BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

IN RE:	)	
	)	
DOCKET TO EVALUATE CHATTANOOGA GAS COMPANY'S GAS PURCHASES AND RELATED SHARING INCENTIVES	)))	**DOCKET NO. 07-00224**

POST HEARING BRIEF OF THE CONSUMER ADVOCATE

Robert E. Cooper, Jr., the Attorney General and Reporter for the State of Tennessee, through the Consumer Advocate and Protection Division ("Consumer Advocate"), respectfully provides the following brief in lieu of closing statements, as requested by Chairman Kyle during the July 13, 2009 Hearing on the Merits before the Tennessee Regulatory Authority ("the Authority" or "TRA").

PROCEDURAL HISTORY

The Hearing on the Merits in this Docket took place at 9:00 a.m., July 13, 2009, before Chairman Kyle, Director Roberson, and Director Freeman. At that time, the Consumer Advocate and Chattanooga Gas Company ("CGC") requested consideration of a Proposed Settlement Agreement ("Settlement Agreement" or "Proposed Settlement Agreement") previously filed with the Authority on July 8, 2009. In support of that Settlement Agreement, Vance Broemel, of the Consumer Advocate, and Craig Dowdy, representing CGC, provided testimony summarizing the Settlement Agreement and requesting the Authority's approval of the same. After deliberation, the Authority rejected the Proposed Settlement Agreement and requested that the parties proceed in presenting their proof. It is important to note that while all statements of the Consumer Advocate and CGC are a recorded part of the proceedings in Docket 07-00224, neither party is subsequently bound by statements made or positions taken in support and consideration of a Proposed Settlement Agreement once that proposed settlement is rejected.[1]

Upon the Authority's rejection of the Proposed Settlement Agreement reached between the Consumer Advocate and CGC, the parties presented their respective proof for the Authority's consideration and answered all questions proffered by the Directors. Following the presentation of that proof, the Authority ordered that the parties submit written briefs in lieu of oral closing remarks no later than two weeks following receipt of a transcript of those proceedings. In accord with that order, the Consumer Advocate responds as follows:

INTRODUCTION

A regular review in the areas of capacity supply planning and asset management is essential to ensure that the best interests of ratepayers are protected. The interests of any Local Distribution Company ("LDC") who receives a portion of the profits from the sale of "excess capacity" are, at least in part, in conflict with the interests of ratepayers. Consider the present Docket.[2] CGC is responsible for drafting a capacity supply plan providing for an amount of transportation and supply assets that it believes are necessary to meet the needs of its customers and which are paid for entirely by its ratepayers. Then, all "excess capacity" resulting from the

[1] *See Tenn. R. Evid. 408*; Harpeth Valley Utilities Dist. of Davidson and Williamson Counties, No. M2006-00035-COA-R3-CV, 2007 WL 1237687, at *5 (Tenn. Ct. App. April 26, 2007)(no app. filed); *see also* Tenn. R. Civ. P. 68.

[2] As more fully explained in the next section of this brief, the term "excess capacity" refers to any transportation and supply assets that are purchased by ratepayers but not used in supplying the natural gas needs of those customers.

plan drafted by CGC will be sold by Sequent, CGC's asset manager and affiliate. In return, Sequent will receive a portion of the proceeds from these sales, at present fifty (50%) percent, which will flow as income to Atlanta Gas & Light Resources, Inc. ("AGL"), the parent company of both CGC and Sequent. In essence, the entity drafting the Capacity Supply Plan will also sell all "excess capacity" generated by that plan and retain a significant portion of the revenues flowing from those sales.

The Consumer Advocate must stress that it is not its position that CGC has intentionally oversubscribed to transportation and supply assets in its Capacity Supply Plan. However, for purposes of this Docket, it is irrelevant whether they have or have not. It is similarly irrelevant whether or not they have set the asset manager selection criteria in the best interests of ratepayers, or properly complied with the Asset Management Agreement. The Consumer Advocate's recommendation is not based on past conduct. Rather, it is the position of the Consumer Advocate that in any situation in which the interests of a regulated entity conflict by design with the interests of ratepayers, safeguards must exist to ensure that the company acts in the best interests of its ratepayers.

In much the same way that the Securities and Exchange Commission requires an audit of the financial statements of **all** publicly traded companies, the Consumer Advocate believes that **all** LDC's governed by the TRA should have regular independent reviews in place to ensure the reasonableness of the their respective Capacity Supply Plans, asset manager selection criteria, and to ensure compliance with the Asset Management Agreement governing the return to their ratepayers. It is not sufficient to wait and see if wrongdoing will occur and only then act to protect ratepayers. A regular, and preferably at least triennial, review in these three primary areas is necessary to ensure that the best interests of ratepayers are protected. In this way, the Authority can close the barn door now, before any horses escape. Therefore, the Consumer Advocate would ask that the Authority grant a regular review of CGC's Capacity Supply Plan, asset manager selection criteria, and compliance with its Asset Management Agreement, that provides at least as much protection and transparency as provided in the Settlement Agreement proposed by the Consumer Advocate during the July 13, 2009 Hearing on the Merits.

THE NATURE OF CAPACITY SUPPLY PLANNING WILL INEVITABLY RESULT IN EXCESS CAPACITY

In the present case, CGC is a wholly-owned subsidiary of AGL, an energy-based services holding company. CGC sells and distributes natural gas to residential, industrial, and transport customers in areas in and around Chattanooga and Cleveland, Tennessee. CGC annually files a Capacity Supply Plan with the Authority which is intended to provide sufficient quantities of natural gas to meet the year-round needs of its customers. It is important to note that the current review of this process focuses only on portions of the plan filed with the Authority and not the underlying reasonableness of or necessity for the quantities prescribed therein.

Due to the current nature of pipeline contracts, natural gas providers are effectively required to purchase a set daily amount of year-round capacity, storage, and other supply assets that will satisfy the needs of their customers during a peak day level of usage. A pipeline's peak usage is typically defined as the type and amount of natural gas that a provider expects to need for use by its customers on the coldest day expected in that service area. CGC bases its peak day usage on an eight degree "coldest day." This requires that CGC keep enough capacity, natural gas storage, and other supply assets available to meet its customer demands on an eight degree day in the Chattanooga region. Obviously, on days when usage falls below this peak due to temperatures warmer than eight degrees, i.e., most days of the year, CGC's customers will use less natural gas than planned. Therefore, the "transportation and storage assets obtained by [CGC] are more than that which is required to meet the needs of its customers on a daily basis," *Transcript of Proceedings*, p.178:17 – 179:12 (July 13, 2009).

The purchase of transportation and storage assets by CGC is directed by the company's Capacity Supply Plan. This Capacity Supply Plan is a complex system by which CGC attempts to appropriately plan the correct mix of storage and transportation capacity on various pipelines to transport natural gas from Texas and the Gulf of Mexico. Pursuant to the rules of the Authority, the annual projected cost of the capacity, storage, and related assets needed to supply and transport natural gas, as well as the actual amount of natural gas used, is charged directly to CGC's ratepayers through an adjustable billing mechanism called the Purchase Gas Adjustment ("PGA"). Thus, CGC receives a dollar-for-dollar recovery from its customers for all natural gas purchased, as well as any money that the company spends to store and transport this gas.

During most of the calendar year, except for periods of peak day usage, CGC has more natural gas storage and transportation capability than it requires to meet the needs of its customers, or what the Consumer Advocate refers to as "excess capacity," and this "excess capacity" is at the heart of this Docket. CGC's "excess capacity" is of value, mainly for companies wishing to serve customers who have businesses that have not locked in fixed amounts of gas purchases and are therefore not part of the gas company's planned "firm capacity." These customers are willing to take the risk of curtailing their work if not enough gas is available or if it is too expensive. In short, such "non-firm" customers are willing to pay for gas with the understanding that their service may be interrupted if the demands of customers who are part of the fixed or firm capacity require all of the planned-for gas, which can happen on cold winter days. It is these "non-firm" customers, therefore, who are ultimately served by the "excess capacity" that CGC has built into its gas supply plan.

During the July 13, 2009 Hearing, CGC's witness, Tim Sherwood, took exception with the term "excess capacity" used by the Consumer Advocate. Mr. Sherwood did not, however, dispute the existence of this "excess capacity" as defined by the Consumer Advocate at that time, *Transcript of Proceedings*, pp.178:17 – 179:12 (July 13, 2009). Mr. Sherwood explained that if you were to purchase a car with four seats but used fewer than four seats most of the time, these would not be referred to as "excess" seats, but Mr. Sherwood's analogy fails to take into consideration that it is CGC's ratepayers, not the company itself, which buys the assets in question. Id at p. 180: 9-22. If one must compare the process in question to an automobile, the following example is more illustrative of the current situation:

> Assume that every Christmas your family needs a fifteen-passenger van to carry the family to grandmother's house. To meet this need, your brother-in-law, without asking your family members, purchases such a van. He then sends a bill equally dividing the cost of the van to you and the other members of your family, but pays nothing himself. Despite having no input with regard to the van purchased, you and your relatives comply with this request because it was purchased for your use. Then, your brother-in-law realizes that he is making his morning commute for the remainder of the year with fifteen empty seats in the van. He decides to fill these "excess" seats by taking neighbors into the city with him for a fee. The amount of this fee fluctuates with market variables such as road conditions (is it raining, icy, etc.), the cost of gasoline and the price of alternative forms of transportation, but his profits are generally increasing from month-to-month. Once they learn of this practice, the relatives demand to receive their fair share of these profits because all of the revenue received by your brother-in-law is flowing from their investment, to which he has contributed no money. In order to satisfy their demands,

> your brother-in-law agrees to pay the others 50% of the profits generated from the van they bought and paid for.

Just as the fairness of the deal in the example above will depend on how much revenue the van generates in a given year, CGC's ratepayers must be satisfied that they are receiving a fair return on the assets for which they have paid. Put simply, the complexity of the issues in this Docket cannot be adequately explained by Mr. Sherwood's oversimplified analogy. While Mr. Sherwood may take exception to the "excess capacity" label, there is no dispute that capacity paid for by ratepayers is sold to others when not being used to serve those ratepayers.

Furthermore, as approved by the Authority, CGC has sold the rights to its "excess capacity" to an "asset manager," named Sequent, by way of an open Request For Proposal ("RFP") Process. Sequent is an affiliate of CGC and also a wholly owned subsidiary of AGL, CGC's parent company. Under the contract between Sequent and CGC, Sequent pays CGC's ratepayers a specific and confidential amount of money upfront, a "guaranteed minimum," and then splits the proceeds from the sales of "excess capacity" throughout the year with consumers on a 50/50 basis above the guaranteed minimum return.[3] This results in two broad issues in the present case: (1) whether the gas supply plan, which determines the need for the overall amount of capacity, is generally accurate or is there too much capacity being planned for, which would mean that ratepayers are paying an unnecessary charge and that Sequent is receiving a windfall because it has even more capacity to sell; and (2) are ratepayers, who actually pay for all the capacity in the plan, receiving a fair return in the Sequent-CGC contract and are all transactions

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[3] The Consumer Advocate has presented testimony that it believes this sharing percentage is likely too low. At the very least, a review should be conducted to ascertain the reasonableness of this sharing arrangement; *See, Direct Testimony of Terry Buckner*, pp. 13:14 – 21:9 (May 30, 2008); *See also, Transcript of Proceedings*, p. 57:3-20 (July 13, 2009).

related to this return clearly accounted for? In order to address these issues, the Consumer Advocate recommends a triennial review of CGC's Capacity Supply Plan, Asset Manager Selection Process, and compliance with its Asset Management Agreement.

CHATTANOOGA GAS CUSTOMERS DESERVE AT LEAST THE SAME LEVEL OF ASSET MANAGEMENT REVIEW AS THAT GRANTED BY THE TRA TO THE CUSTOMERS OF NASHVILLE GAS

The Consumer Advocate is of the opinion that certain regulatory mechanisms in association with Asset Management Agreements should be adopted by the Authority in order to protect the best interest of Tennessee consumers, and that those regulatory mechanisms should be adopted universally and applied to all three LDC's operating within this State.

The practice of outsourcing the asset management process is a relatively new practice among LDCs operating within Tennessee. Historically, the three LDCs operating within this State, CGC, Atmos Energy Corporation ("Atmos"), and Piedmont Natural Gas Co. ("PNG" or "Nashville Gas"), have managed their excess capacity in-house. However, the current trend of asset management appears to outsource these responsibilities and transactions to third parties or third party affiliates, and in turn, these LDCs receive a minimum guarantee, a sharing percentage, or combination of both in order to compensate the LDC and its customers. In fact, each of the three LDCs in Tennessee currently holds contracts with third party asset managers. Specifically, Atmos has outsourced these responsibilities to affiliated asset manager Atmos Energy Marketing; Nashville Gas and CGC have outsourced these responsibilities to CGC's affiliated asset manager Sequent. In this proceeding the Consumer Advocate does not dispute the fact that these third party asset managers likely have the capability and expertise to effectively manage these assets and to provide an adequate return for the LDC's customers. The third party asset manager is essentially handed regulated assets, purchased 100% by Tennessee consumers, with little regulatory oversight, audits, or transparency.[4] The fact that Atmos and CGC have contracted with affiliated asset managers does not lessen the fact that regulatory oversight is warranted.

The Consumer Advocate has publicly asserted and actively advocated for a triennial review of such transactions for all of Tennessee's LDCs. Specifically, in TRA Docket 05-00165, the Consumer Advocate urged the TRA to approve a *Proposed Settlement Agreement* ("Nashville Gas Agreement") which set forth a triennial review process to investigate and report on the various activities associated with Nashville Gas's Asset Management contracts. This Nashville Gas Agreement outlined the scope of the triennial review process, and included at a minimum a review of the following areas of transactions and activities: (a) natural gas procurement; (b) capacity management; (c) storage; (d) hedging; (e) reserve margins; and (f) off-system sales. On December 14, 2007, the TRA approved the Nashville Gas Agreement between Nashville Gas and the Consumer Advocate for the benefit of Nashville Gas consumers.[5]

Throughout the current Docket, the Consumer Advocate has continually urged the TRA to adopt similar regulatory mechanisms in association with CGC's Asset Management Agreements. The Consumer Advocate and CGC filed a Proposed Settlement Agreement on July 8, 2009, which incorporated the regulatory mechanisms the Consumer Advocate believed necessary to meet the concerns outlined in the Consumer Advocate's proof and adequately afford

[4] While it is true that the TRA's ACA audit addresses the issue of how items flow through the Purchase Gas Adjustment, it does little to address the reasonableness of the Capacity Supply Plan and compliance with the Asset Management Agreement.

[5] See *Order Approving Settlement* (December 14, 2007).

CGC's consumers similar protections to those which Nashville Gas's consumers enjoy. Nashville Gas has approximately 164,000 customers in the middle Tennessee area. CGC's 62,000 customers should be afforded no less protection than the 164,000 customers served by Nashville Gas. CGC's 62,000 natural gas consumers in the Chattanooga, Tennessee area are not afforded the opportunity to shop around for a natural gas provider. If a residential consumer in Chattanooga seeks natural gas, they are provided the name of one company, and one company only, CGC. Because the consumers lack choice, consistency is essential when it comes to assuring the ratepayers of Tennessee that, no matter the gas company operating in their area, such mandatory safeguards exist to ensure transparency of all transactions, including those transactions associated with asset management.

Out of the three natural gas LDCs in Tennessee, Nashville Gas is currently the only company that has procedures in place which the Consumer Advocate believes have the capability to ensure that consumers are treated fairly with respect to assets which are purchased 100% by consumers. The Consumer Advocate does not cast value judgments as to the veracity of each of these company's specific dealings; however, the Consumer Advocate believes that each company should have similar, if not identical, triennial review procedures in place to serve as regulatory safeguards in the area of asset management.

The asset management business is specialized and technical by its very nature, and involves assets which are purchased by consumers through the PGA for consumer use. The Consumer Advocate understands that excess capacity is an unavoidable consequence of capacity planning, but the Consumer Advocate also understands that an LDC also has relatively little risk should they over-plan this capacity. The consumers bear most of the risk involved with such planning; therefore, once the regulated assets are turned over to a third party, consumers should have every assurance that the asset management agreements are structured in such a way as to ensure a reasonable return on the assets they have funded. The Consumer Advocate is of the opinion that the most efficient mechanism to ensure such confidence is requiring Tennessee's LDCs to submit to a triennial review of transactions and contracts associated with asset management in a similar or identical manner to the review ordered in TRA Docket No. 05-00165 involving Nashville Gas.

THE AUTHORITY SHOULD PUT MECHANISMS IN PLACE THAT PROVIDE AT LEAST AS MUCH PROTECTION FOR CONSUMERS AS PROVIDED IN THE PROPOSED SETTLEMENT AGREEMENT BETWEEN THE PARTIES

While not waiving the statutory protections associated with settlement negotiations and agreements, the Consumer Advocate feels that clarification may be necessary as to what the provisions enumerated in its Proposed Settlement Agreement hoped to achieve so that the Authority may understand the need to address these issues in its final order in this Docket. Prior to moving to reject the Proposed Settlement Agreement, Chairman Kyle stated in reference to her opinion on the Settlement Agreement:

> I am unconvinced this is in the best interest of consumers, Chattanooga Gas, and the agency's resources. It is well within the agency's discretion to open a contested case and order an evaluation and report on the prudency of CGC's gas supply plan, asset management, RFP process, and IMCR filings. In this regard, the proposed settlement offers no new processes for evaluation. It simply attempts to impose strict requirements on the Authority as well as establishing arbitrary procedures, processes, and time lines on the agency. For these reasons, I move to deny the settlement.

Transcript of Proceedings, p.26:1-13 (July 13, 2009). While it is true that the Authority has the power to "order an evaluation and report on the prudency of CGC's gas supply plan, asset management, RFP process, and IMCR filings," the Authority cannot do these things without first opening a contested case on each of these processes. Id. The strength of the Proposed Settlement Agreement lay in the fact that it provided a mechanism for the Authority to order such reviews without any additional proceedings which would inevitably cause additional expenses to be borne by ratepayers. Furthermore, the Proposed Settlement allowed the Authority to tailor the scope and cost of any review, as well as the frequency of any needed future reviews to the particular circumstances of the time. This process would have allowed the Authority to streamline the process of ordering these reviews and avoid unnecessary dockets and expenses. Finally, the Proposed Settlement left almost every aspect, including scope, timing, and frequency of any ordered review, to the discretion of the Authority. In light of this, the Consumer Advocate would aver that the Proposed Settlement Agreement placed no obligation on the Authority to order any review it felt unnecessary, but provided a useful mechanism for instituting whatever reviews the Authority did believe useful. To the extent that the Authority's staff was included in this process, the Consumer Advocate only sought to ensure that the Authority's voice was heard through the entirety of any review.

As this Docket progressed, the Consumer Advocate began to realize that its testimony on the sufficiency of CGC's Capacity Supply Plan, while raising additional questions, did not answer the issues enumerated to a degree sufficient to allow the Authority to make a final determination on these issues. Thus, the Consumer Advocate came to the decision that any attempt to argue points on which it obtained insufficient evidence to make a final conclusion would only cloud the plain public policy need for a regular review of certain mechanisms. It became clear to the Consumer Advocate that a review by an independent consultant with expertise in this area would provide a better approach to resolving these issues. This is why the

Consumer Advocate included a mechanism for implementing this type of review in the Settlement Agreement it proposed to the Authority during the July 13, 2009 Hearing.

It is the position of the Consumer Advocate that certain minimum safeguards should exist for all LDCs operating in the State of Tennessee to ensure that each company's ratepayers are not required to pay for more capacity than is necessary to meet their needs, and that they receive a fair return on all sales of excess capacity resulting from the LDC's capacity supply plan. In order to ensure that the best interests of ratepayers were protected both in this and future Dockets before the Authority, the Consumer Advocate's and CGC's Proposed Settlement Agreement addressed the following five issues: (1) reasonableness of the capacity supply plan; (2) reasonableness of CGC's asset manager RFP Process selection criteria; (3) compliance with the Asset Management Agreement; (4) assurance that CGC will take no action to further reduce the ratepayers' sharing percentage above any guaranteed minimum; and (5) a mechanism for determining what amount of expenses CGC might recover in relation to this Docket. It remains the opinion of the Consumer Advocate that the final order of the Authority should provide at least as much protection for ratepayers as was included in the Proposed Settlement. Following is an individual summary on each area of concern.

I. Capacity Supply Plan

As explained more fully in the above section on "Capacity Supply," each LDC is responsible for drafting a Capacity Supply Plan designed to meet the needs of its ratepayers. Furthermore, the ratepayers will pay for 100% of the transportation and storage assets called for in that plan, but receive only a fraction of the profits from the sale of any "excess capacity." Additionally, the current ACA review of CGC's Capacity Supply Plan analyzes the method and cost by which the LDC goes about procuring the assets called for in this plan, but does little to ensure that the amount and underlying need for the prescribed quantities are reasonable. The Consumer Advocate is of the opinion that this procedure could be strengthened.

In response to the need to ensure some level of reasonableness in CGC's Capacity Supply Plan, the Consumer Advocate provided for an independent review mechanism in its Proposed Settlement Agreement. This mechanism would have required CGC to file a Capacity Supply Plan with the Authority by September 15, 2009, and would have required CGC to designate the type and amount of transportation and storage assets it intended to use in order to meet the needs of its ratepayers. Additionally, CGC would have included the criteria it employed in determining whether to enter specific asset contracts. After the filing of such a plan, the Authority could have reviewed the same and determined if further scrutiny was warranted. If so, an independent consultant could have been retained to review and report on the prudence of CGC's Capacity Supply Plan. As discussed earlier, the scope, cost, and frequency of this review would be left to the discretion of the Authority.

It is the opinion of the Consumer Advocate that this mechanism would have provided ratepayers with assurances that the transportation and supply assets purchased by them are necessary in relation to the expected use of natural gas by CGC's customers. Without such a mechanism for review, there can be no assurance that an LDC is not oversubscribing to such assets in its Capacity Supply Plan.

II. RFP Selection Criteria

With regard to whether the ratepayers are receiving a fair return on the sale of excess capacity, it will help to have a more complete understanding of the asset manager selection process and the way in which proceeds are redistributed to customers. Ratepayers generally receive a return on the sale of excess capacity in two ways: (1) as a part of its Asset Management Agreement, Sequent ensures a guaranteed minimum return to customers regardless of the revenue generated from the sale of excess capacity; and (2) ratepayers receive a percentage of the excess capacity revenues over this guaranteed minimum return.

CGC's ratepayers bear most of the risk in the sale of excess capacity because the PGA described above requires that they purchase one-hundred (100%) percent of CGC's transport and storage assets. The guaranteed minimum mitigates this risk to some degree in that it ensures some return to ratepayers on these assets. However, the trade-off comes in the percentage return. Typically, the higher the guaranteed minimum return, the lower the percentage return to ratepayers above that amount and *vice versa*. Thus, CGC's role in setting the criteria by which asset management proposals will be judged is crucial. It is CGC who determines whether the emphasis will be placed on a higher guaranteed minimum or a higher percentage return. In evaluating whether it is better to take a higher percentage return or guaranteed minimum, it is important to consider that CGC admits that Sequent's profits have been trending upward over time, *Transcript of Proceedings*, p.168:23 – 169:4 (July 13, 2009).

Mr. Sherwood briefly addressed the fairness of the return to ratepayers in his testimony on July 13, 2009. During that testimony, he provided the following hypothetical with two fictional asset managers named "Chair Kyle" and "Tim Sherwood:"

> Perhaps Chair Kyle is really good at asset management and her 50 percent was going to result in $10 million. Tim Sherwood is not as good at asset management and his 70 percent was only going to result in $5 million. If I'm only making the decision on which percentage is higher, I can't really have any real knowledge that the customers are going to do better by simply selecting the person who is willing to bid the higher percentage,

Transcript of Proceedings, p.161: 1-9 (July 13, 2009). Once again, this hypothetical appears compelling, at least initially. However, further review of the facts in the present situation will reveal that the above analogy is just not applicable to the current RFP Process.

It is not the asset managers competing in the RFP process who select the percentage return to ratepayers. CGC does not simply choose the asset manager offering the best combination of sharing and guaranteed minimum, it instead requires all asset managers to bid based on a 50/50 sharing mechanism. Mr. Sherwood did not dispute, and in fact agreed, that CGC is responsible for selecting the criteria, or "minimum standards," which frame the RFP process in advance of receiving bids. Id at 175:4-11. Specifically, CGC determines what sharing percentage and other guarantees it thinks are appropriate before it accepts bids from potential asset managers. Only after a sharing percentage is decided in advance by CGC, do third parties submit their bids as to a "guaranteed minimum" amount.

Therefore, no matter what the percentage return set by CGC, the "really good" asset manager should win the RFP process. For example, using the figures from Mr. Sherwood's above example, if CGC determined that it wanted to increase the return to ratepayers up from 50% to 70%, this would likely result in a lower guaranteed minimum from all companies bidding in this process due to the decreased return to each company. Thus, if Chair Kyle could earn $10 million in total as an asset manager (as indicated above), she would retain a $3 million profit, rather than the $5 million under 50/50 sharing, and would return the remaining $7 million to ratepayers. In light of this arrangement, she would likely offer a lower guaranteed minimum than she did while retaining 50%, thus reducing her risk associated with any single bad year to match her reduced profit. Whereas the other bidder in the example above, who can only earn a total of $5 million, will retain just $1.5 million for himself and cannot offer as high a guaranteed minimum as Chair Kyle for that reason. Regardless of the chosen sharing percentage, Chair Kyle would likely win the RFP process because she is the better asset manager in this example; it is simply a question of how much profit she should be allowed to retain for selling assets belonging to CGC's ratepayers.

Due to the current asset manager's relationship as an affiliate of CGC, it is important to ensure that the process of setting evaluation criteria is structured to bring the maximum fair return for ratepayers rather than to guarantee the retention of an affiliated asset manager. Therefore, the Consumer Advocate negotiated a proposed mechanism by which an independent consultant would be able to review this process. In the proposed process, CGC would have filed a notice of RFP and the process that would be followed in awarding that contract. CGC would have filed the confidential responses of the bidders and the selected bid based on the evaluation criteria. After receipt of this notice and the resulting bids, the Authority, if it deemed it proper, would have ordered a review of the reasonableness of the RFP process, the selection criteria, and CGC's compliance with this process by an independent consultant. The Consumer Advocate avers that this process would have provided assurance that CGC's ratepayers were receiving the maximum possible return on their investments.

III. Compliance with Asset Management Agreement

In order to ensure that CGC's ratepayers are properly receiving all amounts owed to them under the Asset Management Agreement between CGC and Sequent, and that the existing Asset Management Agreement is being fully complied with, some mechanism must be put in place to test CGC's compliance with this agreement. Therefore, the Settlement Agreement proposed by the Consumer Advocate provided that CGC would file an Interruptible Margin Credit Rider ("IMCR") with the Authority no later than March 31, 2010. This IMCR acts as the basis for the sharing arrangement of savings with ratepayers. After receipt of the IMCR, the Authority would have discretion to order the retention of an independent consultant for the purpose of reporting on CGC's compliance with the provisions of the Asset Management Agreement. The full scope of this review allows for scrutiny of any transactions related to the management of CGC's assets. The Proposed Settlement offered by the Consumer Advocate on this issue resembled the Nashville Gas Agreement in TRA Docket 05-00165, and identified several specific areas that may have been of interest to the independent consultant: including the minimum payment to ratepayers and sharing provisions in the asset management agreement, as well as CGC's natural gas procurement, storage and transportation capacity utilization, hedging, and off system sales. However, the Proposed Settlement Agreement left a final determination of scope to the Authority.

The Consumer Advocate has attempted to stress throughout this Docket and at the hearing on the merits that it places a tremendous amount of importance on this area of the Proposed Settlement Agreement. It is essential that a review be instituted to ensure compliance with the Asset Management Agreement governing the stated return to ratepayers. Without this review, the worth of a review in the prior two areas described above would be greatly reduced. If there is no way to ensure compliance with the Asset Management Agreement, then there is no way to ensure that an otherwise proper Capacity Supply Plan and sharing arrangement for ratepayers are followed.

IV. Assurance That CGC Would Not Exercise Certain Tariff Provisions Further Reducing the Return to Its Ratepayers

As to the percentage return to ratepayers on amounts over the guaranteed minimum, CGC's ratepayers currently receive fifty (50%) percent of this amount from Sequent. However, under the existing tariff provisions, CGC has a right to take an additional fifty (50%) percent of this amount for itself. This would leave customers with only a twenty-five (25%) percent return on the sale of assets purchased entirely by ratepayers. In response to these concerns, the Consumer Advocate, as part of the Proposed Settlement, negotiated an agreement that CGC would not exercise this right, "so long as Sequent or an affiliated party remains the asset manager of CGC and there is no challenge or proceeding from any party to change the 50/50 sharing formula with the asset manager," *Proposed Settlement Agreement*, p. 19, D (July 8, 2009).

While it is CGC's right to invoke this provision under the existing terms of its Tariff, CGC appeared satisfied with the fifty (50%) percent retained by its affiliate asset manager, Sequent. However, should the asset manager cease to be an affiliate of CGC or the circumstances of the sharing arrangement change, CGC would have retained the right to invoke the provision at that time. Id. The Consumer Advocate believed that this was a reasonable position given that CGC was under no obligation to give up its right but was willing to do so barring a change of circumstances.

There was some concern raised by Director Roberson that this provision might have "binding authority" on the TRA and prevent them from taking the current 50% return to ratepayers and "flowing that through to put that in energy conservation for the customers of Chattanooga Gas," *Transcript of Proceedings*, p.22:14 – 23:1; 23:14-17 (July 13, 2009). The Proposed Settlement only required CGC not to enforce its current right under the Tariff to take away an additional portion of the funds currently retained by ratepayers. This section would have had no effect on the power of the Authority, and would not have acted as "binding authority" on any party other than CGC.

With regard to the question of using the funds returned to ratepayers for the purpose of conservation, this issue was not contemplated by the parties in Docket 07-00224 and was not amongst the enumerated issues adopted by the Authority in its March 17, 2008 Order. Therefore, it is the opinion of the Consumer Advocate that this particular issue is best taken up in a separate proceeding designed to answer the Authority's specific questions on this point.

V. CGC's Costs in This Docket

The Proposed Settlement Agreement offered by the parties at the July 13, 2009 Hearing on this Docket contained a compromise requiring CGC to present evidence as to the amount of its costs incurred and capping a maximum recovery of $500,000.00. However, as stated at the Hearing on the Merits, it was the intention of the parties to work together to provide a joint recommendation to the Authority on this issue, *Transcript of Proceedings*, pp.6:22 – 7:1 (July

13, 2009). Given that the parties reached a Proposed Settlement only three business days prior to the July 13, 2009 Hearing, there was insufficient time for CGC to gather and provide evidence as to the amount of its costs incurred and, even if they had been able to gather these records in that timeframe, there would have been insufficient time for the Consumer Advocate to sufficiently review them.

As stated at the July 13, 2009 Hearing, the Consumer Advocate is still willing to work with CGC in an effort to resolve this issue, *Transcript of Proceedings*, pp.6:22 – 7:1 (July 13, 2009). Therefore, the Consumer Advocate relies upon the Hearing Officer's Order that "the Hearing on the merits would not be the appropriate time to raise the issue of or take proof on litigation costs," and that CGC file proof of its costs, "along with itemized supporting detail and a proposed method of recovery, after the close of the proceeding," *Pre-Hearing Order*, p.4 (July 6, 2009). As a result, we have not attempted to address this in our brief because we anticipate separate proceedings on this issue during which we will make every effort to present a joint recommendation as to CGC's costs.

CONCLUSION

For all of the foregoing reasons, the Authority should, at a minimum, grant a triennial review of CGC's Capacity Supply Plan, asset manager selection criteria, and compliance with its Asset Management Agreement, to begin as soon as is practicably possible. Furthermore, the Authority's Order should provide at least as much transparency and protection for ratepayers as was provided in Nashville Gas Agreement and in the Settlement Agreement proposed by the parties during the July 13, 2009 Hearing on the Merits.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served via first-class U.S. Mail, postage prepaid, or electronic mail upon:

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This the 31st day of July, 2009.

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