARED DIRECT TESTIMONY
OF
STEVE LINDSEY

IN RE:
CHATTANOOGA GAS COMPANY
DOCKET NO._________

Q. Please state your name and business address.

A. My name is Steve Lindsey, and my business address is 2207 Olan Mills Drive, Chattanooga, Tennessee 37421.

Q. Mr. Lindsey, what is your position with Chattanooga Gas Company?

A. I am Vice President and General Manager for Chattanooga Gas Company ("CGC" or "the Company").

Q. Please provide a summary of your background and professional experience.

A. I graduated from Georgia Institute of Technology in 1989 with a Bachelor's Degree in Mechanical Engineering and began work with Atlanta Gas Light Company ("AGLC") as a Distribution Engineer. I have served in various positions since that time, including: Commercial/Industrial Representative, Engineering Supervisor, Service Center Manager, Managing Director of Field Operations, and Managing Director of Marketer Services, Marketing, and Sales. In 2003, I was appointed Vice President of Operations for Chattanooga Gas Company. In February 2005, I was appointed Vice President and General Manager for CGC and AGLC. My primary responsibility is the general oversight of the operations for both companies. I am testifying in my capacity as Vice President and General Manager for CGC.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to (1) provide a general overview of CGC; (2) discuss the major challenges that CGC and its customers face today and going forward; and (3) introduce our request for a rate increase and our comprehensive rate-design proposal, including the Energy Conservation Program and Conservation and Usage Adjustment, which is designed to address the challenges CGC and its customers face given volatile gas prices and limited supply. Finally, I will introduce the Company's Bare Steel and Cast Iron replacement program. Altogether, these proposals are intended to provide lower gas costs and more reliable service long-term while ensuring that CGC remains a financially viable Company.

In addition to my testimony, Michael Morley will provide testimony concerning the Company's expenses, investment in utility property, capital structure, and revenue deficiency of $5.8 million; Philip Buchanan will provide testimony concerning the Company's base revenue; David Heintz will address the Company's class cost-of-service study; Daniel Nikolich will describe the Company's proposed comprehensive rate design proposal, which includes an Energy Conservation Plan ("ECP") and a Conservation and Usage Adjustment ("CUA"); Dr. Roger Morin will address the required capital structure and cost of equity; and Richard Lonn will address the Company's proposed Bare Steel and Cast Iron replacement program.

I.
GENERAL OVERVIEW OF CGC

Q. Would you please describe the Company?

A. CGC has been serving customers in Tennessee for over 116 years and now serves 61,000 customers in Chattanooga and Cleveland and the surrounding Hamilton and Bradley County areas, including approximately 52,000 residential customers, 8,400 commercial and small industrial customers, and 70 large industrial customers. Though the Company certainly has undergone significant changes over the years, we never have wavered on our commitment to provide safe and reliable natural gas service. Today, CGC is a wholly-owned subsidiary of AGL Resources Inc. ("AGLR"), an energy-based services holding company. AGLR also is the parent company of utilities operating in five other states along the east coast from Florida to New Jersey.

Q. When was Chattanooga Gas Company's last rate increase?

A. CGC was last granted a general rate increase of $642,777 effective October 1, 2004, in Tennessee Regulatory Authority Docket No. 04-00034. Prior to that case, CGC had not had a rate increase since 1998. Since that time, i.e., 1998, inflation has risen 19.3%, but our average residential customer's base rates have risen less than 1%.

Q. Why is the Company requesting a rate increase and comprehensive rate design proposal, including the Energy Conservation Program and Conservation and Usage Adjustment, at this time?

A. When the Tennessee Regulatory Authority ("TRA" or "Authority") approved the $642,777 rate increase in Docket No. 04-00034, the new base rates were projected to produce a base revenue of approximately $31 million. The projected base revenue for the attrition period (calendar year 2007) is $28.5 million. Although we have worked hard to control costs since the last rate case, these efforts are more than being offset by lost base revenue. Put simply, the Company's rates are designed to recover its costs, including a just and reasonable return, by a charge per therm. Therefore, when consumption decreases, the Company is not given the same opportunity to recover its costs. Of course, conservation is good for our customers, the state, and the country and should be promoted by energy companies across the country. But therein lies the problem; under traditional rate design mechanisms, the interests of our customers and the interests of CGC are not aligned. Our comprehensive rate design proposal is designed to alleviate this conflict by both encouraging conservation while at the same time providing CGC an opportunity to earn a just and reasonable return. This proposal will align the interests of the customer and the interests of the Company. It is important to note that, under the Company's proposal, customers who conserve still could experience significant decreases in their natural gas bill. Ultimately, the Company's proposal is a comprehensive rate design plan designed to save customers money through proactive measures aimed specifically at reducing consumption.

Q. Mr. Lindsey, how have you been successful at managing costs while maintaining and/or enhancing customer service and reliability?

A. As mentioned above, CGC has been extremely successful at managing its costs in the face of over 19% inflation. CGC has been successful, in part, by taking advantage of the opportunities available to it by being part of the AGLR system. Although I am ultimately responsible for the day-to-day operations of CGC, I make every effort to take advantage of these benefits available to CGC in order to provide real benefits to CGC's customers.

Q. Can you please describe how CGC has been able to achieve financial and operational benefits as a result of its affiliation with the AGLR system?

A. Yes. CGC benefits from AGLR in a number of ways. First, as demonstrated in the Virginia Natural Gas, Inc. ("VNG") and NUI Corporation ("NUI") acquisitions, economies of scale provide the opportunity for greater efficiencies, cost mitigation, and uniform application of industry-leading "best practices" measures. As a subsidiary of AGLR, CGC has the opportunity to draw on the experience gained by its affiliated LDCs and to refine practices that have proved beneficial to customers in other service areas. Likewise, CGC jointly participates in, and reaps the benefits of, shared programs that result in service improvements that could not be undertaken if CGC were not affiliated with AGLR. In addition, AGLR's industry standing and its ability to provide competitive compensation and career opportunities enable CGC to benefit from outstanding talent in all aspects of its operations. Significantly, AGL Services Company ("AGSC") experts provide assistance to CGC in all facets of its operations. CGC could not afford to employ such experts as a stand-alone company.

Though bigger is not necessarily better, we clearly believe the operational synergies, implementation of "best practices," and market presence of AGLR all are positive factors in minimizing costs to, and providing high-quality customer service for, our customers. Indeed, these benefits realized through AGLR are real. For CGC's fiscal year ended September 30, 2000, just prior to AGLR's acquisition of VNG, CGC's operations and maintenance expense, including AGSC shared service allocations, was $15.9 million. As Company witness Morley will describe in more detail, the operations and maintenance expense included in the cost of service in this case is $11.7 million, a *decrease* of

$4.2 million, most of which can be attributed to the synergies and cost savings achieved through AGLR's acquisition of VNG and NUI, as well as AGLR's substantial investments in technology and implementation of industry "best practices" during the past five years. In addition, while our costs have decreased, we have maintained or enhanced customer service through enhanced technology and our never-ending commitment to operational excellence. Finally, we have managed to refund since 2003 over $7 million as a result of our decision to enter into an agreement with Sequent Energy Management, L.P. ("Sequent"). Under this agreement, Sequent manages CGC's gas supply assets and this arrangement has helped mitigate the commodity or gas portion of the customer's bill.

II.
MAJOR CHALLENGES FACED BY CGC AND ITS CUSTOMERS

Q. What are the major issues/challenges that CGC and its customers face today and in the future, particularly in view of increased gas costs?

The largest challenge for CGC is to ensure that reasonably priced and reliable natural gas service is available for its customers. There are two primary factors that impact customers' rates and reliability: (1) the actual price of the commodity, which is recovered from customers through the Actual Cost Adjustment ("ACA") as a pass through charge, and (2) the cost to CGC of operating the system and delivering the commodity, which is recovered from customers through base rates. I believe that we have been very successful at managing costs *within our control* on both of the above-mentioned factors by focusing on both short-and long-term issues and solutions. Although we constantly are seeking out value, we have picked much of the "low hanging fruit" in the areas that impact the distribution portion of the customer's bill and finding more value on that front will prove to be more and more challenging. Of course, we have -- and always will -- seek out ways to provide additional value, both quantitative and qualitative, to our customers. To date, our efforts have enabled us to control and even reduce certain costs while maintaining or even enhancing customer service and reliability. In fact, although inflation has risen 19.3% since 1998, our average residential customer's base rates have risen less than 1%. And that is good news. During this period, however, gas prices have continued to increase and in fact have risen 233% since 2000, which has led to the primary factor that is counter-balancing our efforts, namely, increased conservation by our customers. The challenge is that conservation limits our ability to earn a just and reasonable return and maintain reliable service under the current rate structure because the Company's base revenue is so heavily dependent on customer usage.

Q. Mr. Lindsey, does your comprehensive rate design proposal address these issues?

A. Yes. Energy conservation is a prevailing issue and concern not only for CGC and its customers, but also across Tennessee and the entire United States. Indeed, as the Wall Street Journal points out in a June 27, 2006 article, the United States has among the highest natural gas prices in the world among industrial nations and, ultimately, if they remain high, will drive companies out of the United States and cost workers their jobs. (*See* "Unlikely Duo Tackles Drilling," page A6). I believe it is imperative that CGC, as a local distribution gas company, provide leadership in encouraging conservation, which ultimately will serve to keep gas prices down, keep industry in Tennessee, and Tennessee workers in their jobs. However, it also is imperative that CGC have a mechanism in place that ensures that conservation does not prevent the Company from having the opportunity to earn a just and reasonable return. Our customers need low cost and reliable gas service, but they also need a financially sound company to provide that service. As the National Association of Regulatory Utility Commissioners ("NARUC") stated via resolution in 2005, "[I]nnovative rate designs, including 'energy efficient tariffs' . . . may assist, especially in the short term, in promoting energy efficiency and energy conservation and slowing the rate of demand growth of natural gas . . .." To further quote NARUC, "[C]urrent forms of rate design may tend to create a misalignment between the interests of natural gas utilities and their customers." Our proposal aligns customers' interests and CGC's interests resulting in lower costs for customers and preservation of a precious resource, while maintaining a financially sound CGC. I believe CGC's proposal is a first in Tennessee, and indeed, the total package likely is one of the first of its kind in the country.

Q. Mr. Lindsey, please explain why it is so critical to encourage conservation.

A. Significantly, the commodity or gas price now accounts for approximately 75% of a customer's bill. To date, we have been very successful at managing these costs through CGC's asset management program, which has enabled us to refund over $7 million to customers since 2003. In 2005 alone this program generated approximately $4.5 million, which enabled CGC to give an approximate $43 credit to each residential customer's bill during the first quarter of 2006. In addition, the Company also has ensured that it is able to purchase natural gas supplies at market prices. But, frankly, in light of the significant impact that gas prices have on customers' overall bills, more is required. For that reason, we are proposing a plan that is designed to encourage conservation, thereby lowering customers' overall gas bills.

Significantly, in recognition of the impact that high gas prices have on customers, the TRA, in the fall of 2005, expressed concern that anticipated higher-than-normal gas bills during the 2005-2006 winter season could result in a large number of customers, who normally pay their bills on time, being unable to do so. As a result, CGC, and the two other major local gas distribution companies in Tennessee, developed a plan to automatically place customers who were in good standing as of November 1, 2005 on a budget billing plan, instead of discontinuing service when a customer was unable to pay on a timely basis. At this point it appears that the plan was successful. The number of accounts shut off for failure to pay during the 2005-2006 heating season declined by 30%, while the number of customers on budget billing increased by approximately 25%. However, that plan does not address the underlying problem of higher gas prices. It was an important short-term solution to a long-term problem. Our proposal is a longer-term solution in Tennessee for what is a national, and in fact, global problem. I have seen no natural gas price forecast that has prices returning to a pre-2000 level. As such, the most meaningful option for customers to reduce their natural gas bills is through measures aimed at reducing consumption.

III.
CGC'S COMPREHENSIVE RATE STRUCTURE PROPOSAL

Q. Please describe the comprehensive rate design proposal.

A. The proposal consists of three primary components: (1) the Energy Conservation Program, (2) the Conservation and Usage Adjustment, and (3) the Chattanooga Assisted Rate for Energy Service ("CARES") program. In addition, as described in the testimony of Company witness Nikolich, we also are introducing specific rate design proposals by class of service that are designed to encourage conservation. All of these programs taken together are designed to align customers' interests and CGC's interests, and provide long term benefits to both.

Q. Please describe the ECP component.

A. As more fully described in the testimony of Company witness Nikolich, CGC proposes a comprehensive plan designed to assist customers with both controlling their current energy costs and in acquiring more energy efficient equipment. To help customers control their current energy costs, the Company proposes two programs: a 21 point home energy check up and inspection program and a weatherization kit. A customer would have to pay $39 for the energy check up and inspection and $5 for the weatherization kit, and both programs would allow the customer to save up to $170 on their energy bill. In other words, for a one time cost of just $44, a customer could achieve up to $170 in savings annually. In addition to these two programs, the Company is proposing a series of rebates for high energy efficiency furnaces and water heaters to assist customers with the initial investment of purchasing such equipment. As detailed in the testimony of Mr. Nikolich, if customers take advantage of all of these programs, they could save $366 annually.

Q. Please describe the CUA component.

A. This CUA component is designed to adjust CGC's annual base revenue that it recovers through base rates to account for the impact of conservation. As described more fully in the testimony of Company witness Nikolich, traditional rate design is based on volumetric charges. Put simply, under a volumetric rate design a utility has no incentive to encourage conservation because the more volumes consumed by the customer, the more revenue the company generates. That is, if rates are established based on an assumed level of sales, and conservation results in lower volumes actually being delivered to the utility's customers, the utility will not have the opportunity to recover its costs and earn a fair and reasonable return on its investment. As a result, utilities that have volumetric rate designs actually have an incentive to discourage conservation. The ECP is designed to encourage customers to conserve and the CUA to adjust the Company's base revenue so that it has the opportunity to recover its costs when customers reduce consumption. In other words, the Company will have the same opportunity to recover the revenue it would have recovered had customers consumed the same volumes assumed by the Authority when it set the Company's rates. At the very least, utilities should be indifferent to conservation. CGC believes, however, that utilities should have an incentive to promote conservation. Traditional volumetric rate design is contrary to both of those concepts. Under CGC's proposal, while the amount customers will pay for distribution service will stay flat, the amount of commodity consumed will decrease, which will reduce the commodity or gas cost billed to the customers. As described above, the commodity portion currently is approximately 75% of a customer's bill. The reduction in the volumes consumed and the related cost savings will provide benefits for customers in the form of reduced gas bills.

Q. Mr. Lindsey, will the CUA guarantee that CGC is able to earn the return authorized by the Authority?

A. No. CGC still will have to control costs and maintain and attract new customers, which I believe we have been very good at in the past. The CUA proposal simply will provide CGC the opportunity to earn the return it would have been able to earn absent conservation and the resulting base-revenue loss. Despite its best efforts at controlling costs, CGC cannot continue to sustain the impacts of existing and increasing conservation and the accompanying revenue loss. Ultimately, this proposal will provide us the opportunity – indeed, the incentive -- to focus on encouraging conservation.

As Company witness Dr. Morin testifies, however, if the Company's proposed rate design plan, including the CUA, as well as the Bare Steel and Cast Iron Tracker, its risk and required return on equity would be reduced. Specifically, if the TRA approves the Company's comprehensive proposal, the Company would reduce its request for a rate increase by approximately $420,000, or to about $5.4 million in total. This reduction compensates for the risk differential as discussed by Dr. Morin in detail.

Q. Please describe the CARES program.

A. The CARES program will provide a qualifying low income senior a 100% discount on the customer charge portion of CGC's base rates. As set forth in the testimony of Mr. Nikolich, between 889 and 3,555 customers are expected to take advantage of this program.

Q. Will these programs be effective if the TRA chooses to implement one but not all of the recommendations?

A. I believe to have an effective program, the TRA must resolve to adopt a comprehensive plan that aligns the respective interests of the customer and the utility as they relate to energy conservation and one that encourages proactive energy conservation programs from the utility. The Company's proposal does that. I therefore respectfully urge the TRA to adopt the Plan as a total package.

Q. Will you briefly address the proposed Bare Steel and Cast Iron Tracker?

A. As Company witness Lonn will discuss in more detail, CGC is in the process of replacing approximately 82 miles of bare steel and cast iron mains that remain in its distribution system today. If this program is accelerated as proposed in the testimony of Mr. Lonn, the Company's construction program would increase approximately $2-2.5 million per year over the next eight years. Unlike other construction projects that extend the system and add new customers, this main replacement activity will not produce additional base revenue. Thus, the program will cause the rate base to increase resulting in an increase in the return requirements, the related taxes, and the deprecation expense without any offsetting base revenue. To alleviate the need for reoccurring rate cases and to allow the program to be implemented as proposed, CGC is proposing the adoption of a recovery mechanism that adjusts base rates each year to offset the impact of the construction program. Mr. Lonn will provide a more-detailed discussion of this program and Company witness Nikolich will discuss the mechanism for recovery of the costs.

Q. Is it correct that if the Bare Steel and Cast Iron Replacement Program Tracker is implemented, the proposed base rate increase would be reduced by approximately $303,000?

A. Yes.

Q. Do you have any final comments?

A. Yes. We have worked hard to achieve benefits for CGC's customers and we have been able to do so by focusing on both short-and long-term issues and solutions. Although we constantly are seeking out value in the distribution component of the bill, we have picked much of the "low hanging fruit" and finding more value on that front will prove to be more and more challenging. Of course, as mentioned above, the distribution component of the bill is only approximately 25%. The remainder relates to gas costs. We cannot control gas prices, but we have taken significant strides to manage this most volatile portion of the bill. Our comprehensive rate design proposal is just one more step in this process, providing both CGC and the TRA an opportunity to be a leader in the effort to promote energy conservation. I respectfully urge the Authority to consider the long-term benefits that this program will bring to both our customers and the State of Tennessee.

Q. Does this conclude your testimony?

A. Yes.